

VAT – the basics

Introduction

VAT registered businesses act as unpaid tax collectors and are required to account both promptly and accurately for all the value added tax (VAT) they collect.

The VAT system is policed by HMRC with heavy penalties for breaches of the legislation. Ignorance is not an acceptable excuse for failing to comply with the rules.

This tax guide provides you with a basic introduction. We would be happy to provide any further clarification or advice you require.

Rates

Most purchases carry a VAT charge. VAT is levied on most business transactions and on many goods and some services.

There are three rates of VAT in the UK:

- 20% (the 'standard' rate)
- 5% ('reduced' rate) and
- 0% ('zero' rate)

Outputs and inputs

Businesses charge VAT on their sales. This is known as output VAT and the sales are referred to as outputs. Similarly, VAT will be payable on most goods and services purchased by the business. This is known as input VAT.

The output VAT is being collected from the customer by the business on behalf of HMRC and must be regularly paid over to them. However, the input VAT suffered on most (but not all) goods and services purchased for the business can be deducted from the amount of output tax owed to HMRC.

If your input tax is greater than your output tax, HMRC will owe you a refund.

Registration

You will probably have to register for VAT if any of the following apply:

- The taxable turnover of your business in the previous 12 months reaches the VAT registration limit (£85,000 from 1/4/19), although you can also register on a voluntary basis if your turnover is below this.
- You believe your turnover in the next thirty days will exceed the registration limit.
- You take over a business as a going concern whose turnover meets the conditions in the previous 2 points.
- You buy goods from elsewhere in the EU to a value above the registration limit in one calendar year.

There are penalties for failing to register on time.

Goods and services liable to VAT are known as 'taxable supplies'. Once registered you must charge VAT on all taxable supplies.

Exempt supplies

VAT doesn't apply to everything. Supplies which are specifically not subject to VAT are referred to as "exempt". This includes insurance, financial services, postal services, health and education, although there are exceptions in every category.

Should you register?

If your taxable turnover is below £85,000 you don't have to register but you may be eligible to apply for 'voluntary registration'.

There can be advantages in registering such as:

- increased business credibility;
- potential savings if your supplies are zero rated but you can still reclaim VAT on your purchases;
- potential savings if you mainly supply other VAT registered businesses who don't mind being charged VAT and you can then still reclaim VAT on your purchases.

This does however have to be weighed up against the hassle factor of completing VAT returns and paying the VAT due every quarter. If you supply the general public, you will probably not want to register as this simply puts your prices up by 20%.

Taxable person

A taxable person is anyone who makes or intends to make taxable supplies and is required to be registered. For the purpose of VAT registration, a person includes:

- an individual
- a partnership
- a company, a club and an association
- a charity.

If any person carries on two or more businesses, all the supplies made in those businesses will be added together in determining whether or not the person is required to register for VAT.

VAT returns

Once registered you must make a quarterly return to HMRC showing amounts of output tax to be accounted for and of deductible input tax together with other statistical information.

In most cases, each VAT return must be completed and filed electronically within one month of the end of the 3 month period it covers. Special rules apply for traders who use the Annual Accounting Scheme (see below).

Businesses which make zero rated supplies and who are entitled to receive repayments of VAT are allowed to submit monthly returns. This enables the business to secure more prompt refunds of input tax from HMRC.

Administration

Record keeping

In addition to the general requirement to maintain complete and up to date records for the taxman, special rules apply to VAT registered businesses. Obviously, the records should identify all supplies, purchases and expenses. The business must also maintain a VAT account showing the output tax payable and input tax recoverable by the business. These records should be kept for at least six years.

Inspection of records

The maintenance of records and calculation of the liability is the responsibility of the registered person but HMRC will need to be able to check that the correct amount of VAT is being paid over.

From time to time therefore a VAT officer will come and inspect the business records. The VAT officer will want to ensure that VAT is applied correctly and that the returns and other VAT records are properly written up.

However, you should not assume that in the absence of any errors being discovered, your business has been given a clean bill of health.

Offences and penalties

HMRC have wide powers to penalise businesses which ignore or incorrectly apply the VAT regulations. Penalties can be levied in respect of the following:

- late returns/payments
- late registration
- errors in returns.

Filing

Since 1 April 2019, most VAT registered traders with turnover above £85,000 are required to file VAT returns electronically using HMRC's making tax digital (MTD) connectivity. This is facilitated by using accounting software that is MTD compatible. If you are about to register for VAT and will be affected by the MTD filing requirement, we can help you choose and install appropriate accounts software.

Cars

The treatment of car expenses for VAT purposes can be quite complex. In the first instance, when you buy a car you generally can't reclaim the VAT unless the car is a taxi, for self-drive hire, or for driving instruction.

Car leasing

If you lease a car for business purposes, you'll normally be able to reclaim 50% of the VAT you pay. But you can reclaim 100% of the VAT if the car is used as one of the following:

- exclusively for a business purpose (i.e.: it's not available for private use by your employees or anyone else)
- a taxi, for driving instruction or self-drive hire

Repairs and maintenance

You can reclaim all the VAT charged on vehicle repairs and maintenance so long as:

- your business pays for the work
- there is some business use of the vehicle

Car fuel

With the exception of car fuel, you can claim back the VAT on all your motor expenses in full, if you have valid VAT invoices for those costs.

For car fuel used for private motoring, there are special rules. If you reclaim VAT on fuel that is used for private purposes, you must pay a VAT scale charge based on the CO₂ emission band of the car. This is a fixed charge that is not related to the amount of actual use. £1 of private petrol and you're caught.

Scale charges are the most common omission from VAT returns and are one of the first things looked for on a VAT inspection and easy to identify when they are missing.

It is normally sensible to calculate whether it is worth your while reclaiming the VAT on private fuel. If the amount of VAT, you can reclaim on the fuel you buy is less than the amount of VAT

to pay on the scale charge then you opt out of reclaiming the VAT on the fuel in order to avoid the scale charge.

If the car is driven by an employee of the business (including by a director of your company) and the company car driver repays you in full for any private fuel used, then no scale charges are due. However, the business should charge output VAT on the amount the driver repays.

Car parking

You are able to reclaim the VAT on business car parking including that at the business premises.

Mileage allowance

When you pay a fixed mileage rate to your employees for business travel (e.g. the standard 45p per mile), this is intended to cover various elements such as fuel, repairs, insurance, depreciation, etc.

However, you are allowed to reclaim the VAT on the fuel element, which many businesses forget to do.

Entertaining expenses

VAT cannot be recovered on business entertainment expenditure. This includes the gratuitous provision to customers or clients of hotel accommodation, food and drink or tickets to events.

If a director or employee entertains a customer or client whilst away from the workplace location, part of the bill may give rise to recoverable VAT. This would relate to the VAT which relates to the director's or employee's own meal cost, as this would constitute 'subsistence' rather than business entertainment.

Subsistence expenditure can also include, for example, the cost of staying in a hotel when attending a client meeting. Input VAT under such circumstances would be deductible. The input tax on the subsistence of contract workers who are not employed by the company cannot be reclaimed.

Conversely, where a business organises an event which is also attended by directors and employees acting as hosts, the whole of the VAT on the cost is irrecoverable. None of the cost may be attributed to staff subsistence.

Staff entertaining such as staff parties, team building exercises, staff outings and similar events, qualifies for input VAT recovery. This can include the entertainment costs relating to directors, partners or sole proprietors of a business where they attend staff parties together with other employees but excludes entertainment expenditure where the event is organised solely for the business proprietors.

Official VAT schemes

There are various official VAT schemes, mainly for small businesses:

Cash accounting - If your taxable turnover is under £1,350,000 a year, you can arrange to account for VAT on the basis of cash received and paid, rather than the invoice date or time of supply.

Annual accounting - You can complete one VAT return per year rather than four if your turnover is under £1,350,000. You must also make nine payments on account throughout the year, and a balancing payment with the VAT return.

Flat rate scheme - This is for businesses with a turnover of under £150,000. It saves on administration as you just pay a set percentage of your VAT inclusive turnover based on your business sector, rather than accounting for VAT on each individual "in and out". It can also reduce the VAT you pay in some situations. It is important to identify the right business sector to avoid problems down the line.

Retail schemes - These apply to retailers and offer an alternative if it's not practical to issue invoices for a large number of supplies direct to the public. You need to choose the right scheme for your situation.

How we can help

If you need to be registered for VAT, it is essential that you comply with all the VAT regulations. We can assist you in a number of ways including the following:

- determining whether and when you should register for VAT
- completing and submitting your application to register for VAT
- advising on the suitability of official VAT schemes
- setting up your accounting system to deal with VAT
- providing VAT planning advice for complex transactions such as when buying property
- tailoring your accounting systems to bring together the VAT information accurately and quickly
- ensuring that your business is VAT efficient and that adequate finance is available to meet your VAT liability on time
- providing assistance with the completion of VAT returns
- negotiating with HMRC if disagreements arise and in reaching settlement