

# Problems for small business consultants using the VAT flat rate scheme

## Indirect Tax

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The ATT highlights that recent decisions in tax tribunal cases have disagreed with HMRC's published guidance on what category should apply to small business consultants using the flat rate scheme and calls for HMRC to revise its guidance in line with these decisions.

The ATT's VAT sub-group has been following the progress of several cases through the tribunal courts, namely *Chilly Wizard Ice Cream Co Ltd* VTD 19977, *Calibre TAS Ltd* VTD 20508, *Idess Ltd* TC 3638, *SLL Subsea Engineering Ltd* TC 4256, and *KTD Management Ltd* TC 4808

These cases have one feature in common: they all found in favour of the taxpayer after HMRC had challenged the business category applied under the flat rate scheme. This scheme was intended to simplify VAT accounting for small business that simply choose the relevant business category which then determines the percentage of its gross business income that will be paid as VAT.

Why has HMRC started to challenge the business categories being applied? The issue stems from the fact that some business sectors are not covered by the 51 scheme categories. This results in many consultants, say on health and safety or employment law, correctly choosing the sweep-up category for 'other business services not listed elsewhere', which has a rate of 12%.

However, HMRC has been taking a different view. Its guidance in VAT Notice 733, para 4.4, states:

*'If you act as a consultant and you do not fit into another specific sector, you should choose management consultant. This sector is not restricted to businesses that fit the traditional idea of management consultancy.'*

By applying this guidance to our examples, HMRC believes that the correct percentage to apply is the higher rate of 14% since this applies to management consultants. However, the courts have disagreed.

HMRC has also been trying to apply the category for 'architect, civil and structural engineers' (14.5%) to mechanical engineers. However, in *Idess Ltd* and *SSL Subsea Engineering Ltd* it was concluded that a mechanical engineer provides services linked to plant and machinery rather than land, so the sweep-up category with the 12% rate is the correct one to choose.

The clear message from each of the cases cited is that a business owner should use ordinary everyday words in choosing their category. So an advertising consultant would never describe him or herself as a management consultant and a mechanical engineer would never describe him or herself as a civil engineer. Yet HMRC guidance continues to ignore this message.

Despite assurances in *Notice 733* that a choice of sector would not be changed retrospectively as long as the original choice was reasonable, HMRC has been challenging the choice from the outset and issuing retrospective

tax assessments. However, the court decisions show that HMRC's view and guidance are flawed.

The ATT suggests that this issue now requires a final resolution and clarity for scheme users. President Michael Steed says:

*'We feel it is the right time for HMRC to amend its guidance and accept that honest small business owners have adopted the correct category as intended by the legislation.'*

Read [ATT's press release](#).

UPDATE: As this edition was going to press, HMRC has issued a revised VAT Notice 733 redrafting the problematic para 4.4. Read more on this on the [ATT website](#).