

VAT Flat Rate Scheme (FRS) - Guide to joining and leaving

Contractors can carefully plan when they join and leave [HMRC's VAT Flat Rate Scheme \(FRS\)](#) to maximise its benefits. If they time it right, contractors forced to leave the scheme can benefit from an additional three months that could save them up to £1,500 in VAT.

"Some of the detailed rules about joining and leaving the FRS are not widely known and misinterpreted, even by tax experts," explains [James Abbott](#), founder and head of tax at contractor accountant [Abbott Moore](#).

"Contractors who factor the FRS into their tax planning can maximise the cash benefit their limited company receives. It could be potentially worth thousands of pounds in VAT that a contractor need not pay."

Key points to remember when joining the FRS

Abbott notes that, on the face of it, the rules governing when you can join the FRS are quite straightforward: "A contractor's limited company can join the FRS so long as in the next 12 months they expect their gross fees to be less than £150,000, excluding VAT, exempt supplies and outside the scope supplies.

"But what many contractors don't appreciate is that historical sales are irrelevant. This is particularly important for [contractor limited companies](#) that experience a fall in income."

In Abbott's experience, there are many common scenarios when this happens: "A high earning interim might semi-retire, or you might have a husband and wife company where one spouse decides to become a homemaker.

"Let's say in the latter example you had a husband and wife sharing their limited company and both are earning £140,000 a year. The total earnings of £280,000 a year is well above the FRS threshold.

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"But let's say they have children, and one spouse opts to stop working, then their income going forward will drop to £140,000 a year, which is below the £150,000 threshold. The remaining contractor can opt to join the FRS even though in the past it breached the limit by some margin."

Staying in the scheme when fees are unusually high

Once in the FRS, so long as their total income remains below £230,000 including VAT, contractors can stay within the scheme.

Abbott reminds contractors that once their limited company has to leave the scheme as a result of breaching the limit, then it is not possible to rejoin for another 12 months: "That's why staying inside whenever possible is so important.

"If a contractor has earned an unusually high amount of fees during a 12 month period that they believe is a blip and they also believe that their VAT inclusive sales for the next 12 months will be below £191,500, then there are FRS rules enabling them to stay in the scheme."

Contractors, or more often their accountant, can appeal to HMRC's commissioners for a concession to stay registered, citing the FRS rules about an unexpected business activity that is not expected to reoccur.

Contractors can gain an extra three months of FRS, and as much as £1,500

Abbott highlights that another key point that is often overlooked is that contractors only have to consider whether they have breached the limit on the anniversary of first joining the scheme.

"What has become apparent through the analysis of the legislation and HMRC's guidance is that what exactly this anniversary means has been misinterpreted by contractors, their advisers and even HMRC."

HMRC's guidance is actually at odds with what the legislation says. Abbott explains how it should work: "Say a contractor joined on 1 April 2012 and they complete VAT Returns quarterly to 31 March, 30 June and so on. During the 2012-2013 tax year they exceeded the threshold £230,000 and the level of income is likely to stay above £191,500 going forward so they have to leave.

"The rules say that you have to come out of FRS in the VAT period that you exceed the threshold. HMRC's guidance has wrongly interpreted the legislation so that in our example it would mean the VAT period ending 31 March 2013 and the contractor would leave the scheme before 1 April 2013."

Defining the anniversary is key

Abbott continues: "It all comes down to how you define the anniversary of when the scheme was joined. If you think about it, if you got married on 1 April, then your anniversary is not 31 March, it is 1 April. The same principle applies to a contractor's anniversary of joining the scheme.

"Remember, the rules say that a contractor has to consider whether they have exceeded the threshold on the anniversary of when they joined, and they must come out of FRS in the VAT period they exceeded the threshold.

"So, the 'consideration' of whether the limit has been exceeded is done on 1 April, the anniversary of the 1 April 2012 joining date. And that means the VAT period of leaving is actually April-June 2013, not January-March 2013. So, the contractor in our example does not actually have to leave the scheme until the end of June 2013."

Why is this nit picking over dates important? "By carefully choosing when to join the FRS, and properly understanding when they should leave, a contractor could gain an additional three months of FRS that might be worth a VAT saving of £1,000 to £1,500."

Choosing the tax point of invoices

Contractors can further control when they have to leave, and the resulting financial benefit, by varying the tax point of their invoices: "Contractors can time their sales invoices if they are coming to year-end and think they are going to breach the limit.

"If they have control over the tax point of invoices, a contractor may not wish to raise the biggest fee note just before their anniversary expires."



James Abbott

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James Abbott is the owner of Abbott Moore LLP and often speaks on freelancer / contractor tax matters. He has his own growing portfolio of contractor clients.

Abbott Moore LLP are PCG Accredited Accountants and specialise in providing tax advice to freelancers as well as dealing with their year end accounts and tax returns. [Read Full Profile...](#)

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Abbott concludes: "Many accountants and HMRC tax inspectors remain unfamiliar with the detail of these rules, so contractors with FRS joining and leaving issues should ensure their advisers are up-to-speed when deciding exactly when to join and leave."

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