



The Essential
VAT GUIDE
for SMEs in the UK





VAT contributed an estimated **£133.8 billion to the UK economy in 2019-20**

Most consumers don't give it a second thought. Businesses, however, need to get to grips with their VAT requirements or risk incurring the wrath of HMRC.

This bite-sized guide will give you everything you need to know to get started.

What is VAT?

VAT stands for 'value-added tax'. This tax is added to most goods and services, though you may not even realise it as it's automatically included in the price.

Whether you're buying a t-shirt, creating a Netflix account, or ordering a coffee, you'll have to pay VAT (subject to the supplier being a VAT-registered business, of course). It's an indirect tax that's paid by consumers, collected by businesses, and then reported to HMRC.

And if you're a vendor, you'll have to charge VAT on everything you sell once you meet the £85,000 annual turnover threshold or new rules—as well as keeping detailed records that you regularly send to HMRC. These records will clearly show how much VAT you received from customers and, therefore, how much you owe HMRC.



What is the VAT rate in the UK?

Standard Rate:

20%

The majority of the products sold in the UK have a 20% VAT rate. If your product is worth £5, you must therefore charge £6. The £1 on top is the VAT that you collect on behalf of HMRC before then paying them back later on.

Reduced Rate:

5%

Certain goods and services (generally those considered to have a positive societal impact) qualify for the reduced rate. Check out [this link](#) to learn more about when this rate applies.

Zero Rate:

0%

Zero-rated items are goods on which the Government charges VAT but the rate is currently set to zero. The goods covered by this classification include items such as children's clothes and footwear, water, basic foods, books, and newspapers.



Which businesses need to charge VAT?

The VAT rules here in the UK are simple:

Businesses with a turnover **under £85,000 per year**: If you trade in the UK and your suppliers are in the UK then you **do not need to register** for/charge VAT on their products/services.

Businesses with a turnover **over £85,000 per year**: **Must register** for, and charge, VAT on their products/services.

Note: These rules apply to both registered companies and sole traders alike.



How can I register my business?

Head to the dedicated [HMRC link](#) to apply for VAT online.

Note: You will need to have some crucial information to hand, including:



Your Government Gateway and password

1234 5678 12

Your Unique Tax Reference (UTR), a 10-digit number that you received when registering for Corporation Tax



Your company's bank account details, company number, and registered address

Upon registration, you will receive a VAT certificate that will contain the following:

A unique VAT registration number



Information regarding when you need to file your first VAT return and submit your first VAT payment



Your VAT date of registration

Are any industries/goods/services VAT exempt?

Crucially, you'll have to get your head around the difference between **zero-rated items** and **exempt items**. Understanding this distinction could save you money.

It works like this: zero-rated items are items that are usually subject to VAT, but where the rate is currently set at zero. Businesses that only make zero-rated supplies can register for VAT to recover overheads and costs.

Whereas, exempt items are those where no VAT is paid or charged. The sale of those goods still have to be recorded on a VAT tax return—however, this means that businesses who produce exempt items cannot recover any VAT as none was paid in the first place.

There are also 'out-of-scope' items that exist outside of the scope of VAT, such as voluntary donations to charity or items bought and sold outside of the UK.

Zero-rated items include *(but aren't limited to)*



Printing (books, brochures, newspapers, maps, etc)



Children's/baby clothing and footwear



Utilities



Maternity pads



Equipment for disabled people



Civil aeroplanes



Protective equipment (bicycle helmets, protective boots and helmets for industrial use)

Exempt items, on the other hand, include *(but aren't limited to)*



Education and training



Insurance, finance and credit



Burial or cremation of the dead



Fundraising events by charities



Sport and leisure



Health services by registered medical professionals



Antiques



Building and construction

For more information, head to [GOV.UK's](https://www.gov.uk) full list.

Which VAT scheme should I use?

There are a few different methods by which you can pay VAT to HMRC.

Let's dive into a brief overview of each scheme.

Standard Accounting Scheme

What it is:

You're required to submit a quarterly VAT return and pay HMRC any VAT that you owe.

What you need to do:

Keep a detailed record of all VAT that you charge on each sale—and that you pay with each purchase. Refunds are also paid quarterly. This scheme is most commonly used.

Flat Rate Scheme

Summary:

This only applies to businesses with an annual turnover of less than £150,000. It is most commonly used by small businesses and sole traders as it is incredibly simple to understand.

You pay a fixed percentage of your turnover to HMRC each quarter. You don't have to record VAT that you charge customers or pay yourself. Note: with the Flat Rate Scheme, VAT can only be reclaimed on purchases that cost over £2,000.

Annual Accounting Scheme

Summary:

The scheme is only suitable for businesses whose turnover is below £1.35 million per year. You only have to submit one VAT return each year, though you still pay VAT on a quarterly basis based on best estimates.

It works like this: You pay 9 monthly payments amounting to 10% of the previous year's VAT payments, or if you've only been

registered for less than 1 year, 10% of the previous year's estimated VAT payments. You can also apply to pay 3 quarterly payments amounting to 25% of the previous year's VAT payments.

However, the scheme isn't for everyone—short term losses should be considered. While submitting a VAT return only once a year saves time and admin, it also means that you can only reclaim VAT once a year. Therefore, the scheme doesn't help businesses who have to regularly claim back VAT.

Cash Accounting Scheme

Summary:

Suitable for businesses with a turnover under £1.35 million per year, this scheme means that you pay VAT on all sales (provided the customer has paid you) as well as reclaiming VAT on any purchases (provided you've paid the supplier).

The Cash Accounting Scheme requires businesses to record income when it's received, and record expenses when they are paid. This is different to the Standard VAT Accounting Scheme, where VAT is recorded on the date of issuing or receiving a VAT invoice.

This is beneficial if you have customers who regularly pay late. On the flip side, startups making initial investments in new equipment (and purchasing the aforementioned stock on credit) should avoid using this scheme—you cannot reclaim VAT until you have paid the supplier.

Where can I find more information?

If you need help with your VAT requirements then don't worry—we've got you sorted. Osome's accounting experts are on hand 24/7. They'll be happy to guide you through any and all VAT issues that you encounter, meaning you can focus on what you love: growing your business.

Get in [touch](#) today.





Osome facilitates business management for small and medium businesses. Its suite of services includes accounting, tax, business registration, corporate secretary services and payroll management. Osome's automations handle the routine, giving human experts have more time to focus on complex advisory. It services over 5000 SMEs in the UK, Singapore and Hong Kong.

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