



VAT accounting schemes

A guide for clients

Choosing the right scheme for you.

Just about everyone has heard of VAT (value-added tax). We're used to paying it on many of the goods and services we purchase as we go about our everyday lives.

But when you have your own business, you'll learn a whole new world of VAT exists as you work out how to apply it to your own trade. That's because there are numerous VAT accounting schemes that HMRC offers, and which one is right for you will depend on the nature of your business.

To get you up to speed, we'll take a look at each of the main VAT accounting schemes, explaining how they work and who they might suit.

How does VAT work?

Once you reach a turnover in excess of £85,000 over the last 12 months you must register for VAT. If you are below that threshold, you have a choice as to whether to do so.

By voluntarily registering for VAT while below the threshold, you can create a more professional image of your company with financial documents and reclaim VAT on qualifying expenditure.

You'll probably end up having to raise your prices to reflect VAT, however (although any VAT-registered customers can normally reclaim this element), and have to file VAT returns.

Knowing whether you should voluntarily register for VAT is no simple matter and should only be done with the advice of an accountant or financial adviser.

VAT is chargeable at a rate of 20%, although select items have lower rates of 5% or 0%. Normally, you charge VAT on your goods and services and reclaim it on your expenses.

Whether you register for VAT voluntarily or are required to, you'll have a suite of schemes to choose from.

The standard VAT accounting scheme

Most businesses opt for this scheme. Under it, you will be required to keep a thorough record of purchases and sales and submit a quarterly VAT return to HMRC, with the VAT due to be paid one month and seven days after the end of the quarter.

Under the standard scheme, the VAT liability is calculated based on the dates of your paperwork (invoices and receipts), rather than the actual dates of cash in and cash out. This may cause cashflow problems if you have tardy customers, which is where the VAT cash accounting scheme (see overleaf) may prove useful.

VAT annual accounting scheme

The annual VAT accounting scheme is good for businesses that prioritise keeping paperwork to a minimum. You'll still have to maintain the same records but, as the name suggests, you only have to file a return once a year instead of quarterly.

You won't get away with just making an annual payment, however. You must make monthly or quarterly interim payments based on an estimate of what you will owe. This is then corrected to an accurate figure with either a top-up payment or refund at the end of the year.

Only businesses with a turnover of less than £1.35 million are eligible for this annual scheme.

VAT cash accounting scheme

Another option available to businesses with a turnover of less than £1.35 million is the VAT cash accounting scheme.

As we suggested earlier, this can be useful if you have customers who take a long time to pay invoices. This is because instead of your VAT liability being calculated by the date of the invoices you issue, it is based on the date and value of payments received.

However, by the same measure, you can only reclaim VAT based on actual cash spent, not the paperwork associated with a purchase. So, if you use a lot of credit, this may be a cashflow disadvantage for you.

VAT flat rate scheme

The VAT flat rate scheme could be an excellent option for certain smaller businesses.

Instead of passing on the VAT you collect from your customers (less the VAT you are reclaiming yourself) to HMRC, you pay a fixed rate. This is determined by the industry you are in and typically ranges from between 14.5% for professions like accountancy and law to just 4% for food retailers. The trade-off is that you cannot reclaim VAT on your expenditure.

While there's an underlying simplicity to the concept, there are a number of rules that add some complexity.

First, it is only available to businesses with a turnover of £150,000 or less, which will rule it out for a lot of VAT-registered businesses. There are other potential obstacles to joining too. For instance, if your business is "closely associated with another business" or you have committed a VAT offence in the last 12 months, you cannot join.

Second, if you are classed as a 'limited cost' business, the percentage you pay to HMRC rockets to 16.5%, which may prove poor value compared to some of the lower rates. A limited cost business is one whose goods cost less than either 2% of turnover or £1,000 a year (if your costs are more than 2%).

Unfortunately, many variable costs that a small business might incur cannot be put towards the £1,000 threshold, including rent, phone bills and vehicle costs – it catches out more businesses than you might first imagine.

VAT retail schemes

If you are a retailer, there are three specialist schemes open to you that are designed to make it less burdensome to calculate your VAT liability. With all three, you calculate what you owe just once when completing the VAT return.

Depending on your retail activities, you can choose from the point of sale scheme, with which you identify and record the VAT when you make a sale; the apportionment scheme, which is best if you buy goods for resale; and the direct calculation scheme, which is appropriate when a few of your sales are made at one VAT rate and the remainder at another.

Each of these can be used in conjunction with the annual accounting scheme or cash accounting scheme – but not the flat rate scheme. If your turnover (excluding VAT) ever grows to £130 million whilst you are using a VAT retail scheme you will have to agree a bespoke retail scheme with HMRC.

VAT margin scheme

The VAT margin scheme can be chosen when you are trading items for which you did not pay VAT on the purchase. This could be second-hand goods, works of art, antiques and collectors' items.

It allows you to calculate the VAT based upon the value you add between purchase and sale and prescribes a rate of 16.67% on this amount.

As well as items on which you were charged VAT being excluded, so also are precious metals, investment gold and precious stones.

Making tax digital (MTD)

It would be remiss not to mention that, as of April this year, all VAT returns must be filed in compliance with HMRC's Making Tax Digital (MTD) initiative. The simplest way of doing this is by using accounting software like Xero or QuickBooks.

While the change to a new way of doing things digitally may seem daunting, it should actually make things simpler and more efficient for you in the long run.

Contact us to talk about VAT accounting schemes.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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