VAT flat rate scheme and EU purchases

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Should a business using the VAT flat rate scheme buy goods and services from abroad?

The flat rate scheme (FRS) is supposed to simplify VAT for smaller traders, but when the business buys in goods and services from abroad the rules are quite illogical. For instance, can a UK business using the FRS gain a tax advantage buying goods and services VAT free from EU suppliers outside of the UK, rather than from a UK based supplier where 20% VAT will be charged in most cases?

The answer is ‘yes’ in the case of services, but ‘no’ in relation to goods.

FRS and input tax

A key condition of the FRS is that input tax can only be claimed if it relates to capital goods costing more than £2,000 including VAT. So if a UK VAT registered business which sells toys (using the FRS) buys stock from a French supplier, those toys will be a zero-rated sale by the French business. Why is there no VAT saving compared to buying stock from a UK supplier where 20% VAT will be charged by the supplier but a reclaim of input tax is blocked?

The answer is because the FRS user must account for acquisition tax in box two of his UK VAT return in the normal way on the goods bought from France (value of goods multiplied by 20%).

Also the FRS user is then blocked from claiming the same amount as input tax in box four of the same return. This creates a net VAT payment to HMRC. The end result is that the toy seller has gained no VAT advantage by using a French (EU) based supplier.

Goods from outside the EU

In the case of toys imported from outside the EU, VAT will be paid to HMRC when the goods come into the UK. For non-FRS users, this VAT will be claimed as input tax, supported by the evidence of a C79 certificate. But the VAT can’t be claimed by FRS users, i.e. the cost to the business will be the VAT inclusive price.

Buying services from abroad

Here is the twist to the tale: When a non-FRS user buys VAT free services from abroad, where the place of supply is the UK, it will apply a reverse charge entry on its UK VAT return. This means that output tax is accounted for in box one on the VAT return (assuming the services are standard rated in accordance with UK legislation) and reclaim the same amount as input tax in box four.

The input tax claim assumes that the services are wholly used for taxable purposes, i.e. there is no exempt or non-business activity in the equation. The good news is that an FRS user also makes the entries in boxes one and four, i.e. there is no restriction in the box four entry.

Example

John is VAT registered as an accountant and uses the FRS. He uses the services of a UK-based bookkeeper who is also VAT registered. She has charged him £10,000 plus VAT for her services in each of the last three years. The annual cost is £12,000 to John because he cannot claim input tax on her fees.

John has now decided to use the services of an India-based bookkeeper instead. He will pay the bookkeeper £10,000 a year, i.e. the same fee as for the UK bookkeeper.

With the new arrangement, John will carry out a reverse charge entry on his VAT return. The annual entries in box one and box four will be £2,000, i.e. no net payment to HMRC, unlike in the case of goods bought from EU suppliers. John's bottom line profit will increase by £2,000.

Note – the same principles would apply if the Indian bookkeeper was based in an EU country i.e. there would still be a VAT saving of £2,000.

In both cases (EU or non-EU), there is no need for the overseas business to register for VAT in the UK because they are established abroad ie their charges will be £10,000 only and UK VAT is dealt with by the customer (John) doing the reverse charge.