VAT Schemes: What you need to know

The Basics

Growing past the VAT threshold once felt like a milestone. At £500k+ turnover, it's just part of how the business runs — but the scheme you use to calculate and pay that VAT is a decision, not a default.

Different schemes affect not just when you calculate VAT, but how much of it your business ends up funding out of its own working capital.

Most businesses choose a scheme once, early on, and never revisit it. As you've scaled — more staff, more suppliers, more complex income streams — the scheme that made sense three years ago may now be quietly costing you cash flow, or worse, no longer be the one you're legally entitled to use.

This factsheet walks through the main VAT schemes available to established UK businesses, what's changed, and where it's worth taking a closer look.

Standard VAT

By default, when you register for VAT you calculate and submit returns quarterly on an invoice (accrual) basis:

VAT on all invoiced sales, less VAT on all invoiced purchases = VAT due to HMRC

This is straightforward, but it has one significant drawback for a scaling business: you owe HMRC the VAT on a sale the moment you invoice it — whether or not your client has paid you yet.

eg:

- Sales invoiced this quarter: £187,500 + VAT = £37,500 VAT charged
- Purchases invoiced this quarter: £45,000 + VAT = £9,000 VAT reclaimed
- VAT due to HMRC this quarter: £28,500

If a share of that £187,500 is still sitting unpaid on 60- or 90-day terms with larger clients, you're funding that £28,500 out of your own working capital until it lands.

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Cash Accounting Scheme

If invoice-basis VAT is straining your cash flow, the Cash Accounting Scheme changes when the liability arises: you only account for VAT once payment has actually been received from your customer, and you only reclaim VAT once you've paid your own suppliers.

This isn't simply "recording VAT on a cash basis" informally — it's a defined HMRC scheme with its own eligibility rules:

- **You can join if your VAT taxable turnover is £1.35 million or less.**
- **You must leave if your turnover in the last 12 months reaches £1.6 million.**

For a business on 60- or 90-day terms with larger corporate clients, this can be one of the simplest ways to stop funding HMRC ahead of your own customers. The trade-off is administrative: you need clean, well-timed records of when invoices are actually paid, not just raised — so it works best alongside properly maintained bookkeeping systems.

eg:

- Sales received this quarter (cash in): £150,000 + VAT = £30,000 VAT
- Purchases paid this quarter: £45,000 + VAT = £9,000 VAT
- VAT due to HMRC this quarter: £21,000 — only on the cash that has actually landed

Flat Rate Scheme — the one you may have already outgrown

The Flat Rate Scheme was built to simplify VAT admin for small businesses: instead of tracking VAT on every purchase, you charge clients the standard 20% rate but pay HMRC a fixed percentage of your gross turnover, set by industry.

Here's the part scaling directors often miss: you can only join if your VAT turnover is £150,000 or less, and you must leave the scheme once your turnover passes £230,000 (including VAT) in a 12-month period.

If your business is turning over £500k+ and you're still on the Flat Rate Scheme, one of two things is true: it's a compliance gap that should have been corrected years ago, or your accountant migrated you off it and nobody updated the paperwork trail. Either way, it's worth confirming — especially since the "limited cost trader" rate of 16.5%, introduced in 2017 to close down the scheme's biggest advantage, means most service businesses now keep very little of the VAT they collect under Flat Rate anyway

eg:

- Sales invoiced: £10,000 + VAT = £2,000 charged
- Limited cost trader flat rate (16.5% of gross £12,000): £1,980 paid to HMRC
- Business retains: £20 — a fraction of what standard VAT accounting would allow it to reclaim on actual expenses

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Annual Accounting Scheme

Instead of four VAT returns a year, the Annual Accounting Scheme lets you file one — with payments on account spread through the year and a balancing payment (or refund) at the end.

Eligibility follows the same £1.35 million turnover threshold as the Cash Accounting Scheme, so most businesses in our client base could technically use it.

The appeal is administrative: fewer filing deadlines, more predictable payment amounts, less quarterly admin. The trade-off is visibility — if your VAT position is a live input into how you manage cash flow (as it should be for a scaling business), dropping to one return a year can mean losing sight of your VAT liability until it's already due.

We generally only recommend this where a business already has strong internal management reporting to fill that gap.

Partial Exemption

Most established businesses charge VAT on everything they sell and reclaim VAT on everything they buy. But if part of your income is VAT-exempt — common in property, finance, insurance, or education-adjacent services — your VAT position gets more complicated.

Where you make both taxable and exempt supplies, you can usually still recover exempt-related input VAT if it stays under HMRC's de minimis limit: £625 per month on average, and no more than half of your total input tax in the period. Go over either limit, and a portion of the VAT you've been reclaiming needs to be repaid.

As a business grows and its income mix shifts — a new service line, a property disposal, a change in client base — that balance can tip without anyone noticing until the VAT return doesn't add up. This is worth a proactive review, not an annual surprise.

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VAT Grouping

If your business operates through more than one limited company under common ownership or control, you may be able to register them as a single VAT group. That means one VAT return covering every entity, and — critically — no VAT charged on transactions between the companies in the group.

For businesses that have grown through a holding structure, a property company, or a separate trading entity for a new venture, this is one of the most overlooked simplifications available. It reduces admin, removes VAT cash flow friction on intercompany recharges, and gives a single consolidated view of the group's VAT position.

It isn't automatic, and it isn't always the right call — group members become jointly and severally liable for the group's VAT debt — but for the right structure, it's worth a conversation.

Next steps

VAT is not a "set once" decision. As your business grows, the scheme that once suited a smaller operation can quietly become the wrong one — costing you cash flow, creating a compliance gap, or simply adding admin you no longer need.

If you want to know whether your current VAT scheme still fits the business you're running today, let's talk.

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