

## ***AN INTRODUCTION TO VAT***

### What is VAT?

VAT is a tax chargeable on taxable supplies made in the UK by taxable persons. Credit is given for tax paid to other businesses and the net balance is payable or reclaimable - normally on a quarterly basis.

### Taxable persons

A taxable person is defined as one of the following carrying on a business:

- An individual
- A partnership
- An unincorporated association, e.g. trust or charity
- A limited company

### Supplies

VAT law covers all types of supply of goods or services (outputs), whether of a revenue or capital nature. Supplies include sale, hire, or loan of goods. Outputs normally fall into one of four categories:

1. Positive rated - taxable at 20% (occasionally 5%)
2. Zero rated - including socially or economically important items, e.g. exports, most food, books, newspapers, public transport, drugs on prescription, children's clothing
3. Exempt supplies - including necessities such as insurance, postage, finance, education, and health
4. Some receipts are outside the scope of VAT, e.g. dividends, shares of profit compensation for losses, non UK supplies

### Should I be registered for VAT?

You should notify HMRC when:

- Vatable turnover for the past twelve months exceeds £73,000 (2011/12 rate).
- There are reasonable grounds for believing that your turnover for the next 30 days will exceed £73,000

In the first case, notification must be within thirty days of the end of the relevant months. In the latter case, notification must be within thirty days of the date on which grounds first existed.

It is important to monitor turnover because there is a penalty for late registration. This is in addition to the tax payable.

## Can I register for VAT if my vatable turnover does not exceed the prescribed limits?

It is possible to register voluntarily provided you have a *bona fide* business.

## Cash accounting scheme

There is a special scheme applicable to businesses where taxable turnover is expected to be not more than £1,350,000 in the next 12 months.

This allows the trader to account for VAT on the basis of payments received and made rather than on tax invoices issued and received.

It may be advantageous to use cash accounting from the date of registration, although some businesses will not benefit from this scheme.

## Retail schemes

Special schemes of accounting for VAT are available to retailers. We can advise on the best choice.

## Credit for input tax

Input tax paid on purchases can be recovered by registered taxable persons, who are able to offset input tax against their output tax liabilities. Traders with fully exempt outputs cannot register or reclaim any input tax. Credit is available for all VAT paid on inputs where a VAT invoice is available, except for tax on private expenditure, business entertainment, motor cars and goods bought under a second-hand goods scheme. Recovery of input tax may be restricted if the business makes both taxable and exempt supplies.

## How often will I have to complete a VAT return?

Every quarter, a return is issued and must be submitted to HMRC no later than thirty days from the end of the quarter. Make returns and payments on time because extensive legislation exists to levy penalties on defaulters. Businesses with regular repayments may make monthly returns. Those using the Annual Accounting Scheme need make only one return per year, which has to be submitted two months after the end of the scheme year.

We would be pleased to advise you what records you need to keep to complete the VAT return.

## Can I file my VAT return electronically?

All new businesses and existing larger business are now required to file VAT returns online.

### When can, or must, I deregister?

- You *must* deregister when taxable supplies are no longer made, e.g. when trading ceases
- You *can* deregister when anticipated turnover for the next year (measured from any time) is less than £71,000, but this may not be in your interests - seek our advice first

### Tax invoices

Specific rules are laid down as to the form and content of tax invoices. These are to ensure that all the necessary information is recorded for the determination of the rate of tax to be applied, the liability of the supplier to account for the output tax due on the supply, and the entitlement of the recipient to reclaim all or any of it as input tax.

There is no requirement to issue a tax invoice for a zero-rated or exempt supply. However, it would seem appropriate to issue some form of invoice for either type of supply to establish that VAT is not chargeable on it.

Copies of all tax invoices issued and received must be retained for at least six years unless a shorter period (normally at least three years) is agreed with HMRC.

A tax invoice is required to show:

- An identifying number
- The date of the supply and the date of issue of invoice
- The name, address, and registration number of the supplier
- The name and address of the person to whom the goods and services are supplied
- The type of supply by reference to categories e.g. sale, hire purchase, hire, lease, rental etc
- A description that is adequate for the purposes of identifying the goods or services supplied
- For each description the quantity of the goods or the extent of the services, the rate of tax, and the amount payable, excluding tax
- The total amount payable excluding tax
- The rate of any cash discount offered
- The total VAT payable

Anyone supplying goods or services direct to the public does not have to supply a tax invoice unless the customer requires one. Where the tax-inclusive value of supply is not more than £100, the supplier may issue a simplified form of invoice giving only the following details:

- Name, address and registration number of the retailer
- Date of supply
- A description, adequate to identify the goods or services supplied
- The total amount payable including tax
- The rate of tax at the time of the supply

## VAT and property

There are special – and complex – rules for vat on property. Please talk to us about the vat implications of any property transactions you are proposing to enter into.

### Practical Examples

EG 1 Suppose you sell goods for £1,000 + vat to a customer. You actually receive from them £1,200, of which £1,000 is yours and £200 must be paid over to HMRC on your vat return.

If the goods cost you £300 + vat to buy in, you would have paid £360.00 to your supplier, of which £300 is your actual cost and £60.00 is deducted from your vat return.

At the end of the quarter you therefore pay £140.00 to HMRC.

Your profit is £700

#### Points to watch:

- In the example above, vat on overheads haven't been accounted for. You can deduct the vat on your overhead expenses, eg telephone, office costs, in exactly the same way and deduct the amount you pay to HMRC.
- In the example above, vat is basically paid to HMRC on the profit – i.e. profit £700 x 20% = £140.00. In simplistic terms you can say that the vat is being paid on the profit or labour element of your sales (remember there is no recoverable vat on wage payments).
- If you are in a retail business, eg a shop selling to the public, your customers cannot claim vat back, so goods sold for £1,000 + vat cost your customer £1,200. By contrast in a business to business environment the cost to the purchaser is only £1,000 (pre supposing they are a vat registered business).
- Following on from the point above, it therefore follows that if most of your sales are to other vat registered businesses, it pays you to vat register as soon as possible, even if you are below the vat threshold – the vat on your sales costs your customers nothing and you get vat back on your costs. However if most of your sales are to the general public or non vat registered businesses then you should delay vat registration for as long as possible, i.e. when you breach the vat threshold.

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