GRANTS
CHARTERED ACCOUNTANTS
AND BUSINESS ADVISORS

VAT

Flat rate scheme changes –
From April 2017

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1) Introduction

The VAT Flat Rate Scheme was designed by HM Revenue Customs, to simplify the VAT administration for small businesses. The scheme allows the business to apply a fixed flat-rate percentage to its gross turnover to arrive at the VAT due. This method of calculating the VAT payable is a lot simpler than the standard method of deducting VAT suffered on purchases from VAT charged on sales and paying the difference over to HMRC each quarter.

An unintended consequence of the scheme was the level of 'profit' to be made by some businesses. This was due to the amount of VAT being paid over to HMRC being significantly less than the amount collected along with sales income.

The above benefits made the scheme very attractive to small businesses and as a result, most of our clients are registered on the flat rate scheme for VAT.

2) Changes

The Chancellor of the Exchequer recently announced the introduction of a new 16.5% VAT flat rate for businesses with limited costs. Although the legislation has not yet been finalised (and is still subject to change), this will take effect from 1st April 2017. Newly VAT registered businesses will continue to receive a 1% discount on this rate in their first year of registration.

Businesses who currently use the scheme, will need to decide whether they are a limited cost trader. For some businesses - for example, those who purchase no goods, or who make significant purchases of goods - this will be obvious. Other businesses will need to complete a simple test to work out whether they should use the new 16.5% rate.

A limited cost trader will be defined as one whose VAT inclusive expenditure on goods is either:

- less than 2% of their VAT inclusive turnover in a prescribed accounting period
- greater than 2% of their VAT inclusive turnover, but less than £1,000 per annum if the prescribed accounting period is one year

Goods, for the purposes of this test, must be used exclusively for the purpose of the business but exclude the following items:

- capital expenditure
- food or drink for consumption by the flat rate business or its employees
- vehicles, vehicle parts and fuel

Unfortunately, as most of the costs of running your limited company are likely to be classed as 'services' for VAT purposes, rather than goods, we think it is likely that the majority of personal service companies will be classified as limited cost traders from 1st April 2017.

(3) Options

We have been reviewing your options in relation to these changes and will comment on each one in turn:

Option 1 - De-register for VAT

This option will only be available if you expect your turnover, in the next 12 months, to be below the VAT de-registration threshold of £81,000.

If you de-register for VAT, you will not be able to reclaim any VAT you have suffered on expenditure. However, you will have no administration in terms of VAT recording and Returns.

Option 2 – Remain on the flat rate scheme

Under this option, you take no action and simply revert to the flat rate of 16.5% from 1st April 2017.

You retain the simplicity of VAT recording and Returns under the flat rate scheme, but lose the significant 'profits' previously enjoyed.

Option 3 – Change to Standard VAT accounting

Under this option, you would write to HMRC and advise them that you will no longer use the VAT flat rate scheme.

Each quarter, you would calculate your VAT liability by analysing the VAT you have suffered on expenditure and deduct this from the VAT you have charged on your sales income. The balance would be paid over to HMRC.

There will be more work involved administering the standard method of VAT accounting.

(4) Financial implications

There will be financial implications involved no matter what option you decide to choose moving forward. Unfortunately, the profit made from the flat rate scheme is going to be a thing of the past.

There are other considerations, as well as the financial ones, which we mention at point 5 below. However, we thought it would be useful to quantify the financial differences between options 2&3. We would, therefore, refer you to the calculation prepared at appendix one.

This is a very simplistic calculation which assumes a small amount of VAT is reclaimable. In practice, you may be able to reclaim more VAT on expenses, which would obviously alter the end result.

You will note from the calculation that the negative impact of remaining on the flat rate scheme decreases, as your turnover increases.

(5) Other considerations

Clearly, the financial implications are important, but, as you will see from the calculation we prepared, the differences are very small between the new flat rate of 16.5% and the standard method of VAT accounting. Therefore, it is important to consider other factors before making a decision.

Accounting procedures

There is no doubt that the standard method of VAT accounting requires additional work such as:

- Calculating VAT charged on sales income
- Determining expenditure on which VAT can be claimed
- Extracting VAT from payment receipts
- Ensuring VAT Return is completed correctly

Compare this to the flat rate procedures that are a lot simpler. You may, therefore, feel the additional administration is not worth it for the amount of savings involved.

HMRC Inspections

We believe that there is more scope for an HMRC enquiry of your VAT affairs if you are re-claiming VAT suffered on outgoings, rather than using the VAT flat rate scheme. It is very straightforward for HMRC to check you are calculating your VAT correctly under the flat rate scheme without opening an enquiry. However, for HMRC to check that the correct amount of VAT is being reclaimed from them, they would need to open and enquiry and review all necessary business records. This can be a time consuming and costly exercise.

Appendix 1 – Financial Comparisons

VAT
Flat Rate Scheme V Standard Method
<u>From April 2017</u>

Turnover	£35k	£50k	£75k	£87.2k	£100k
Flat rate scheme					
VAT due on flat rate scheme @ 16.5%	£6,930	£9,900	£14,850	£17,266	£19,800
Standard method					
Output VAT due on turnover	£7,000	£10,000	£15,000	£17,440	£20,000
Less: Estimated Input VAT claim	£(215)	£(215)	£(215)	£(215)	£(215)
Net VAT due on standard method	£6,785	£9,785	£14,785	£17,225	£19,785
Additional CT relief on flat rate scheme	(41)	(41)	(41)	(41)	(41)
Net cost / (saving) to remain on flat rate scheme	**£104**	**£74**	**£24**	**£0**	**£(26)**