

A guide to The Flat Rate Scheme

A SIMPLE GUIDE TO THE FLAT RATE SCHEME

This is a basic guide prepared by the Technical Advisory service for members and their clients. It is an introduction only and should not be used as a definitive guide, since individual circumstances may vary. Specific advice should be obtained, where necessary.

UNDERSTANDING THE FLAT RATE SCHEME

As an overview, the Flat Rate Scheme allows you to apply a single percentage to your turnover to work out your VAT liability. This is one amongst a number of schemes offered by HM Revenue & Customs (HMRC) aimed at easing the administrative burdens small businesses face.

The scheme provides a number of advantages, such as:

- the simplicity of the scheme, removing some administrative burdens
- no partial exempt calculation needs to be performed
- no fuel scale charge needs to be paid for businesses paying road fuel.
- HMRC offer a 1% discount for new VAT registered businesses under this scheme (the discount only applies to the first year of registration)

HMRC produce a 'Ready Reckoner' to see how using the scheme will affect your business, this can be found at:

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&id=HMCE_PROD_008882&propertyType=document

Please note that this scheme can be used by partially exempt businesses, and with 'Annual accounting scheme'. The Flat Rate Scheme has its own versions of a cash accounting and retail scheme, but is not applicable to margin scheme, retail scheme and cash accounting scheme users.

Eligibility for the scheme

A business is eligible for the scheme providing both the following two tests are satisfied.

Test 1 is the value of your taxable supplies in the next year does not to exceed £150,000 excluding VAT ignoring the sale of capital assets but include:

- standard, reduced and zero rated supplies.
- sale of second-hand goods sold outside the margin scheme
- sale of investment gold detailed in the VAT Act Section 55 (see VAT Notice 701/21 Gold for further details)

Test 2 is the value of your taxable supplies in the next year does not to exceed £187,500 (which will increase to £191,500 from 4 January 2011) including VAT ignoring the sale of capital assets but include:

- all the items included for Test 1
- the value of exempt supplies (such as rent, lottery commission, bank interest etc.)
- any other income received or receivable (such as non-business etc.)

The scheme can be used until your total turnover exceeds £225,000 (which will increase to £230,000 from 4 January 2011) excluding 'one-off' increases in sales (which need to be notified to HMRC in order to remain in the scheme This

must be checked on the anniversary of joining the scheme. If you are aware that within the next 30 days the threshold of £225,000 will be exceeded you will have to leave the scheme.

There are also a number of other restrictions to joining the scheme, you cannot join the scheme if:

- you are not VAT registered
- you use the second-hand margin scheme or the auctioneers' scheme
- you are required to use the tour operators margin scheme
- you are required to use the Capital Goods Scheme
- you have stopped using the Flat Rate scheme in the previous 12 months
- you have accepted a compound penalty offer or been convicted of an offence in connection with VAT in the last 12 months;
- you have been assessed to a penalty for conduct involving dishonest conduct in the last 12 months;
- you have been registered for VAT in a VAT Group in the last 24 months
- you have been registered for VAT in a VAT division in the last 24 months
- you have been eligible for a VAT group registration in the last 24 months
- your business is 'associated' or closely linked with another business within the last two years
- you expect the value of your taxable supplies in the next year to exceed £1,350,000;

APPLYING FOR THE SCHEME

The scheme does not automatically apply, application is made by completing and submitting form VAT 600FRS:

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&id=HMCE_CL_000057&propertyType=document

The application form has to be sent to:

National Registration Service
HM Revenue & Customs
Deansgate
62-70 Tettenhall Road
Wolverhampton
WV1 4TZ

The application form can also be submitted by email to: frsapplications@hmrc.gsi.gov.uk

If you are also registering for VAT, the form VAT 600FRS can be submitted with the VAT registration form VAT1. In addition a business can join the 'Annual Accounting Scheme' together with this scheme, please see the 'Guide to The Annual Accounting Scheme' for further details.

The Flat Rate Scheme will usually begin from the next VAT period following the receipt of the application form. Applying the scheme to an earlier period must be agreed with HMRC. HMRC will notify you when your business can start using the scheme.

If you wish to leave the scheme notice must be made in writing to the Annual Accounting Registration Unit.

USING THE SCHEME

Calculating the Flat Rate percentage

The key issue with this scheme is determining the appropriate flat rate percentage. HMRC have recommended a four step process in order to establish the correct percentage.

- Step 1 - Review the table of flat rates percentages and see if your business is mentioned
- Step 2 - Re-review the table making sure that your business is not mentioned in a composite sector
- Step 3 - If your sector is not mentioned look at the Businesses not mentioned elsewhere
- Step 4 - Finally If you are still unsure then phone the National Advice Service on 0845 010 9000

The choice you make should be on a sensible and reasonable basis, evidence should be retained as to why a particular choice was made. This could help prevent issues later if HMRC were to challenge the rate used.

If your business looks like it fits into two or more sectors, the percentage of your main business activity (by reference to turnover) should be used. If this balance of business activity changes, continue using the current percentage for the remainder of the VAT year and then change the percentage used if appropriate.

Where a business activity starts or stops the same review needs to be done in addition to checking that this change does not make your business ineligible for the scheme. Any change in flat rate percentage must be notified to HMRC within 30 days of the change or to: Enquiries.estn@hmrc.gsi.gov.uk

Calculating the turnover

The next step is applying the percentage to your turnover, which includes:

- VAT inclusive sales and takings of standard rated, zero rates and reduced rate supplies
- Exempt supplies (such as rent or lottery commission)
- Supplies of capital expenditure goods unless they are in relation to goods where the VAT has been calculated outside the flat rate scheme
- Despatches to other European Commission countries

Amounts excluded from turnover are:

- Private income
- Proceeds from the sale of goods you own but not used in the business
- Sales of gold detailed in the VAT Act Section 55 (see VAT Notice 701/21 Gold for further details)
- Non-business income and supplies outside the scope of UK VAT
- Sale of capital expenditure on which input tax was claimed

Without confusing matters, your business will have to determine how the turnover is calculated as there are three ways of calculating your turnover.

- Basic turnover - Mainly for businesses that deal with other VAT registered businesses.
- Cash based turnover - Similar to the Cash Accounting Scheme, the turnover is on a cash received basis.
- Retailer's turnover - Similar to the retail scheme, used mainly for businesses that sell goods to the public.

Care must be taken if you have any special circumstances to your business, if you buy or sell goods/services within or without the EU, partially exempt business, fuel scale charges, sales of second-hand margin goods and if you act as an agent. In addition, there are special rules for business like florists and Barristers.

Capital Expenditure

The scheme allows for capital expenditure, subject to rules, to be treated outside the scheme. Effectively, the input tax on a capital purchases costing more than £2,000 (including VAT) can be claimed in the normal manner, i.e. through box 4 of the VAT return. The expenditure must be for more than one purchase, over £2,000 and not for a service to qualify. An apportionment must be performed on capital items with a private use element.

To mirror the input tax treatment, if input tax was claimed on the purchase of a capital item, output tax must be charged on the sale. If the capital item was within the flat rate scheme, as for example it cost less than £2,000 then there is no output tax accountable on the sale.

Record keeping and administration

In regard to record keeping, the requirements relate to the flat rate turnover, details of the percentage used and how the tax was calculated. Additional requirements relate to certain capital expenditure in excess of £2,000 in value.

VAT invoices must still be issued for VAT registered customers. The rate of VAT on these invoices should be the appropriate rate of VAT and not the Flat rate percentage. Care must be taken when calculating your VAT liability, the calculation is based on the VAT inclusive total.

Care must be taken when completing the VAT return, as the normal rules are not followed. The differences are:

- Box 1 – this will contain the flat rate scheme amount payable. In addition there maybe output tax on certain capital goods.
- Box 2 – standard rated VAT on goods bought from other EC countries
- Box 3 – completed in the normal way
- Box 4 – this will normally be zero unless there have been capital goods purchased. In addition you can recover VAT on stocks and assets held at registration
- Box 5 - completed in the normal way
- Box 6 - the VAT inclusive amount is included. In addition supplies outside the scheme should be added as excluding VAT
- Box 7 - this will normally be zero unless there have been capital goods purchased or acquired goods from other EU countries
- Box 8 & 9 - completed in the normal way

Accounting treatment

The accounts for your entity need to be compiled using gross amounts. It is normal practice for the flat rate VAT due to be included as a deduction from the turnover figure. This is then disclosed by way of a 'Turnover' note to the accounts, for example:

"Turnover shown in the profit and low account shall exclude either VAT on taxable outputs or VAT imputed under the flat rate scheme."

Alternatively the Flat rate VAT can be shown as a separate expense item within the Profit and Loss account.

FURTHER CONSIDERATION

Further details can be found on the HMRC website, as a source of reference please refer to the VAT Notice 733.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&propertyType=document&columns=1&id=HMCE_CL_000345#P39_3090

This is a guide for ACCA members to assist in understanding the Flat Rate Scheme and to provide assistance when dealing with clients or informing colleagues. This document has no regulatory status and provides an overview.

COURTESY OF



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This Guide is an example only. It may not address all of the issues for each specific client. You should undertake additional research into any client matters not dealt with in the examples and amend your advice accordingly.

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