VAT Schemes

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A GUIDE TO VAT ACCOUNTING SCHEMES

Understanding VAT (value-added tax) is crucial for any business owner. While most of us are familiar with paying VAT on various goods and services, managing VAT for your business introduces a new level of complexity. HMRC offers several VAT accounting schemes, and selecting the right one for your business depends on its specific nature and needs.

HOW DOES VAT WORK?

Once your turnover exceeds £90,000 over the past 12 months, you must register for VAT. If your turnover is below that threshold, registration is optional.

Voluntarily registering for VAT can enhance your company's professional image and allow you to reclaim VAT on qualifying expenses. However, this often necessitates raising your prices to account for VAT (though VAT-registered customers can typically reclaim this amount) and requires filing VAT returns.

Deciding whether to voluntarily register for VAT is complex and should be done with guidance from an accountant or financial adviser.

VAT is generally charged at a rate of 20%, with some items subject to reduced rates of 5% or 0%. Typically, you charge VAT on your goods and services and reclaim VAT on your expenses. Regardless of whether registration is voluntary or mandatory, you'll need to choose an appropriate VAT accounting scheme.

THE STANDARD VAT ACCOUNTING SCHEME

Most businesses use the standard VAT accounting scheme, which requires keeping detailed records of purchases and sales and submitting quarterly VAT returns to HMRC. The VAT is due one month and seven days after the end of each quarter.

Under this scheme, VAT liability is based on invoice dates rather than cash flow, which can create cash flow issues if customers delay payments. In such cases, the VAT cash accounting scheme might be more suitable.

VAT ANNUAL ACCOUNTING SCHEME

The annual VAT accounting scheme is ideal for businesses that prefer minimal paperwork. While you still need to maintain comprehensive records, you only file a return once a year instead of quarterly.

However, you must make interim monthly or quarterly payments based on an estimated VAT liability, with a final adjustment payment or refund at the end of the year. This scheme is only available to businesses with a turnover of less than £1.35 million.

VAT CASH ACCOUNTING SCHEME

Businesses with a turnover under £1.35 million might find the VAT cash accounting scheme advantageous, particularly if customers take a long time to pay invoices. VAT liability is calculated based on actual cash received rather than invoice dates.

This scheme allows you to reclaim VAT based on actual payments made, not on purchase paperwork. However, if you frequently use credit, this might negatively impact your cash flow.

VAT FLAT RATE SCHEME

The VAT flat rate scheme simplifies VAT calculations by allowing businesses to pay a fixed rate determined by their industry, typically ranging from 4% to 14.5%. This scheme is only available to businesses with a turnover of £150,000 or less.

A key trade-off is that you cannot reclaim VAT on your expenditure. Additionally, if your business is classified as a 'limited cost' business, the flat rate increases to 16.5%, which might be less advantageous. A 'limited cost' business spends less than 2% of turnover or £1,000 annually on goods, excluding many common expenses like rent, phone bills, and vehicle costs.

VAT RETAIL SCHEMES

Retailers can choose from three specialist schemes designed to simplify VAT calculations:

- **Point of Sale Scheme**: Record VAT at the time of sale.
- **Apportionment Scheme**: Best for those who buy goods for resale.
- **Direct Calculation Scheme**: Suitable if you sell a mix of items at different VAT rates.

These schemes can be combined with the annual or cash accounting schemes, but not with the flat rate scheme. Businesses with turnover exceeding £130 million must negotiate a bespoke retail scheme with HMRC.

VAT MARGIN SCHEME

The VAT margin scheme is for trading items purchased without VAT, such as second-hand goods, art, antiques, and collectibles. VAT is calculated on the added value between purchase and sale at a rate of 16.67%. Excluded items include those originally bought with VAT, precious metals, investment gold, and precious stones.

MAKING TAX DIGITAL (MTD)

As of April this year, all VAT returns must comply with HMRC's Making Tax Digital (MTD) initiative. Using accounting software like Xero or QuickBooks simplifies this process, making it more efficient in the long run.

FINAL THOUGHTS

Choosing the right VAT accounting scheme for your business is critical and can significantly impact your financial operations. Always seek professional advice to ensure you make the best decision for your specific circumstances.