

What is a Limited Cost Trader for the Flat Rate VAT Scheme?

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What is a limited cost trader?

A limited cost trader is a business using the VAT Flat Rate Scheme that spends very little on goods. This typically applies to freelancers, contractors, and small service-based businesses.

HMRC says you're a limited cost trader if your spending on goods is either:

- Less than 2% of your VAT-inclusive turnover, or
- Less than £1,000 a year (roughly £250 per quarter)

If you fall into this category, you must use a higher flat rate of 16.5%, regardless of your industry. This can make the Flat Rate Scheme less tax-efficient, especially if most of your expenses are for services (like software, phone bills, or accountancy fees), which don't count as goods.

What counts as 'goods'?

To qualify, goods must be:

- Not a service (e.g. software, phone bills, accountancy, travel etc.)
- Tangible (something you can physically touch)
- Used exclusively for your business
- Not excluded under HMRC's rules (e.g. food, fuel, or anything with personal use)

Examples that do count:

- Office supplies (paper, ink, stationery)
- Tools or equipment used only for work
- Protective clothing (if required for your job)

If your spending is mostly on subscriptions, travel, or services, there's a good chance you'll be classed as a limited cost trader so it's worth checking whether the Flat Rate Scheme is still the best fit.

Is the Flat Rate Scheme still beneficial for me?

In your first year using the scheme, you get a 1% discount, so a rate of 15.5% applies. That can still be worthwhile (at least for the initial year), depending on how much you invoice and what VAT you expect to

incur on expenses.

Here's a simple example:

- **Net invoices:** £50,000
- **VAT charged to clients (20%):** £10,000
- **Gross turnover:** £60,000
- **Flat Rate VAT to pay (15.5%):** £9,300

In this case, you keep the difference, so that is **£700 saved**. If you were on the standard scheme, you'd need to incur over **£700 in VAT on expenses** for it to be more worthwhile. It's worth noting that you can apply for the flat rate scheme for the initial year, and then switch to standard after that, as in the above example, if the rate increased to 16.5%, the saving reduces to just £100, so the standard scheme is likely a better option.

If you'd like help crunching the numbers or weighing up your options, just reach out to your dedicated accountant or email us at support@mightyaccounting.com.

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- [How to Register for VAT with HMRC](#)
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