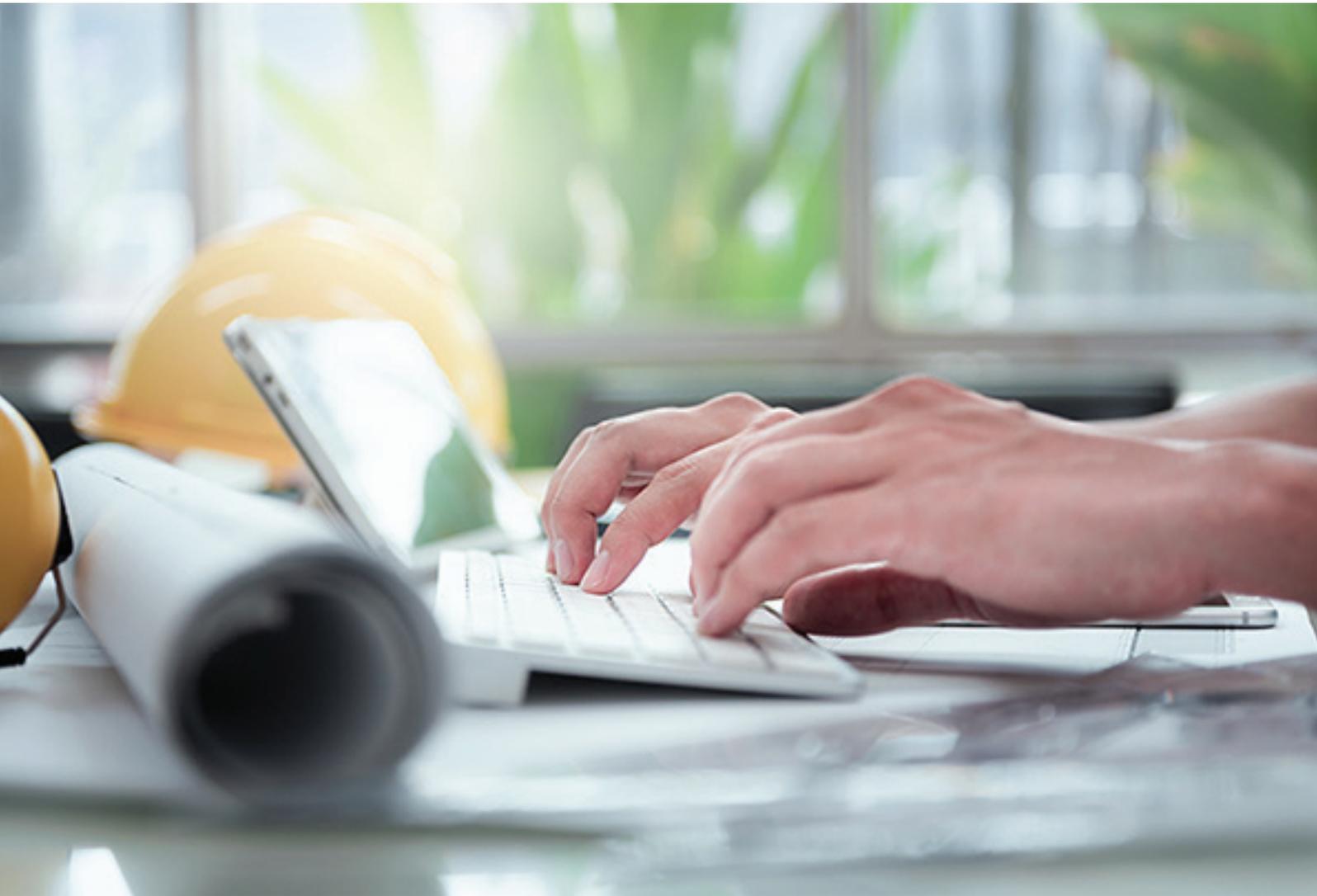




Orange Genie

Contractor Management Outsourcing

Accountancy



Guide to VAT for Contractors and Freelancers



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1.0

Introduction for Contractors and Freelancers

Value Added Tax VAT, as it is also known, was first introduced into the UK in 1973. It is a tax based on the value of goods or services. VAT is charged, by a VAT registered business when it sells goods or services to another business, or to a non-business customer. In most contractors' circumstances, it is the consultancy services that they supply that will attract VAT. VAT charged is called Output tax.

Businesses pay input VAT on their purchases of goods and services; input VAT is reclaimable from HMRC.

Registered VAT businesses charge output VAT on their sales of taxable goods and/or services and reclaim VAT on purchases with the resultant balance either due to or from HMRC.

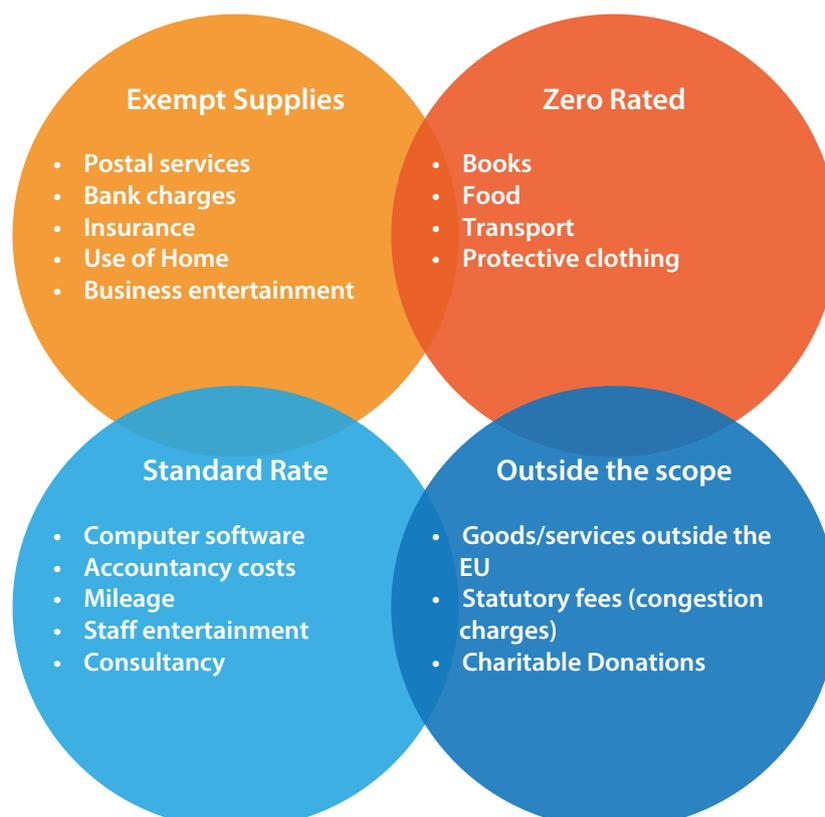
2.0

VAT Rates

The current rate of VAT for most supplies is 20%, although lower rates exist for some supplies, such as energy which is 5%.

Supplies can be taxable, exempt or outside the scope. VAT is charged on taxable supplies but not on exempt supplies or supplies which are outside the scope of VAT.

Here we show you some common expenses that fall into each definition.





3.0

Do I need to register for VAT?

You have to register for VAT once your company turnover reaches £85,000 in any twelve month period or is expected to in the next 30 days in isolation.

If you don't register for VAT straight away, you will need to look at your cumulative total of taxable supplies (net invoices) for the last 12 months, or since you started trading and register when you believe that reaches £85,000.

You can also voluntarily register for VAT, should your company be making taxable supplies i.e. justifiable business expenses, where VAT can be claimed back.

If you are going to voluntarily register, you might want to consider who your client is and how this will affect them. Most large businesses and agencies are VAT registered; therefore they can reclaim the VAT on your invoices. However, if you are working with individuals who aren't VAT registered then you might look 20% more expensive than your competitors as your client would not be able to reclaim the 20% VAT back.

4.0

What VAT scheme should I choose?

Having VAT registered there are various schemes available that may benefit your business. Your accountant will talk through the options with you and help you decide.

Standard
accounting
scheme

Flat rate
scheme

Cash
accounting
scheme

Annual
accounting
scheme

4.1

Standard VAT Scheme

If you opt for the standard VAT scheme you will be able to reclaim the VAT on the expenses you incur, this is dependent on whether they initially had VAT on them or not. For example, if you incurred insurance costs of £50, because this is exempt from VAT, there would be no VAT for you to reclaim.

You pay HMRC the difference between the VAT you have charged on your invoices and the VAT that you have incurred on your vatable expenses.

Example

- You raise an invoice to your client of £1,000+VAT (£1,200) and incur £120+VAT (£144) in Accountancy Fees
- You pay HMRC £200 received on your invoice less the £24 incurred on allowable expenses = £176

4.2

Flat Rate VAT Scheme

On the Flat Rate Scheme you would still charge your client 20% on top of your day rate, but when paying HMRC on a quarterly basis, you would pay over a smaller % of VAT depending on your business activity; therefore you are able to retain the difference in your company as income on the Profit & Loss account. The amount payable to HMRC is based on a % of your gross invoices.

The % applicable on the flat rate depends on your industry sector. There is a 1% discount available on the Flat Rate Scheme for the first 12 months from the date of your VAT registration.

You aren't able to reclaim the VAT on your expenses on your VAT return when on the Flat Rate Scheme, unless you have made a single capital purchase in excess of £2,000.

The Flat Rate Scheme can be advantageous to those that like to keep things simple and do not incur many allowable business expenses which include VAT.

Example

- You raise an invoice to your client of £1,000+VAT (£1,200) and incur £120+VAT (£144) in Accountancy Fees
- You are an IT consultant and the flat rate % applying to your sector is 13.5%
- Under the flat rate scheme you pay HMRC 13.5% of your gross invoice , £1,200 at 13.5%, £162.
- You are not able to claim the £24 VAT on the accountancy fee but you have made a surplus in the case of £38, compared t the standard scheme

The Government introduced a new flat rate % from the 1st April 2017, for the new category of “Limited cost trader”. This reduced the surplus made by many contractors registered for the Flat Rate VAT scheme.

Limited Cost Traders use a Flat Rate of 16.5% (with 1% discount in the first year of being VAT registered).

You’re a Limited Cost Business if the amount you spend on relevant goods including VAT is either:

- less than 2% of your VAT inclusive turnover or
- greater than 2% of your VAT inclusive turnover but less than £1,000

Relevant Goods	Non-Relevant Goods
<ul style="list-style-type: none">● Gas and electric used exclusively for business	<ul style="list-style-type: none">● Accountancy, legal and advertising fees
<ul style="list-style-type: none">● Stationary and office supplies	<ul style="list-style-type: none">● Anything provided electronically
<ul style="list-style-type: none">● Software supplied on disc - cloud software would not be allowed	<ul style="list-style-type: none">● Leased or hired equipment
<ul style="list-style-type: none">● Journals and magazine in physical form used in business	<ul style="list-style-type: none">● Capital expenditure
	<ul style="list-style-type: none">● Subsistence
	<ul style="list-style-type: none">● Vehicles and mileage
	<ul style="list-style-type: none">● Goods for sale

If you’re a Limited Cost Trader this means that you may pay more VAT under the Flat Rate Scheme than you would on the Standard Rate. Please speak to your accountant about checking which scheme is most tax efficient for you.

Example

- You raise an invoice to your client of £1,000+VAT (£1,200) and incur £120+VAT (£144) in Accountancy Fees
- At 15.5% (including 1% discount for the first year) you would pay HMRC $£1,200 * 15.5\% = £186$
- You have received £200 in VAT from your client, and paid £186 to HMRC, you have therefore retained £14 in your company as income, under the standard scheme you would have paid £176.

4.3

Cash Accounting Scheme

On the cash accounting scheme you only account for VAT when you have received payment from your end client/agency or incurred VAT on your expenses.

The flat rate VAT scheme, has its own cash based method that you can use. The scheme is not available if you are behind with your VAT returns or payments or you have committed a VAT offence in the past 12 months.

This table explains a little more why you may use this option



Advantages

- Your company does not have to pay output VAT to HMRC until you receive payment from your customers
- Automatic relief for impaired debts

Disadvantages

- Input tax cannot be claimed until you have incurred the expense
- Not suitable for businesses with a lot of cash sales or zero rated supplies which would simply suffer a delay in the recovery of input VAT

4.4

Annual accounting scheme

Most contractors and freelancers will have their company VAT returns filed on a quarterly basis, however there is the option to submit just the one VAT return per year. This might seem appealing to some contractors as it might mean less admin however you still need to pay HMRC an assessed amount on a quarterly basis. The assessed amount is based on 25% of your estimated VAT bill or based on previous VAT returns submitted.

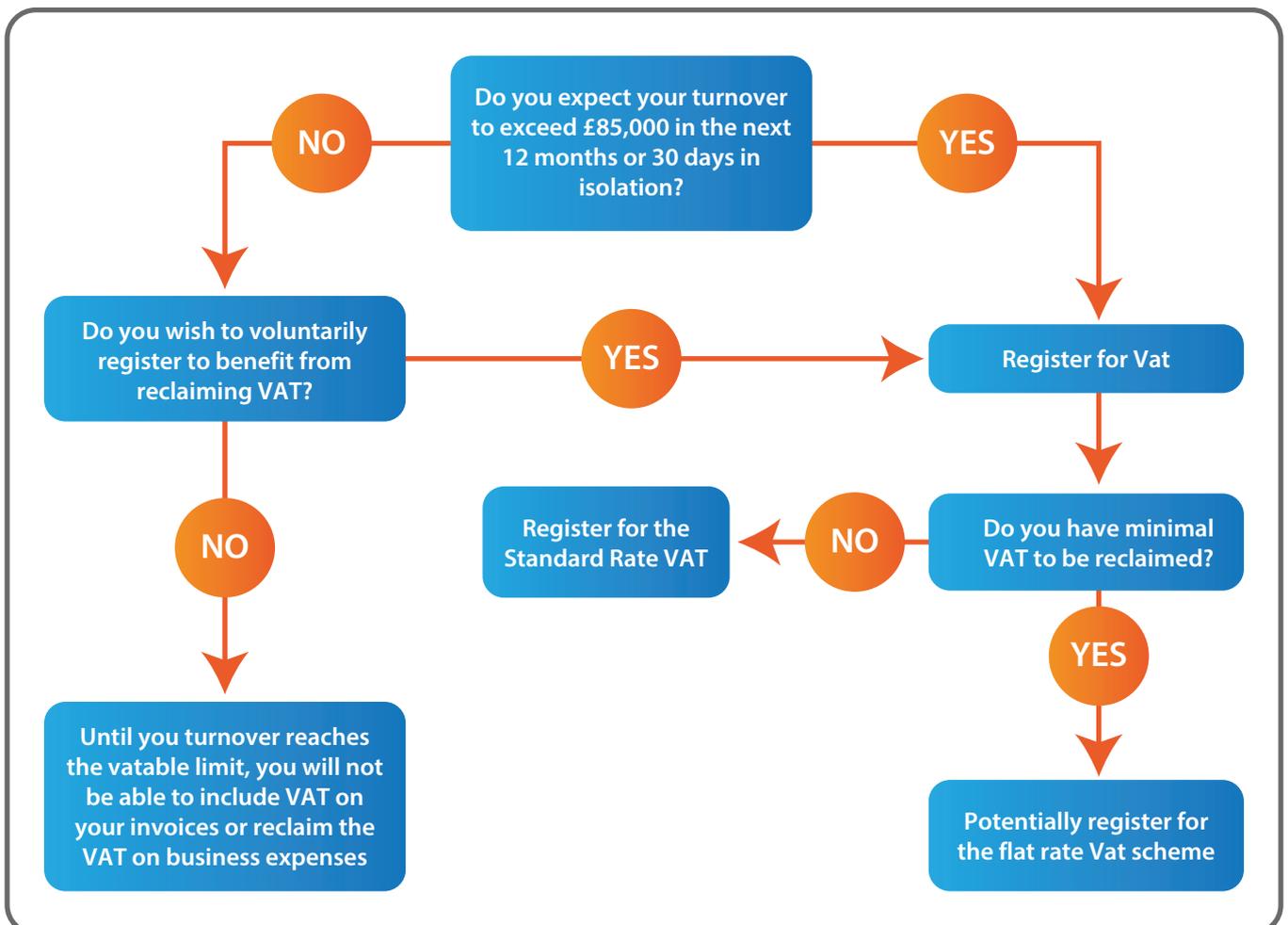
By filing the VAT returns once per year, you may have to pay a balancing amount that you weren't expecting; by

filing quarterly it is easier to manage cash flow.

If you are on the standard VAT scheme and reclaim VAT on your expenses, then this would not be an appropriate scheme for you to choose as you would have to wait for your refund on vatable expenses until you file the annual VAT return.

You can't use the annual accounting scheme if you left the scheme within the past 12 months or are not up to date with your VAT returns and payments.

Most contractors and freelancers register for the Standard rate scheme or Flat Rate VAT scheme. The flowchart below may help.



5.0

What does it mean to be VAT registered?

Once you are VAT registered you are compelled to charge VAT at the current rate (20%) on all invoices generated by your company on top of your daily or hourly rate and expenses.

HMRC will issue you with a 9-digit numerical reference which must be quoted on all of your invoices to your end client/agency. HMRC will allocate a tax period for filing returns which is usually every 3 months unless requested otherwise. We request that the 3 monthly return falls in line with your company yearend if we complete the VAT1 on your behalf.

VAT is chargeable not only on the cost of your services but also on any expenses recharged to your client. Charging VAT does not usually increase the cost to

your agency/client as most businesses are VAT registered and can reclaim the VAT back on your invoices. It is normal practice for contractors and freelancers to be VAT registered so this should not come as any surprise to your agency. Your agency would expect to see a copy of your VAT certificate before they will start paying the VAT to your Limited Company.

Appropriate records must be kept and maintained by your company in case of VAT investigations. You should keep a copy of all invoices and receipts for at least 6 years from the end of the last company financial year they relate to, or longer if they show a transaction that covers more than one of the company's accounting periods.

6.0

VAT Invoice

You will need to send VAT invoices to your clients for the services you have provided; this can be on a weekly or monthly basis. Here is an example of the details that legally need to be included on your invoice:

VAT invoices are automatically prepared by FreeAgent once the system is aware of your VAT registration so you don't need to worry about forgetting something.



Your Test Company Limited
1 Company Address
Town
County
AB12 3CD

Invoice Number: 001
Date of Invoice: 01/01/2018
Payment Due Date: 31/01/2018

Your Test Agency Limited
2 Company Address
Town
County
AB12 3CD

20 days	Consultancy work for December 2017	£300	Amount	£6,000
			VAT	£1,200
			Total	£7,200

Payment Terms:

Payment should be made within 30 days by money transfer only to the following account:
The Contractors Bank
Sort: 01-01-01
Acc#: 012345678
Reference: Use invoice number

VAT Number: 123456789
Company Registration Number: 09876543
Company Telephone Number: 01296 123456
Company Email Address: mycompany@email.co.uk

7.0

VAT Return

You will need to approve your VAT return and the form can be daunting.

Whilst the same form is used for both standard rate and flat rate registrations, the completion looks different. The following pages demonstrate what the numbers mean.

Standard VAT Registration, Cash Accounting - Example Form

VAT due on sales and other outputs	1	£4,340.00	1	VAT that has been charged on the invoices which have been paid during the period
VAT due on acquisitions from other EC Member States	2	£0.00		
Total VAT due (the sum of boxes 1 and 2)	3	£4,340.00		
VAT reclaimed on purchases and other inputs (including acquisitions from the EC)	4	£213.29	4	VAT that has been incurred on vatable expenses that have been paid out for during the period
Net VAT to be paid to Customs or reclaimed by you (Difference between boxes 3 and 4)	5	£4,126.71		
Total value of sales and all other outputs excluding any VAT.	6	£21,700	6	Total net invoices (excluding VAT) that have been paid during the period
Total value of purchases and all other inputs excluding any VAT.	7	£1,570	7	Total net amount incurred on expenses during the period including those that have no VAT on them
Total value of all supplies of goods and related costs, excluding any VAT, to other EC member states.	8	£0		
Total value of acquisitions of goods and related costs excluding any VAT, from other EC member states.	9	£0		

Flat rate return (cash basis) – Example form.

VAT due on sales and other outputs	1	£12,672.00	1	16.5% limited cost trader rate of the gross invoice total where payments have been received during the period
VAT due on acquisitions from other EC Member States	2	£0.00		
Total VAT due (the sum of boxes 1 and 2)	3	£12,672.00		
VAT reclaimed on purchases and other inputs (including acquisitions from the EC)	4	£0.00	4	VAT cannot be reclaimed when on the flat rate scheme, unless it is for a purchase in excess of £2,000 for a capital asset
Net VAT to be paid to Customs or reclaimed by you (Difference between boxes 3 and 4)	5	£12,672.00		
Total value of sales and all other outputs excluding any VAT.	6	£76,800	6	Total gross invoices (including VAT) that have been paid during the period
Total value of purchases and all other inputs excluding any VAT.	7	£0	7	The net amount of capital assets in excess of £2,000 would be listed here, but other expenses cannot be reclaimed, therefore this box is blank
Total value of all supplies of goods and related costs, excluding any VAT, to other EC member states.	8	£0		
Total value of acquisitions of goods and related costs excluding any VAT, from other EC member states.	9	£0		

8.0

Important Dates

HMRC will allocate your VAT quarter on registration. The due dates for the return and payment of each quarter are shown below.

VAT Quarters	Due Dates
● January, April, July, October	● 7th March, 7th June, 7th September, 7th December
● February, May, August, November	● 7th April, 7th July, 7th October, 7th January
● March, June, September, December	● 7th May, 7th August, 7th November, 7th February
● Annual VAT Return	● 2 months after the annual period ends

9.0

What we can do to help?

As a part of our Professional and Professional Plus packages, at Orange Genie Accountancy we can assist you with the initial calculations on whether you need to register for VAT or not and what scheme would be most beneficial for you. We would register you for VAT and request agent authorisation so that we are able to file returns on your behalf and speak to HMRC regarding any queries on your VAT account. We will send regular reminders to you so that we can calculate and prepare your quarterly VAT return and file this for you by the deadline, along with providing the payment details you need to make the payment on time.

VAT Penalties

If you are late filing, or paying over your VAT, HMRC will impose penalties, please see below a breakdown of how these are calculated. Orange Genie Accountancy will ensure you don't miss a deadline.

Default	Surcharge if turnover is less than £150,000	Surcharge period
1st	No surcharge but if you default within 12 months you enter a surcharge period	None, but if you miss another VAT deadline within 12 months of the issue of a help letter you will formally enter the surcharge system.
2nd	No surcharge but you enter a surcharge period	12 months
3rd	2% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
4th	5% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
5th	10% or £30 (whichever is more)	12 months from the date of the most recent default
6th	15% or £30 (whichever is more)	12 months from the date of the most recent default

Default	Surcharge if turnover is less than £150,000	Surcharge period
1st	No surcharge but you enter a surcharge period	12 months
2nd	2% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
3rd	5% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
4th	10% or £30 (whichever is more)	12 months from the date of the most recent default
5th	15% or £30 (whichever is more)	12 months from the date of the most recent default
6th or more	15% or £30 (whichever is more)	12 months from the date of the most recent default

Deregistering

You may want to de-register from VAT for a number of reasons:

- Closing your company down
- Turnover is below the de-registration threshold (£83,000)
- You are already below the de-registration threshold but no longer have vatable expenses to reclaim
- You join a VAT group

In order to de-register your company from VAT, a VAT7 form will need to be filed; this can be completed by your accountant through the HMRC online services. The de-registration date can only be back dated if you are ceasing to trade, for all other reasons it is the day you apply or a day in the future that you can de-register from.

You will need to continue to charge VAT until such time as HMRC notifies you of the exact date of de-registration, it can take 3 weeks for HMRC to confirm that you have been removed from the scheme. Once you have de-registered you will no longer have to charge VAT on your invoices but equally you can no longer reclaim VAT on your expenses.

HMRC will make a final VAT return available for you to submit to cover the final period of registration.

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VAT can be complex and getting it wrong can be expensive. If you need more advice or if you still have questions, please call Orange Genie Accountancy today. One of our many friendly and experienced accountants would love to help you.

