
VAT – Flat rate scheme for small businesses

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Introduction

The VAT Flat Rate Scheme was introduced in the Budget 2002 as an alternative to the normal method of VAT accounting. It allows eligible businesses to calculate their net VAT liability as a flat rate percentage of their total turnover. The scheme is open to small businesses whose annual taxable turnover (not including VAT) does not exceed £150,000 and whose total turnover (including the value of exempt and non-taxable income but not including VAT) does not exceed £187,500 a year.

The scheme is designed to help small businesses reduce the time and money involved in keeping VAT records and calculating the VAT due. Her Majesty's Revenue and Customs (HMRC) believes that using the Flat Rate Scheme saves the average business 2 days a year of VAT administration. Undoubtedly, it also reduces the workload of HMRC. It should be noted that although the scheme may save administrative time and money, it will not necessarily reduce the VAT due to HMRC, and in some circumstances may increase the VAT due.

This publication is based upon the HMRC Notice 733: *Flat rate scheme for small businesses*, and Crown Copyright is acknowledged. Basic VAT information can be found in Notice 700 *The VAT Guide*.

Trade Sectors

Each business must determine its Trade Sector to ascertain the flat rate percentage it must apply. New Trade Sectors were determined by the HMRC on 1 January 2004, and further changes were made on 1 April 2004 and on 1 December 2008 to accompany the change of the standard VAT rate from 17.5% to 15%. This publication contains all the trade sector names and flat-rate percentages current at 1 December 2008. Previous trade sector names and rates can be found on the HMRC website: www.hmrc.gov.uk.

Where a business makes supplies in two or more trade sectors, it must choose the trade sector for which the business receives the greater turnover.

HMRC provides a ready reckoner on its website: www.hmrc.gov.uk to help businesses decide which trade sector they are in and therefore which flat rate percentage

they will use. It also estimates how much VAT will be payable using the Flat Rate Scheme, and compares this to the VAT payable using normal VAT accounting.

Flat Rate Percentages

The flat rate percentages are based on the previous VAT returns submitted by businesses that are eligible to join the scheme and reflect the average VAT paid across each trade sector. Under the Flat Rate Scheme, tax paid on purchases is not recovered and this was taken into consideration when the percentages were calculated. Input tax can, however, be reclaimed on single capital assets costing £2,000 or more (inc VAT). Because the flat rates are an average, some businesses will pay less on the scheme and some pay more.

To encourage small businesses to join the Flat Rate Scheme, HMRC reduced the flat rate percentages across all trade sectors from 1 January 2004. These were further reduced on 1 December 2008 in line with the reduction in the standard rate of VAT.

Annual and Cash Accounting Schemes

The Flat Rate Scheme can be used in conjunction with the Annual Accounting Scheme. It cannot be used with the Cash Accounting Scheme, but it has its own similar cash based method.

New Registration discount

On 1 January 2004, HMRC introduced a 1% reduction in the published flat rates for new VAT registrations during their first year of registration. This reduction is designed to encourage businesses eligible for VAT registration to move straight onto the flat rate scheme. After the first registration anniversary, the rates revert to the published level.

Overview of the Flat Rate Scheme

What is the flat rate scheme?

The flat rate scheme allows small businesses an alternative to the normal transaction based method of VAT accounting. Businesses using it calculate their VAT payment as a percentage of their VAT-inclusive turnover.

Pre-Budget Report 2008 – VAT Changes

In his Pre-Budget Report on 24 November 2008 the Chancellor announced that the standard rate of VAT will be reduced to 15% on 1 December 2008. This means that for any sales of standard-rated goods or services that take place on or after 1 December 2008 providers should charge VAT at the new rate of 15%. The 15% rate will remain until 31st December 2009, and from 1 January 2010 it will revert to 17.5%.

Only standard-rated sales are affected. There are no changes to sales that are zero-rated or reduced-rated for VAT. Similarly, there are no changes to the VAT exemptions.

Cash Accounting

Where a business uses the cash accounting scheme it needs to be particularly careful about recording the tax point for the sale. This is generally when the invoice is issued, but not always. The business must account for VAT at 17.5% where the tax point falls before 1 December 2008 even if it receives the payment on or after 1 December 2008. Many businesses will use the cash accounting scheme in conjunction with the flat rate scheme, in which case the correct flat rate must be applied according to when the tax point falls, not when the payment is received.

Flat-Rate Scheme

Most, but not all, of the flat rates for this scheme have been cut from 1 December 2008. You may need to do some number crunching to see if it is still tax efficient to stay within the scheme. The new flat rates are available in our publication 669 – *VAT Flat Rate scheme for small businesses*.

More information on the VAT changes can be found at the end of this publication. A technical guide for businesses is available at: www.hmrc.gov.uk/pbr2008/measure1.htm

How will it help me?

The aim of the scheme is to simplify the way small businesses account for VAT so that you will spend less time and money keeping VAT records and calculating the VAT payable to HMRC. If you use the flat rate scheme together with the annual accounting scheme it can make a significant difference to the cost of complying with VAT regulations. The terms and conditions of the annual accounting scheme can be found in Notice 732 *Annual accounting*.

Might I pay more VAT by using the flat rate scheme?

Some businesses will pay more and some will pay less VAT by using the scheme. This is because the flat rates are averages. You can estimate the effect on your business by using the ready reckoner at www.hmrc.gov.uk/business/services/vat-flat-rate.htm.

The accounting simplifications, however, apply to all businesses that use the scheme and the time saved should be taken into account when deciding whether or not to join the scheme.

Who can join the scheme?

The scheme is open to small businesses whose annual taxable turnover (not including VAT) does not exceed £150,000 and whose total turnover (including the value of exempt and non-taxable income but not including VAT) does not exceed £187,500 a year. See the “Eligibility and conditions of the scheme” section.

Who cannot join the scheme?

There are some exclusions. You cannot use the scheme if you:

- already use any of the schemes for second-hand goods, tour operators or capital goods;
- have been guilty of a VAT offence or dishonesty in the last 12 months;
- have been 'associated' with another business or have registered as part of a VAT group or in VAT divisions in the last 24 months.

For a complete list of the exclusions see the “Eligibility and conditions of the scheme” section.

How do I join the scheme?

There is an application form, an explanation of how to complete the form and where to send it in Notice 733 *Flat rate scheme for*

small businesses. You may also apply by telephone or e-mail.

How the scheme works

How does the scheme differ from normal VAT rules?

Under the normal VAT rules you have to identify the VAT on each sale you make, record the value and VAT separately and pay the VAT to us as output tax. Similarly you have to identify the VAT included in the things your business buys, record the value and the VAT separately and claim the VAT back from HMRC as input tax.

Under the flat rate scheme you do not have to identify, or separately record, the VAT on your sales and purchases to calculate the VAT you owe. You simply record all the supplies your business makes, including exempt supplies, and apply the appropriate flat rate percentage for your trade sector to the total in each period. The result is the VAT you owe to HMRC.

How are the flat rates calculated?

The flat rate percentages are calculated from the net tax paid by all the businesses that are currently registered for VAT and eligible for the scheme. The net tax paid varies with different trade sectors and so there are a variety of flat rate percentages. The net tax calculated using the flat rate percentage allows for the fact that businesses can usually recover the tax paid on their purchases. Under the flat rate scheme you normally cannot claim input tax with some exceptions.

How do I calculate my flat rate turnover?

To calculate your turnover, you record the supplies you make either at the time you invoice your customers or at the time you receive payment.

How do I calculate the VAT due?

At the end of each VAT period, take the VAT inclusive turnover of your business and multiply this by the flat rate percentage for your trade sector. For example, if your business is the repair of motor vehicles and your VAT inclusive turnover for the VAT period is £20,000 the calculation is: £20,000 x 6.5% = £1,350. So your tax due is £1,350.

What is the 1% reduction for new VAT registrations?

Newly VAT registered businesses use the flat rate for their sector minus 1%. So, if the rate for your sector is 9%, you apply a flat rate of 8% in your first year of VAT registration.

How do I recover VAT?

If you use the scheme you do not make a separate claim for input tax or for VAT on imports or acquisitions. The flat rate percentage includes an allowance for these items. Two exceptions follow.

Can I recover VAT on the stocks and assets I have on hand at registration?

Yes. The normal rules allow you to recover VAT incurred before you were VAT registered subject to some conditions. This allowance works in the same way if you are using the flat rate scheme. Record the claim for eligible VAT in your VAT account. For details of the recovery of pre-registration VAT see Notice 700/1 *Should I be registered for VAT?*

If you do recover VAT on pre-registration capital assets, any subsequent disposal of those assets has to be accounted for using the normal VAT accounting rules. Add the VAT calculated to your flat rate calculation of VAT due.

What if I buy an expensive capital asset?

If you buy a single capital asset with an invoice value, including VAT, of £2,000 or more you can claim the input tax on your VAT return in the normal way.

If you do recover VAT on an expensive capital asset, any subsequent disposal of that asset has to be accounted for using the normal VAT accounting rules. Add the VAT calculated to your flat rate calculation of VAT due.

Must I issue VAT invoices?

If your customers are registered for VAT, follow the normal rules and issue a VAT invoice. The flat rate scheme affects the way you calculate the VAT you owe to us but does not change the VAT rate applicable to your sales. This means that when you issue a VAT invoice, you show VAT on it at the normal rate for that type of supply (not the flat rate percentage).

Can I use this scheme in conjunction with other schemes?

This table below shows which other schemes you can use with the flat rate scheme.

Scheme	Use with FRS?	Further information
Annual accounting	Yes	The annual accounting scheme can help reduce the cost of complying with VAT if you use it together with the flat rate scheme. See Notice 732 <i>Annual Accounting</i> .
Cash accounting	No	Although you cannot use the cash accounting scheme and the flat rate scheme together, the flat rate scheme has its own cash based method that is very similar to the cash accounting scheme. If you move from the normal cash accounting scheme to the cash based method of calculating your flat rate income, you do not need to make the adjustment normally required on ceasing to use cash accounting.
Retail Schemes	No	Although you cannot use a retail scheme and the flat rate scheme together, the flat rate scheme has its own retail based method that is very similar to the ordinary retail schemes. If you want to leave a retail scheme to join the flat rate scheme, simply follow the rules about ceasing to use the retail scheme in Notice 727 <i>Retail schemes</i> .
Margin scheme for second hand goods	No	If you sell a significant proportion of second hand goods using margin schemes or the auctioneers' scheme, the flat rate scheme would be of limited value to your business. This is because the flat rate scheme calculates VAT on the total received for your sale rather than on the margin.

Eligibility and Conditions of the scheme

Who can join the scheme?

You can apply to use the scheme if there are reasonable grounds for believing that the following turnover tests are met:

- Your taxable turnover (not including VAT) in the next year will be £150,000 or less; and
- Your total business income (not including VAT) in the next year will be £187,500 or less.

How do I calculate my taxable turnover for the first turnover test to join the scheme?

The flat rate scheme is for small businesses. The first turnover test is the value of your taxable supplies excluding VAT. For the first test, exclude any anticipated sales of capital assets but always include **all** of the following:

- the VAT exclusive value of standard rate, zero rate and reduced rate supplies;
- the VAT exclusive turnover from the sale of second hand goods sold outside the margin scheme; and
- any sales of investment gold that are covered by the VAT Act, Section 55. See Notice 701/21 Gold

How do I calculate my total income for the second turnover test to join the scheme?

The second turnover test is the value (excluding VAT) of all your business supplies except anticipated sales of capital assets. This includes, in addition to your taxable supplies, **both** of the following:

- the value of any exempt supplies, such as rent or lottery commission; and
- any other income received or receivable by your business. This includes any non-business income such as that from charitable or educational activities.

Note: non-business income is included in the joining test because the scheme is for small businesses. When you use the scheme, non-business income is not included in the VAT inclusive turnover to which the flat rate applies.

How do I know what my future turnover is going to be?

You may forecast your future turnover in any reasonable way. If you have been registered for VAT for 12 months or more, the turnover declared on your returns may be a reasonable guide but take into account any proposed or expected changes. If you are not VAT registered when you apply for the scheme, you may forecast your turnover by looking at:

- any period of trading before you join the scheme or registered for VAT;
- the turnover of the previous business owner; or
- information on business plans or loan applications.

What if my future turnover rises over my forecast?

However you estimate your future turnover, HMRC will not penalise you provided there were reasonable grounds for what you forecast. It is sensible, therefore, to keep a record of what figures you used to calculate your future turnover. If your forecast of turnover had no reasonable basis, you may be excluded from the scheme immediately or even from the date your ineligible use began.

What if my turnover rises once I have joined the scheme?

You may stay in the scheme provided your total VAT inclusive turnover for the year just gone does not exceed £225,000. Make this check on each anniversary of your business joining the flat rate scheme. Additionally, you must leave the scheme if your income increases so that there are grounds for believing it will exceed £225,000 in the next 30 days alone.

Who cannot join the scheme?

You cannot use the scheme if **any** of the following apply:

- you are not registered for VAT;
- you use the second-hand margin scheme or the auctioneers' scheme;
- you are required to use the tour operator's margin scheme;
- you are required to operate the Capital Goods Scheme in respect of certain capital items;
- you have stopped using the flat rate scheme in the 12 months before the date of your new application;
- in the 12 months before your application you have either:
 - accepted a compound penalty offer or been convicted of an offence in connection with VAT; or
 - been assessed with a penalty for conduct involving dishonesty;
- you are, or within the past 24 months have been, registered for VAT in the name of either a:
 - VAT group; or
 - division;
- you are, or within the past 24 months have been, eligible for VAT group treatment;
- your business is 'associated' with another.

I usually receive repayments from HMRC; can I use the flat rate scheme?

No. The flat rate scheme only calculates VAT due to HMRC and so is unsuitable where you regularly receive payments from HMRC. This does not stop a VAT return from a business on the scheme from being a claim for VAT but these cases will be very rare.

How to apply for the Flat Rate scheme

How can I apply?

By post

You can use the application form in Notice 733 or download a version from the website (you can complete it on your computer print it off, sign it and post it if you prefer).

By e-mail

Download the scheme application form from: www.hmrc.gov.uk/business/services/vat-flat-rate.htm. Fill it in on your computer and send it to the e-mail address for flat rate scheme applications: frsapplications@hmrc.gov.uk

By phone

Call the National Advice Service on 0845 010 9000. They can take your application over the phone.

How do I fill in the application form?

The guidance in the table below should help you fill in the form. If you are in doubt telephone the National Advice Service.

SECTION A	
Business name	Use your normal business name. If you are already registered for VAT, this should be the name on your VAT Certificate of Registration.
Business Address	This is your principal place of business. Again, if you are already registered or VAT, this should be the address on your VAT Certificate of Registration.
Telephone number	You do not have to give this, but it may help HMRC to process your application more quickly if they can telephone you to clear up questions about your application.
VAT registration number	If you have not been advised of a VAT registration number, leave this blank. Make sure you send the scheme application to the same office as you sent the VAT 1 Notification of VAT registration.

SECTION B	
Main business activity	Decide which of the trade sectors most accurately describes your business. If your business covers more than one sector, use the sector that is the main part of your business. Decide which is the main part by the amount of turnover each makes.
Flat rate percentage	This is the percentage for your sector as shown in the table on page 8 of this publication. This will be the percentage you apply to your VAT inclusive turnover to calculate the net VAT payable to us. (If you are in your first year of VAT registration the flat rate you actually use will be 1% below this.)
Start date	Your options are: <ul style="list-style-type: none"> • leave this blank. Your authorisation will start at the beginning of your next VAT accounting period after HMRC process your application; • write "date of registration" or "EDR". Your authorisation will begin from the date you registered for VAT provided you apply at or close to the time you register; or • write the date you want to start the scheme. This cannot normally be a date before the date you apply.

SECTION C	
Signature and date	The form should be signed and dated by the owner, a partner or a director of the business that is applying. A signature is not required on an electronic application. Just type your name in the box.

If your accountant or other representative applies by phone for you to use the scheme, HMRC will send you a copy of the application form completed by their staff for your records. If there are any errors on it contact HMRC immediately.

Where do I send the completed application form?

Post applications should be sent to the National Registration Unit for your postcode. Their addresses are in Notice 700/1 *Should I be registered for VAT?* And on the HMRC website at:

www.hmrc.gov.uk/business/vat/send-regnderevars.htm

Do I need to keep a copy of my application?

Yes. This is a good idea and will help if you have to contact HMRC about your application. Please also note the office to which you send it.

When can I apply?

You can apply at the time you register for VAT or any later time. If you apply near the time of your VAT registration, you can begin to use the scheme from the date you are registered for VAT. There is a 1% reduction in flat rate for all businesses using the scheme during their first year of VAT registration. The earlier you apply to use the scheme the longer you will be able to get the benefit of the reduction.

If you are already VAT registered when you apply to use the scheme, it is best to apply as early in a VAT accounting period as you can. This is because your authorisation to use the flat rate scheme normally takes effect from the beginning of the VAT accounting period after HMRC have processed your application. If you are applying at the end of a VAT period it will be clearer exactly which day you wish to start using the scheme if you put that date on your application form even if this will be the start of your next VAT accounting period.

When can I start to use the scheme?

HMRC will notify you either that:

- your application has been accepted and the date from which you can operate the flat rate scheme; or
- the reason why HMRC have not allowed it.

What if I don't receive a reply to my application?

HMRC will deal with your application under their Taxpayer's Charter standards. If you do not hear from them within 30 days, please contact the office to which you sent the application to check that it has been received.

What if I want to use both the flat rate scheme and the annual accounting scheme?

Notice 732 *Annual accounting* contains the joint application form. Complete that form if you want to start using both the flat rate scheme and the annual accounting scheme together. If you are already using one scheme and you want to use the other as well then just complete the form for the scheme you wish to join.

Determining your Flat Rate percentage

Which flat rate applies to my business?

To work out the flat rate for your business, look at the Trade Sectors and Flat Rate Percentages table below and decide which of the sectors most closely describes what your business will be doing in the coming year. Just give the words their ordinary meanings. If you have difficulty deciding on a sector, go to the flat rate scheme ready reckoner at www.hmrc.gov.uk/business/services/vat-flat-rate.htm

The number allocated to your trade sector is your flat rate percentage. You apply the flat rate percentage to your VAT inclusive turnover to get the VAT payable to us under the scheme.

What if you disagree with my choice of sector?

If HMRC approve you to join the scheme, they will not change your choice of sector retrospectively as long as your choice was reasonable and you have kept a record of why you chose it.

The table of trade sectors and flat rates

The table shows the trade sectors and the flat rate percentages calculated for each. These are the flat rates that apply from 1 December 2008.

For details of previous rates see the HMRC website.

Trade Sector (from 1 December 2008)	Flat Rate %age
Accountancy or book-keeping	11.5
Advertising	8.5
Agricultural services	7
Any other activity not listed elsewhere	9
Architect, civil and structural engineer or surveyor	11
Boarding or care of animals	9.5
Business services that are not listed elsewhere	9.5
Catering services including restaurants and takeaways	10.5
Computer and IT consultancy or data processing	11.5
Computer repair services	10
Dealing in waste or scrap	8.5
Entertainment or journalism	9.5
Estate agency or property management services	9.5
Farming or agriculture that is not listed elsewhere	5.5
Film, radio, television or video production	9.5
Financial services	10.5
Forestry or fishing	8
General building or construction services*	7.5
Hairdressing or other beauty treatment services	10.5
Hiring or renting goods	7.5
Hotel or accommodation	8.5
Investigation or security	9
Labour-only building or construction services*	11.5
Laundry or dry-cleaning services	9.5
Lawyer or legal services	12
Library, archive, museum or other cultural activity	7.5
Management consultancy	11
Manufacturing that is not listed elsewhere	7.5
Manufacturing fabricated metal products	8.5
Manufacturing food	7
Manufacturing yarn, textiles or clothing	7.5
Membership organisation	5.5
Mining or quarrying	8
Packaging	7.5
Photography	8.5
Post offices	2
Printing	6.5
Publishing	8.5
Pubs	5.5
Real estate activity not listed elsewhere	11
Repairing personal or household goods	7.5
Repairing vehicles	6.5
Retailing food, confectionary, tobacco, newspapers or children's clothing	2
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	6
Retailing that is not listed elsewhere	5.5
Retailing vehicles or fuel	5.5
Secretarial services	9.5
Social work	8
Sport or recreation	6
Transport or storage, including couriers, freight, removals and taxis	8
Travel agency	8
Veterinary medicine	8
Wholesaling agricultural products	5.5
Wholesaling food	5
Wholesaling that is not listed elsewhere	6

*"Labour-only building or construction services" means building or construction services where the value of materials supplied is less than 10 per cent of relevant turnover from such services; any other building or construction services are "general building or construction services".

How do I operate the 1% reduction?

A 1% reduction in flat rate came into effect on 1 January 2004 for businesses in their first year of VAT registration. Businesses on the scheme may take 1% off the flat rate in the table above for all turnover they get from 1 January 2004 until the day before the first anniversary of them becoming VAT registered.

Examples

A business registers for VAT on 1 December 2003 and uses the flat rate scheme from that date with a flat rate of 10%. From 1 January 2004 to 30 November 2004 they can use 9% if there are no changes to the business during this time.

Another business registered for VAT on 6 January 2004 but does not join the flat rate scheme until 1 July 2004 at a rate of 6%. From 1 July 2004 to 5 January 2005 they may use 5% if there are no changes to the business during this time. If on 1 November 2004 the business changes and their new flat rate is 7.5% then from 1 November 2004 to 5 January 2005 they can use 6.5%. For turnover after 5 January 2005 they must use 7.5%.

What if my business falls into more than one of the sectors?

If your business includes supplies in two or more sectors, you must apply the percentage appropriate to your main business activity as measured by turnover. Choose the sector for which your business gets the greater part of its turnover. Do not split your turnover or apply more than one percentage.

Example

If a taxi business also did some car repairs it would have to decide from which of the two trade sectors it expected to get the larger amount of turnover. It would apply the flat rate percentage appropriate for that trade sector to the whole of its VAT inclusive turnover.

If the taxi part of the business..	and the car repair part of the business..	the flat rate business..
expects to generate VAT inclusive turnover of £40,000 in the next year	expects to generate VAT inclusive turnover of £15,000 in the next year	should apply the flat rate percentage for a taxi business of 8% to the total VAT inclusive turnover for both parts. If this total was £75,000, the business would pay £6,000 in that year.

What happens if the balance between parts of my business changes?

If the balance changes but you continue to do all the same activities, continue to use the percentage that was appropriate at the beginning of the year until the anniversary of you joining the scheme. Review the balance between the parts of the business each year. Make this review for the first day of the VAT period in which the anniversary of you joining the scheme falls. If on that date, the balance has changed, or you expect it to change over the year ahead, change trade sectors to that for the larger portion of your expected business. A change of trade sector may also mean that your flat rate changes. If this occurs use the new flat rate from the start of the VAT period in which your anniversary falls; not just from the anniversary to the end of the period.

What will happen if I start or stop a business activity during the year?

If you stop a business activity or start a new one during the year you will need to reconsider if the flat rate scheme is still the better way for you to calculate your VAT. The change may mean you are no longer eligible to use the scheme. If you are to continue using the scheme, consider which business activity now represents the larger part of your expected business. Apply the appropriate percentage from the date of the change in your business until your next anniversary of joining the scheme or the next change to your business whichever comes first. If you change flat rate percentages you must write and tell us within 30 days of the change taking place.

What happens if the Table of flat rates changes?

In general terms, always use the flat rate given in the Table for your trade sector. From time to time HMRC will make changes to the Table.

If changes are made to the:

- flat rate for a trade sector;
- standard or reduced rate of VAT; or
- liability of a particular type of supply,

then HMRC will publish an amended Table of flat rates. If you change your rate only because HMRC have changed the Table of flat rates you do not have to write and tell them about it.

When must I start using the new Table?

The new table will have a start date published with it. The start date might be different for different trade sectors. From the start date for your sector you must use any new flat rate given in the new table.

How do I deal with two flat rates in one VAT period?

Where a change in flat rate occurs in the middle of your VAT accounting period you will have to do two calculations for that one period. One calculation will be from the beginning of the period to the day before the start date of the new table and one from the start date to the end of the period.

What if the start date for a new table coincides with changes to my business?

If the start date coincides with the day you would otherwise make a change (e.g. starting a new business activity) then make the change as normal but use the rate on the new table. If there is more than one change or table amendment in your accounting period then you will need more than two VAT calculations for the period.

How do the April 2004 changes affect couriers?

It depends when you applied to join the flat rate scheme. If you were using the scheme on the 5.5% rate on 2 March 2004 then you can continue to use that rate until either 30 June 2004 or a change occurs in your business, whichever comes first. When this happens you must change to the 9% rate (8% from 1 December 2008) or follow the rules regarding changes in your business. If you

asked to join the scheme as a courier after 2 March 2004, no matter what start date HMRC have agreed with you, you must change to the 9% rate on 1 April 2004 (8% from 1 December 2008) or follow the business change rules if there is a change to your business before this date.

Any business who feels the scheme is no longer suitable for them may leave the scheme by following the procedure outlined in the "Leaving the Scheme" section.

Using the scheme and keeping records

How do I work out my flat rate turnover?

It is important that you get this right. If you include items that are not part of the turnover, you will pay too much VAT. If you leave out items, you will pay too little VAT and could be assessed and have to pay a penalty and interest. Do not forget, the turnover to which you apply the flat rate is all that you receive including the VAT.

There are three ways of calculating your turnover. They are:

Method	Description
Basic turnover	This is principally for those who deal mainly with other VAT registered businesses. If you are used to accounting for VAT on an invoice basis, this can be the simplest to operate.
Cash based turnover	This method is the flat rate scheme equivalent of cash accounting. It is based, not on the time you make the supply but, on the time you are paid for your goods or services. This can be helpful if you give extended credit or have a lot of bad debts.
Retailer's turnover	This is essentially the same as a retail scheme and is best if you are a retailer selling goods to the public.

All of these methods are covered in greater detail in later sections. Whichever method you use, you should use that method for at least 12 months.

What must I include in my flat rate turnover?

Your flat rate turnover is VAT inclusive and includes all the supplies made by your business. This includes **all** of the following:

- the VAT inclusive sales and takings for standard rated, zero rated and reduced rate supplies;
- the value of exempt supplies, such as rent or lottery commission. You can find out more about exempt income in Notice 700 The VAT Guide;
- supplies of capital assets, unless they are supplies on which VAT has to be calculated outside the flat rate scheme; and
- the value of your despatches to other member States of the EC if you are making intra EC supplies. For details see Notice 725 The Single Market.

Note: As exempt and zero-rate supplies are included in flat rate turnover you apply the flat rate percentage to the exempt and zero rate turnover. You may pay more VAT by being on the scheme if these supplies are a larger proportion of your business turnover than the average for your trade sector.

What income do I exclude from my flat rate turnover?

You exclude from your flat rate turnover:

- private income, for example income from shares;
- the proceeds from the sale of goods you own but which have not been used in your business;
- any sales of gold that are covered by the VAT Act section 55 (see Notice 701/21 Gold)
- non-business income and any supplies outside the scope of VAT; and
- sales of assets to be accounted for outside the scheme.

Do I need to keep any special records?

Yes.

Must I keep a VAT account?

Yes. Like all other businesses registered for VAT, you must keep a VAT account. If the only VAT to be accounted for is the VAT calculated under the flat rate scheme, just record that in the VAT payable portion of your VAT account.

In some cases, however, you may have VAT to account for outside the flat rate scheme,

for example the purchase or disposal of a large capital asset. This should be entered in the VAT account in the normal way in addition to your flat rate VAT. For further details of the VAT account see Notice 700 *The VAT Guide*.

This rule has the force of law.

You must keep a record of your flat rate calculation showing:

- your flat rate turnover for the VAT accounting period;
- the flat rate percentage you have used; and
- the tax calculated as due.

This record must be kept with your VAT account.

Do I still need to issue VAT sales invoices?

Yes. You must still issue VAT invoices to your VAT registered customers. Your customers will treat these as normal VAT invoices. When you come to calculate the scheme turnover, do not forget to include the VAT inclusive total of any invoices you have issued into the method of working out turnover that you are using.

How do I calculate the VAT on these invoices?

Record VAT on your sales invoices using the normal rate for the supply (standard, reduced or zero rate or exempt) and not the flat rate percentage assigned to your trade sector. At the end of the VAT period you add up the VAT inclusive total of all your supplies whether you gave a VAT invoice or not and apply the flat rate percentage to this total to give the amount of VAT you must pay to us.

How do I fill in my VAT return?

Filling in your VAT return is different on the scheme from the normal VAT rules because you are calculating net tax without reference to output tax and input tax. Follow the rules in the "Filling in your VAT return" Table below where they differ from those on the VAT return form. If the value for any box is none, write none in the box. Do not leave any box blank.

Filling in your VAT return	
Box 1	Use this for the VAT due under the flat rate scheme (see box 6 below). You may have other output tax to include in the box such as the sale of a capital asset on which you have claimed input tax separately while using the flat rate scheme.
Box 2	Use in the normal way for recording VAT payable on acquisitions from the EU see Notice 725 <i>The Single Market</i> .
Box 3	Will be the sum of boxes 1 + 2 in the normal way.
Box 4	Will usually be none. Though there may be a claim if you: <ul style="list-style-type: none"> • buy a capital asset exceeding £2,000 (inc VAT); or • can recover VAT on stocks and assets on hand at registration.
Box 5	Will be the result of box 3 minus box 4 in the normal way.
Box 6	Enter the VAT inclusive turnover to which you applied the flat rate scheme percentage. You should also include the VAT exclusive value of any supplies accounted for outside the flat rate scheme, such as the sale of a capital asset. For example: If your VAT inclusive turnover is £10,000 and your flat rate is 8% put the £10,000 in this box and include the £800 in box 1.
Box 7	Will usually be none, except where: <ul style="list-style-type: none"> • you bought a capital asset costing more than £2,000 (including VAT) and you are claiming the input tax in box 4 or • you have acquired goods from other Member States of the EU. Put VAT exclusive value in this box.
Boxes 8 & 9	Use in the normal way.

See Notice 700/12 *Filling In Your Return* for further details.

How do I pay my VAT using the flat rate scheme?

You can pay by cheque, postal order or electronic means. You may get extra time to pay if you pay by electronic means. If you are thinking of using the flat rate scheme in conjunction with the annual accounting scheme then be aware that it is a condition of the annual accounting scheme that you pay by electronic means. For further details on payment see Notice 700 *The VAT Guide*.

Can I send the VAT return electronically?

Yes. HMRC offer an electronic VAT return service that enables businesses to render their returns over the Internet. Businesses using this service must also pay any VAT due by electronic means. If you wish to use this facility you must register and enrol through

the Government Gateway at www.gateway.gov.uk. You can access the Gateway directly or through the HMRC website at www.hmrc.gov.uk.

Do penalties and surcharges apply to flat rate scheme users?

Yes. Surcharges are applied in the normal way if you send your return in late or pay any VAT due after the due date. For details see Notice 700/50 *Default surcharge*.

Any businesses that have a turnover up to £150,000 are offered help to avoid late returns and payments instead of a first surcharge.

If you make errors on your VAT return, which are discovered by a VAT officer before you have corrected them, then you may be liable to a penalty, in addition to being assessed for any VAT due. See Notice 700/42 *Misdeclaration penalty and repeated misdeclaration penalty* and Notice 700/43 *Default Interest*.

What if my business grows?

If your business grows but you remain eligible to use the flat rate scheme you do not need to take any further action. You must check your turnover at least once a year on your anniversary of joining the scheme. If you are expecting sales of £200,000 or more in the next month you should check that you do not exceed the forward look test "*How often do I have to check my turnover?*" in the facing column.

What if the increase in my turnover is a one-off?

If, when you do your annual check you find that your turnover has exceeded the £225,000 limit but you expect that turnover in the next year will be below £187,500 you may be able to remain on the scheme with HMRC agreement. If you wish to remain on the scheme in those circumstances, apply in writing to your local office. You will need to demonstrate that:

- your VAT inclusive total turnover in the coming year will not exceed £187,500;
- the increase was the result of unexpected business activity which has not occurred before and is not expected to recur; and
- the increase arose from genuine commercial activity.

What if the nature of my business changes?

If you change the nature of your business but remain eligible to use the flat rate scheme, apply the appropriate flat rate percentage for the trade sector for the new type of business from the date of the change.

You must write and tell HMRC of the change within 30 days of the date of the change. This should be recorded with your VAT account.

What if the business change makes me ineligible to use the flat rate scheme?

If the change in your business results in you becoming ineligible to use the flat rate scheme you must write and tell us and revert to the normal VAT rules.

Leaving the scheme

When can I leave the scheme?

If you wish to leave the scheme you must write and tell HMRC. You may leave the scheme voluntarily at any time but it would be expected that most businesses would leave the scheme at the end of an accounting period. HMRC will confirm the date you left the scheme in writing.

When must I leave the scheme?

The following table shows what conditions can cause you to become ineligible to continue using the scheme and the date on which you must leave the scheme.

How often do I have to check my turnover?

You have to make sure that you have not exceeded the limits each year on your anniversary of joining the scheme. If your business is growing rapidly, you will need to check at least monthly that your turnover for the next 30 days alone will exceed £225,000 (excluding sales of capital assets).

Can HMRC withdraw the scheme from me?

Yes. HMRC may withdraw the scheme at any time for the protection of the revenue. They will specify the date of withdrawal in their notice of withdrawal.

Additionally, if they withdraw the scheme because you were never eligible to use it, they will backdate the withdrawal to the time when you started using the scheme and you

will have to account normally for VAT from then.

Can I rejoin the scheme?

Yes once you meet the requirements again. After having left the scheme, however, you will not be eligible to rejoin for a period of 12 months.

Ref	If you become ineligible because ...	then you must leave the scheme with effect from ...
(a)	at the anniversary of your start date the tax inclusive value of your supplies in the year then ending (excluding sales of capital assets) exceeded £225,000.	for businesses on quarterly VAT returns: <ul style="list-style-type: none"> the end of the VAT period containing your anniversary; or for annual accountants: <ul style="list-style-type: none"> the end of the month after the month containing your anniversary, or the end of your annual VAT period, whichever comes first.
(b)	there are reasonable grounds to believe your turnover for the next 30 days alone will exceed £225,000 (excluding sales of capital assets).	the beginning of the period of 30 days.
(c)	you become a tour operator and have to account for VAT using the Tour Operator's Margin Scheme.	the date you became a tour operator.
(d)	you intend or expect to acquire, construct or otherwise obtain a "capital item".	the date your intention or expectation occurred.
(e)	you become eligible for VAT group treatment or register in the name of divisions.	the date you become eligible or registered in divisions.
(f)	you become associated with another business.	the date you become associated.
(g)	you decide to account for VAT using the second hand margin scheme or the auctioneer's scheme.	the beginning of the VAT period in which you decide to use either scheme.

What must I do after leaving the scheme?

In general, the transition from the scheme to the normal VAT rules is straightforward but there are some circumstances where you may need to make extra adjustments to ensure your VAT returns are accurate. If:

- you stop using the FRS at any time other than at the end of a VAT accounting period;
- you use the cash based method under the flat rate scheme and you do not move immediately to the cash accounting scheme described in Notice 731 Cash accounting when you leave the scheme, you will have to make an adjustment;
- the value of your stock has increased whilst you have been on the scheme, you may be eligible to make an additional input tax claim;
- you have recovered input tax whilst using the scheme you may need to pay additional output tax.

What if I cease to use the flat rate scheme in the middle of a VAT accounting period?

From your effective date of withdrawal from the scheme, you will have to account for VAT under the normal VAT rules. When this is in the middle of a VAT accounting period, you will need to do two calculations when you complete your next VAT return. One calculation for the period when you were:

- on the flat rate scheme (using the rules for calculating liability under the flat rate scheme); and another for when you were
- not on the flat rate scheme (using the normal VAT accounting rules).

This will give you two sets of figures, one for each period. The amounts to go on your VAT return will be the two amounts for each box added together.

Can I recover VAT on increased stock on hand when I leave the scheme?

Yes. Where the conditions described in the next paragraph are met you can recover VAT on stock which you have on hand when you leave the scheme.

What are the conditions of the optional stock adjustment?

You may make the adjustment described in the following paragraph where:

- you have stock on hand when you cease to use the flat rate scheme for which you can not subsequently recover input tax;
- the value of the stock on which input tax is irrecoverable exceeds the value of stock on hand and on which you had recovered VAT when you started to use the scheme;
- you made and make no separate claim for input tax in respect of the stock on hand; and
- you remain registered for VAT.

This table has the force of law.

Step	What you need to do	Example
1	Establish the VAT exclusive value of stock on hand and on which you had recovered input tax before you joined the flat rate scheme. (Remember , if you were previously on cash accounting, this will be based on stock for which you had paid.)	£10,000
2	Establish the VAT exclusive value of stock on hand and on which you will be unable to recover input tax after you cease to use the flat rate scheme	£20,000
3	Subtract the figure at step 1 from the figure at step 2. (If the figure at step 1 is larger than the figure at step 2, you will not be entitled to the adjustment. No further action is necessary.)	£20,000 - £10,000 = £10,000
4	Multiply the result of step 3 by the standard rate of VAT.	£10,000 x 17.5% = £1,750
5	Claim the VAT calculated at step 4 in the VAT recoverable portion of your VAT account in the first return you make after leaving the flat rate scheme.	£1,750 recoverable from us as a result of FRS stock adjustment

How do I make the stock adjustment?

Provided you meet the stated conditions, you may make the stock adjustment. The stock adjustment requires you to value stock. You do not need a formal stock-take for the purpose of the calculation, but your figures must be reasonable and it makes sense to keep a record of how you valued stock in case HMRC query the figures.

The Basic Turnover method

How do I work the basic turnover method?

Apply the flat rate percentage to the VAT inclusive total of the supplies that have their tax point in the VAT accounting period.

Tax points are worked out using the normal VAT rules for time of supply. If you issue VAT invoices, it is very often the date you issue an invoice. It can, in some circumstances, be the date you receive payment or the date you complete a service or make goods available to your customer. The detailed rules are in Notice 700 *The VAT Guide* and you must follow those rules.

The Cash based Turnover method

How do I use the cash based turnover method?

Apply the flat rate percentage to the supplies for which you have been paid in the accounting period.

This is different from the basic turnover method as it depends only on the time you are paid not the time of your supply. However, this method does not change the time of supply. This is not important in normal circumstances, but in the event of a change in tax rate or liability or in case of insolvency, the basic method tax point will determine the treatment of your supplies.

What do I do if I was using the cash accounting scheme in Notice 731 immediately before using the cash based method?

You carry on as before. There is no need to calculate and pay the tax still owed when you change schemes. Include any payments you receive whilst using the flat rate scheme in the total to which you apply the flat rate percentage.

What is the time of payment under the cash basis?

For the cash basis, include amounts you are paid in your VAT inclusive turnover according to the date when you receive payment.

This rule has the force of law.

Cash (coins or notes): you receive payment on the date you receive the money.

Cheques: you receive payment on the date you receive the cheque or the date on the cheque, whichever is the later. If the cheque is not honoured you do not need to account for the VAT. If you have already accounted for the VAT you can adjust your records accordingly.

Giro, standing order or direct debit: you receive payment on the date your bank account is credited with such a payment.

Credit or debit card: you receive payment on the date you make out a sales voucher for a credit/debit card payment (not when you actually get paid by the card provider).

What if I receive a payment "net of deductions"?

This rule has the force of law.

If you receive a net payment, you must include the full value before such deductions (and including the relevant VAT) in your scheme turnover. This will usually be the value shown on your sales invoice.

Some examples of payments that you may receive that are net of deductions are:

- where commission has been deducted by your customer;
- where commission or payment for expenses has been deducted by a factor or agent collecting money on your behalf;
- where commission or payment for expenses has been deducted by an auctioneer selling goods on your behalf; or
- made by an employer/contractor who has deducted income tax.

What if I receive payments in kind (for example, barter, part exchange)?

This rule has the force of law.

If you are paid fully or partly in kind, such as by barter or part exchange, you must include the value including VAT in your flat rate turnover each time you make or receive a 'payment'. You receive 'payment' on the date you receive the goods or services agreed in lieu of money. You must account for VAT on the full value of the supply, which is the price, including VAT, which a customer would have to pay for the supply if they had paid for it with money only.

The general rules about payments in kind are in Notice 700 *The VAT Guide*.

What if I want to stop using the cash based method?

This rule has the force of law.

If at any time you stop using the cash based accounting method, you must account for VAT on all the supplies made by you while you were using the method for which payment has not been received. The supplies must be included in your scheme turnover in the return for the period in which you cease to use the cash based method. The only exception to this is if you cease to use the FRS, but immediately start to use the cash accounting scheme described in Notice 731 *Cash accounting*.

You may be able to balance this adjustment with a claim for relief for stocks on hand or a claim in respect of bad debts.

The Retailer's Turnover method

What is the retailer's turnover method?

The method is based on your daily takings. To use the method you must record payments as they are received from your customers, for example, through your till, and total the takings daily. You may find it helpful to make weekly and monthly totals. At the end of your VAT accounting period apply the flat rate percentage to the flat rate turnover for that period.

What do I need to add to my daily takings to get my flat rate turnover?

Flat rate turnover is your daily takings plus any other items of income your business receives including those from outside the retail environment. Examples of these might be rent from a flat above the shop or installation or callout charges if they are invoiced for rather than going through your till. When you come to the end of the VAT accounting period, calculate your daily takings as below. Then add to them the VAT inclusive amount of any other income and apply the flat rate percentage to the total.

What do I include in daily takings?

This rule has the force of law.

You must include and record the following in your daily takings as they are received from your customers:

- cash;
- cheques;
- debit or credit card vouchers;
- Switch, Delta or similar electronic transactions; and
- electronic cash.

What non-cash sales do I include in daily takings?

This rule has the force of law.

In addition to cash payments you must add the following to and record in your daily takings on the day you make the supply:

- the full value of credit sales (excluding any disclosed exempt charge for credit);
- the cash value of any payment in kind for retail sales;
- the face value of gift, book and record vouchers redeemed; and
- any other payments for retail sales.

May I make any deductions from my daily takings?

Yes. Your till roll or other record of sales together with the additions explained above constitutes your daily takings and it is this figure which you must start with when calculating your flat rate VAT. You may, however, reduce this daily takings figure with the amount of any of the following:

- void transactions (where an incorrect transaction has been voided at the time of the error);
- illegible credit card transactions (where a customer's account details are not legible on the credit card voucher and therefore cannot be presented and redeemed at the bank);
- unsigned or dishonoured cheques from cash customers (but not from credit customers);
- counterfeit notes;
- where a cheque guarantee card is incorrectly accepted as a credit card;
- acceptance of out of date coupons which have previously been included in the daily takings but which are not honoured by promoters;
- supervisor's float discrepancies;
- till breakdowns (where incorrect till readings are recorded due to mechanical faults, for example till programming error, false reading and till reset by engineer);

- use of training tills (where the till used by staff for training has been returned to the sales floor without the zeroing of figures);
- customer overspends using Shopacheck;
- inadvertent acceptance of foreign currency (where discovered at a later time, for example when cashing up);
- receipts for goods or services which are to be accounted for outside the flat rate scheme;
- refunds given to customers in respect of taxable supplies to cover accidental overcharges or where goods are unsuitable or faulty; and
- instalments in respect of credit sales.

What are the rules for making adjustments to my daily takings?

If you wish to make adjustments to your daily takings, remember the following rules.

This rule has the force of law.

- You must be able to provide evidence to support any adjustments to your daily takings figure;
- if you make an adjustment but subsequently receive a payment, the amount must be included in your daily takings; and
- you must not make any reductions from daily takings for till shortages that result from theft of cash, fraudulent refunds and voids or poor cash handling by staff.

For further details about cash handling, see Notice 727/3 *Retail schemes: How to work the Point of Sale scheme*.

Are there other rules about daily takings?

Yes. If you are involved in part-exchange, sale or return, credit sales, deposits, vouchers, coupons, or other special transactions, you will have to make other adjustments to your daily takings. Notice 727/3 *Retail schemes: How to work the Point of Sale scheme* will help. The rules for these adjustments apply to businesses using the flat rate scheme in the same way that they apply to businesses using the normal VAT system. If you are in doubt, contact the National Advice Service.

Special circumstances

This section deals with situations that can arise and advises you how to deal with them under the flat rate scheme.

What if I sell goods to other Member States of the European Union (EU)?

The income you receive from sales of goods to other members of the EU forms part of the VAT inclusive turnover to which you apply the flat rate percentage.

If your business has a higher proportion of this type of sale than others in your trade sector you may find that operating the flat rate scheme puts you at a disadvantage with respect to your competitors.

What if I sell services to other Member States of the EU?

The VAT due on services to other Member States depends on the place of supply of those services; see Notice 741 *Place of supply of services*. If your supplies are outside the scope of VAT do not count them as part of your flat rate turnover.

What if I buy goods from other Member States of the EU?

You must account for VAT on these acquisitions from other Member States in box 2 of your VAT return in the same way as businesses using the normal VAT system. Such acquisition tax is treated in the same way as input tax charged to you by a UK supplier and is not normally recoverable whilst you are using the flat rate scheme. (There is an exception to this rule for capital assets with a VAT inclusive value of at least £2,000). For full details about intra-Community trade see Notice 725 *The Single Market*.

How does flat rate scheme affect reverse charges on services?

On the scheme you do not make any adjustment to your flat rate turnover for reverse charges on your purchases. For more information about reverse charges, see Notice 700 *The VAT Guide*.

Do I have to make any partial exemption calculations?

No. On the flat rate scheme, you are treated as fully taxable and do not have to make any partial exemption calculations. You must, however, include your exempt income in the turnover to which you apply the flat rate.

I am a Name at Lloyd's, how do I use the scheme?

Names at Lloyd's registered for VAT may use the flat rate scheme like any other business providing you meet the conditions of the turnover tests. You must include in the turnover calculations all income which is classed as 'with recovery of input tax'. Similarly all income that is classed as 'with recovery of input tax' must be included in your flat rate turnover to which you apply your flat rate percentage.

What restrictions are there on Barristers accounting methods?

Barristers who wish to join the flat rate scheme must make sure that their chambers do not use method 3 of accounting for common expenses. This is sometimes called the combination method and is incompatible with the flat rate scheme. If a barrister, in a chambers that is using method 3, wishes to join the scheme the chambers must change its method of accounting for common expenses, to either methods 1 or 2, before HMRC can give permission for that barrister to join the scheme.

Do I need to pay road fuel scale charges?

No. You need not pay any road fuel scale charges while you are using the flat rate scheme since you are not reclaiming any input tax on the road fuel your business uses.

How does the flat rate scheme affect bad debt relief?

Bad debt relief arises if you account for and pay output tax on supplies for which you are subsequently not paid. Full details are in Notice 700/18 *Relief from VAT on bad debts*. The normal rules of that notice apply to the flat rate scheme except that, if you are using the cash turnover method, you do not have to have accounted for and paid tax on the supply for which you have not been paid.

You may be eligible for additional bad debt relief if you:

- have used the cash based method of calculating your flat rate turnover; and
- made flat rate supplies for which you have not been paid 6 months after the supply was made; and
- have not accounted for and paid tax on the supply; and
- have written off the debt in your accounts.

If you meet all these conditions you can make the adjustments described in the following paragraph.

How do I make the additional bad debt relief adjustment for users of the cash based method?

Step	What you need to do	Example
1	Identify the VAT in the unpaid supply.	Total price = £1,175 VAT= £175
2	Calculate the VAT that would have been paid under the flat rate scheme if your customer had paid you. That is the total owed (including VAT) multiplied by your flat rate scheme percentage.	£1,175 x (say) 10% = £117.50
3	Subtract the sum of step 2 from the sum of step 1.	£175 - £117.50 = £57.50
4	Step 3 is your special allowance under the flat rate scheme. Include it in your VAT account in your next return.	£57.50 is added to the VAT deductible portion of your VAT account and creates a claim or reduces the VAT payable.

How do I deal with second hand goods under the scheme?

You can include the total from any sales of second-hand goods in your VAT inclusive turnover to which you apply the flat rate percentage. This is the simplest option if you only make occasional sales of second-hand goods but you will pay more VAT on these supplies. You may consider this simplicity is worth the extra expense or you could leave the flat rate scheme, use normal accounting and the second-hand margin scheme for these sales. You cannot, however, use the flat rate scheme and the margin scheme at the same time.

You can find more about the second hand margin scheme in Notice 718 *Margin schemes for second-hand goods, works of art, antiques and collectors items.*

How do I deal with the purchase of a capital asset?

Provided it is not covered by the capital goods scheme, a capital asset can be treated like any other purchase under the flat rate scheme. The input tax is included in the flat rate calculation and you make no separate claim for input tax.

If, however, you buy a single capital asset with a VAT inclusive value of £2,000 or more, you can choose to recover the VAT as input tax in the normal way.

You **cannot** do this if the asset in question is:

- acquired for resale, or for incorporation in goods to be sold;
- acquired to be hired out, leased or let; or
- for consumption within one year; or
- covered by the capital goods scheme.

How do I deal with selling a capital asset?

How you account for the sale of a capital asset under the flat rate scheme depends on what you did when you bought it. There are two possibilities:

- If you bought the capital asset whilst using the flat rate scheme and did **not** make a separate claim for input tax, then no special rule applies. You add the VAT inclusive income received from the sale of the asset to the VAT inclusive turnover to which you apply the flat rate percentage.
- If the capital asset was bought before you joined the flat rate scheme, or you chose to claim the input tax separately while on the scheme, you must account for output tax separately on the sale using the normal VAT rules. In those cases, the income will not form part of the turnover to which you apply your flat rate percentage. VAT will be due at the appropriate VAT rate in force at the tax point for the supply.

How do I deal with disbursements made on behalf of my customers?

If you pay amounts to third parties as the agent of your client and debit your client with the precise amounts paid out, you may be able to treat them as disbursements. If you are making such genuine disbursements, then the money received in respect of those disbursements is not part of the VAT inclusive turnover to which you must apply the flat rate percentage. For further information about disbursements see Notice 700 *The VAT Guide*.

How do I prepare accounts for HMRC while I am using the flat rate scheme?

HMRC has confirmed that for businesses who are using the scheme, it is expected that accounts will be prepared using gross receipts less flat rate VAT percentage for turnover and that expenses will include the irrecoverable input VAT.

For those businesses using the scheme for only part of a year, accounts figures for the time on the scheme should be added to those for the time not on the scheme to arrive at the total for the year.

For both Customs and HMRC, there is a requirement to keep a record of sales and purchases. But, for businesses using the scheme, that record does not have to analyse gross, VAT and net separately. The records (whether normal system or flat rate scheme) need only be complete, orderly and easy to follow.

N.B. If you use a computerized accounting system to generate your invoices, there will be a differential between the normal VAT rate of 17.5% (15% between 1 December 2008 and 31 December 2009) applied to your invoices - and recorded in your VAT control file - and your flat rate of VAT. If you are unsure how to manage this accounting difference, consult us or your accounting system provider.

Law, Avoidance and Appeals

Where can I find the Law covering the flat rate scheme?

The primary UK legislation relating to the flat rate scheme for small businesses is contained in Section 26B of the VAT Act 1994, as amended by the Finance Acts 2002 and 2003. This is supplemented by more detailed rules in Regulations 55A to 55V of the VAT Regulations 1995. Parts of this notice also have the force of law and are marked as such.

Why are there so many complex rules in a scheme for small businesses?

The scheme is targeted at small stand-alone businesses and many of the rules are to stop larger businesses gaining an unintended benefit from the scheme. If you are a small stand-alone business then most of the rules will have little or no impact on your use of the scheme. Those rules are explained in this section.

Can I use the scheme if I am in a VAT group?

No. If you are eligible to be in a VAT group, even if you are not currently in one, then you cannot use the flat rate scheme. If you are using the scheme and become eligible to join a VAT group then you must leave the scheme.

If your business has been eligible to join a VAT group in the last two years, but is not eligible at the time you apply, HMRC can let you use the scheme if they agree in writing that your former eligibility is not a risk to the revenue. For details of eligibility to join a group see Notice 700/2 *Group Treatment*.

What if I intend or expect to buy assets that are covered by the capital goods scheme?

If you intend or expect to buy such goods, you cease to be eligible to use the flat rate scheme. You must leave the flat rate scheme and write and tell HMRC immediately.

The capital goods scheme applies to:

- computers and items of computer equipment with a VAT - exclusive value of £50,000 or more; and
- land and buildings, civil engineering works and refurbishments of a VAT-exclusive value of £250,000 or more.

For more information, see Notice 706/2
Capital goods scheme

What is an associated person?

“Associated person” is a technical term and includes cases where:

- one business is under the dominant influence of another; or
- the two businesses are closely bound by financial, economic and organisational links.

Businesses will be associated if one of the companies has the right to give directions to the other or if in practice one company habitually complies with the directions of another. The test here is a test of the commercial reality rather than of the legal form. A business is not associated with its customers just because it supplies them with the goods they request in the form they request them.

Can an "associated" business use the scheme?

No. If you are “associated” with another business in this special sense, you cannot join the scheme. If your business has been associated in this way with another in the last two years, but is not associated at the time you apply, HMRC can let you use the scheme if they agree in writing that your former association is not a risk to the revenue.

I have a close connection with another business; does this mean that we are "associated"?

Not necessarily. Where the normal business relationships exist then businesses are not generally "associated" in this special sense. For example, if a husband and wife are each separately VAT registered, he as an architect and she as an antiques dealer, and he rents the upper floor of her shop at a market rate to use as his office, then they will not be "associated".

I am unsure if my circumstances constitute "association"?

If you are unsure whether the particular relationship between your business and another constitutes "association" then contact the National Advice Service.

When do I have to make a self-supply on leaving the scheme?

You have to make a self-supply when you leave the scheme if you:

- recovered input tax directly on one or more capital items while using the scheme; and
- did not account for VAT on the disposal of any of those items while you were using the scheme.

You make this self-supply by treating the goods as supplied by you and to you on the day after you stop using the scheme.

What do I do if I disagree with HMRC's decision about my use of the flat rate scheme?

You can always ask HMRC to reconsider their decision. You write to the office with whose decision you disagree saying why you disagree and they will ensure that a different officer reviews the decision. You can also appeal to the independent VAT and Duties Tribunal if:

- HMRC refuse to authorise your use of the scheme;
- HMRC remove you from the scheme; or
- you disagree the category and the flat rate percentage that applies to your business.

I have appealed to the VAT and Duties Tribunal, may I continue to use the scheme?

If you have appealed about HMRC's decision to withdraw or refuse use of the scheme, you must not use the scheme until your appeal is resolved. If you have appealed against any other matter, such as an assessment, HMRC will normally allow you to continue to use the scheme pending the appeal outcome.

Q&A on how the new VAT rate affects the Flat-rate scheme

Will the rate change affect my flat rate percentage?

Yes. The table of flat rates has been changed to reflect the new rate of VAT. The new table is set out in Annex E. You should make sure you use the new rate for your sector from 1 December 2008.

My flat rate has not been reduced. Why not?

The flat rate percentages are calculated by reference to the VAT actually paid in each sector and, following the change to the standard rate of VAT, most sectors will find that their flat rates are reduced. However, there are a small number of sectors that, with VAT at 17.5%, would have needed an increase in order to reflect the correct underlying rate for that sector. Following the rate change to 15%, those sectors have been left unchanged rather than increased.

I want to leave the scheme because of these changes. What should I do?

Usually, we would expect you to leave the scheme at the end of an accounting period. You can leave the scheme at any time, but this might mean you having to perform different calculations to determine your VAT liability. If you do wish to leave the scheme, you must write and tell us. We will confirm the date you left the scheme in writing.

I use the cash based turnover method. I have received payment for a supply made prior to the change of flat rates. Which flat rate should I use?

Remember that the cash based turnover method allows you to account for your VAT liability when you receive payment. It does not affect the tax point. Supplies made before the rate change remain taxable at 17.5%, even where payment is received after the change.

To determine your VAT liability for a particular transaction, you will first need to identify and separate all payments made and received so that you can identify the appropriate rate of VAT. You must then

apply the flat rate percentage that was in place at the time of supply and not the rate that is in place when payment is received. You will probably need to refer back to the original invoices.

More information is available at:
www.hmrc.gov.uk/pbr2008/measure1.htm

Contacting HMRC

If you can't find the answer to your question in this notice, the basics of VAT can be found in Notice 700 *The VAT Guide*.

National Advice Service Phone Line

General advice or more copies of HMRC notices, can be obtained by ringing the National Advice Service on 0845 010 9000 between 8.00am and 8.00pm, Monday to Friday. All calls are charged at the local rate within the UK. Charges may differ for mobile phones.

If you have hearing difficulties, you can ring the Textphone service on 0845 000 0200.

If you would like to speak to someone in Welsh, ring 0845 010 0300, between 8.00am and 6.00pm, Monday to Friday.

Postal Address

HM Revenue and Customs
Accounting and Records
Compliance Framework Division
Queens Dock
Liverpool
L74 4AA

Note: This is the address for enquiries and comments only.

Postal applications for registrations should be sent to the National Registration Unit for your postcode. Their addresses are in Notice 700/1 *Should I be registered for VAT?* And on the HMRC website at:
www.hmrc.gov.uk/business/vat/send-regnderegvars.htm

Complaints

If you have a complaint, try to resolve it on the spot with the HMRC officer. If you are unable to do so, or have a suggestion about how HMRC can improve their service, you should contact one of their Regional Complaints Units. The telephone number can be found under 'HMRC - complaints and suggestions' in your local telephone book. Ask for a copy of the HMRC code of practice 'Complaints and putting things right' (Notice 1000).

Further information can be found on the website at www.hmrc.gov.uk.

If HMRC are unable to resolve your complaint to your satisfaction you can ask the Adjudicator to look into it. The Adjudicator, whose services are free, is a fair and unbiased referee whose recommendations are independent of Customs and Excise.

You can contact the Adjudicator at:

The Adjudicator's Office
Haymarket House
28 Haymarket
LONDON
SW1Y 4SP

Phone: (020) 7930 2292

Fax: (020) 7930 2298

E-mail: adjudicators@gtnet.gov.uk

Website:

www.adjudicatorsoffice.gov.uk/index.htm

Further Information

This guide is for general interest - it is always essential to take advice on specific issues.

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

If you would like to receive further information about this subject or other publications, please call us – see our contact details on the next page.

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The ICPA – the organisation for accountants in practice

The ICPA, Imperial House, 1a Standen Avenue, Hornchurch, Essex, RM12 6AA

TEL: 0800 074 2896 FAX: 01255 426 300

E-mail: info@icpa.org.uk Web: www.icpa.org.uk
