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VAT special schemes

Why use a VAT special scheme? What are the advantages for traders? Will users actually save money? Generally speaking, the special schemes are offered to simplify the process of submitting returns – thereby saving registered businesses time – and in some cases adopting a special scheme can have positive cash flow consequences.

Before taking a look at these schemes in more detail it is worth recapping on the standard scheme that all VAT registered traders adopt by default when they first register. This basic VAT process requires that you pay the difference between the VAT output tax you have added to all your taxable sales and any VAT input tax that has been added to the goods and services invoiced to your business. A brief summary of the more commonly adopted schemes are set out below and highlight the advantages of the scheme compared to the standard scheme. In no particular order they are:

Cash Accounting Scheme (CAS)

Whereas the standard scheme calculates the amount of VAT you have to pay each quarter based on invoicing dates, the CAS scheme calculates the amount of VAT you are required to pay based on the dates you receive payment from your customers and make payments to your suppliers. As the name suggests, liabilities are generated by the movement of cash, in and out, rather than the assumption of liability when invoices are sent out or received.

Main advantage of CAS:

If you are owed more by your customers than you owe your suppliers, adopting the CAS scheme should improve your cash flow as you will be paying your net VAT liability when the funds are already in your bank, not when invoices are submitted and received (in which case, the funds to pay your VAT will be partly or wholly in your customers' bank accounts).

Usually, the CAS is not beneficial when a business does not offer credit to its customers or, if on average, the amounts owed to suppliers are higher than amounts owed by customers. You can apply for the CAS if your taxable turnover is expected to be less than £1.35 million in the following 12 months. You would have to leave the CAS if your VAT taxable turnover increased to more than £1.6 million.

VAT Flat Rate Scheme (FRS)

The FRS is the only special scheme that offers the possibility that users will make a cash profit, although changes in the FRS since April 2017 have limited this very attractive outcome for smaller businesses.





If you use the FRS, you pay VAT at a consistent flat rate that is dependent on the type of business you run. The rate is applied to your VAT taxable turnover including VAT. No deduction can be made for VAT you have incurred on purchases of goods and services – although you can deduct VAT paid on certain acquisitions of assets.

The lower the rate applied, the lower your VAT payments will be and there is an increased likelihood that you will collect more in VAT from your customers (less VAT paid to suppliers) than you pay over to HMRC.

This ability to make a real cash profit from using the FRS was not intended when the scheme was introduced and so changes were made from April 2017. Now, if your VAT taxable costs are lower than 2% of your VAT taxable turnover, you will possibly be considered a limited cost trader and be obliged to use a fixed 16.5% flat rate. At this rate, there is no possibility of making a cash profit from adoption of the FRS.

Traders can use the scheme if their taxable turnover excluding VAT in the next year will be lower than £150,000. You will be obliged to leave the FRS if your VAT inclusive annual income exceeds £230,000.



Other schemes include:

1. **Annual Accounting** – pay VAT on account for 9 months each year and a following balancing payment, and submit one VAT return. This simplifies the admin chores of submitting quarterly returns.
2. **Special Schemes for Retailers** – there are a number of these schemes that aim to simplify the calculation of VAT payable when retailers sell goods at varying rates. Retailers considering these schemes should estimate the VAT impact of the alternative schemes available and choose the scheme that offers the lowest VAT payments.

What are the advantages of switching schemes?

There are a number of advantages in switching schemes. But don't forget, if your pattern of trading – turnover levels, working capital needs, admin pressures – changes, you will need to re-examine your choice of VAT scheme to ensure you are still using the most appropriate method of calculating your liability. A summary of the possible advantages are listed below:

- if you are eligible to use the Flat Rate Scheme and are entitled to calculate VAT due at one of the lower flat rate percentages, you may possibly make a cash profit on using the scheme;
- if you use the Cash Accounting Scheme you should obtain a cash flow benefit if the amount you are owed by customers is more than the amount you owe your suppliers;
- the Annual Accounting scheme is beneficial as you are only required to submit one return a year (in place of the usual quarterly returns);
- retailers should take advice to ensure they are using the most appropriate retail scheme.

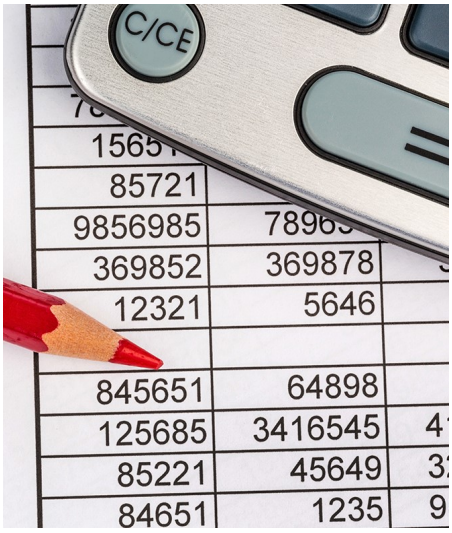
Our conclusion

It is always advisable to prepare a cost benefit analysis to see which scheme will provide the most benefit. If there are no perceived advantages you may be advised to stay with the standard scheme. As mentioned above, if your circumstances change you may be advised to change the VAT scheme currently used.

These circumstances might include:

- a significant increase in your turnover;
- a significant reduction in your turnover;
- a much improved (or reduced) collection of outstanding monies due from customers combined with an increase (or decrease) in the credit terms offered by suppliers;
- pressures on your time; you need to reduce the time spent on admin matters and cannot afford to outsource the submission of your tax returns.

The VAT legislation does afford a degree of choice as to the way in which you calculate the payment you make to HMRC. In which case it seems a shame not to take advantage of their largesse.



Summary action list

- If you are owed more by your customers than you owe to your suppliers, and your turnover is below £1.35m, you may gain a cash flow advantage by switching to the Cash Accounting Scheme.
- If you are registered to use the Flat Rate Scheme, check to see if you are affected by the "limited cost trader" rules. If you are, then you may be advised to exit the scheme.
- If you are a retailer it is worth taking professional advice to make sure you are using the most effective retailer's scheme.
- Take professional advice if you are using the standard VAT method for working out your VAT liabilities, as one of the special schemes outlined in this fact sheet may be more beneficial.

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