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Flat Rate Scheme – explaining the VAT changes

What is a Limited Cost Trader?

How does it work Currently

Normally a business deducts the VAT on its inputs (what they buy) from the VAT charged on what they sell (outputs).

Under the Flat Rate Scheme, that two stage process is simplified to one step.

For example, the flat rate percentage for a clothes shop is 7.5% - so if the owner of that shop sells a dress for £120 including VAT of £20 he will pay a flat rate of £9 ($£120 \times 7.5\%$) to HMRC. The flat rate percentage for a detective agency is 12%.

Exactly which sales count can be complicated - the details can be found on the HM Revenue and Customs (HMRC) website.

The percentages for each type of business vary.

What is changing?

In the Autumn Statement, Chancellor Philip Hammond announced changes which affect businesses which have a very low cost base. These businesses are now called “limited cost traders”.

Limited cost traders can still use the Flat Rate Scheme, but their percentage will be 16.5%. So if they sell £120 of work, including £20 of VAT, the flat rate amount is £19.80 ($£120 \times 16.5\%$).

A limited cost trader is one whose VAT inclusive expenditure on goods for the business in a prescribed accounting period is less than 2% of VAT inclusive turnover, or is more than 2% but less than £1,000 a year.

When working out the amount spent on goods, it cannot include purchases of:

- capital goods (such as new equipment used in a business)
- food and drink (such as lunches for staff)
- vehicles or parts for vehicles (unless running a vehicle hiring business)

A firm will also be a limited cost trader if it spends less than £1,000 a year, even if this is more than 2% of the firm's turnover on goods.

Who will this affect?

It will increase the VAT paid by labour-intensive businesses where very little is spent on goods. For example, this may affect IT contractors, consultants, hairdressers and advisory firms.

It will also affect construction workers who supply their labour, but where the raw materials are provided by the main contractor.

Summary

- A limited cost trader is one who's VAT inclusive expenditure on goods for the business in a prescribed accounting period is less than 2% of VAT inclusive turnover, or is more than 2% but less than £1,000 a year.
- The flat rate scheme is going to affect any business with a low cost base (Limited cost trader)
- Currently the flat rate scheme has variable Vat percentages depending on the sector it operates in.
- As of April 2017 any business using the scheme, or wanting to use it, will have to decide if it is a limited cost trader.
- Limited cost traders will have to use a flat rate percentage of 16.5% irrespective of the type of business.
- Anti-forestalling legislation has also been introduced to ensure that any limited cost trader using the scheme cannot use a flat rate of less than 16.5% beyond 1 April 2017.

How we can help

If you are currently on the flat rate VAT scheme and would like to know more about 'Limited Cost Traders' and need help with explanations, calculations, allowable and dis-allowed goods and services we are here to help.

Dua & Co. clients are encouraged to email or call your Portfolio Manager who will be pleased to help.





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Dua & Co (Watford)

3 Century Court, Tolpits Lane
Watford, WD18 9RS
+44 (0)20 8421 3555

Dua & Co (London)

25 North Row London,
W1K 6DJ
+44 (0)20 7979 2041

Dua & Co (City)

9 Devonshire Square
London EC2M 4YF
+44 (0)20 3356 9706

dua@dua.co.uk

www.dua.co.uk