Chapter 24

VALUE ADDED TAX – VAT

1 VAT registration

1.1 Compulsory registration – historical turnover

(a) Trader

Supplies (i.e. sales) may be

- » Standard rated – 20%
- » Zero rated – 0%
- » Exempt

Taxable supplies are those that are either standard rated or zero rated. Trader is able to register for VAT and must then account for output VAT on sales but may reclaim input VAT on purchases and expenses, both capital and revenue expenditure. If a trader only makes exempt supplies he is unable to register for VAT and cannot reclaim input VAT

(b) A trader making taxable supplies must register for VAT if during the previous 12 months the value of taxable supplies exceeded £81,000. However, VAT registration is not required if taxable supplies in the following 12 months will not exceed £79,000. These figures are exclusive of VAT.

(c) HMRC must be notified within 30 days after the end of the period when taxable supplies exceeded £81,000.

(d) The trader will be registered from the end of the month following the month in which the limit was exceeded, or from an earlier agreed date.

Example 1

Orchid Ltd commenced trading on 1 June 2014. Its sales are as follows:

		£			£
2014	June	3,900	2015	January	4,800
	July	3,800		February	6,000
	August	4,300		March	6,100
	September	5,100		April	7,900
	October	4,700		May	8,200
	November	4,700		June	11,800
	December	4,900		July	13,500

The company's sales are all standard rated.

State

(a) When Orchid Ltd will become liable to compulsory VAT registration

(b) The date by which Orchid Ltd must notify HMRC

(c) The date Orchid Ltd will be registered from

1.2 Compulsory registration – future turnover

(a) A trader must also register for VAT if taxable supplies will exceed £81,000 during the following 30 days. This is regardless of any taxable supplies preceding this 30 day period. Again the figure is exclusive of VAT.

(b) HMRC must be notified by the end of the 30 day period

(c) The trader will be registered from the beginning of the 30 day period.

Example 2

Tulip Ltd commenced trading on 1 April 2015, and its forecast income is £90,000 per month. The company's sales are all standard rated.

State the date that Tulip Ltd must notify HMRC by and the date from which the company will be registered.

1.3 Voluntary VAT Registration

(a) A trader may decide to voluntarily register for VAT where taxable supplies are below the £81,000 registration limit. This will be beneficial when:

» The trader makes zero-rated supplies. Input VAT will be reclaimed, but no VAT will be charged on the zero-rated outputs.

» The trader makes supplies to VAT registered customers. Input VAT will be reclaimed, and it should be possible to charge output VAT on top of the pre-registration selling price. This is because the output VAT will be recoverable by the customers.

(b) It will probably not be beneficial to voluntarily register for VAT where customers are members of the general public, as such customers cannot recover the output VAT charged. If selling prices cannot be increased, the output VAT will become an additional cost.

Whether or not output VAT can be passed on to customers will also be an important factor when deciding whether to remain below the VAT registration limit, or whether it is beneficial to accept additional work that results in the limit being exceeded.

EXAMPLE 3

Vine Ltd has been in business for a number of years. All of its sales are standard rated and are to the general public. The company is not registered for VAT. At present, Vine Ltd's annual income is £78,000.

The company is planning to put up its prices, and this will increase annual income to £84,000. There is no further scope for any price increases. Vine Ltd's standard rated expenses are £4,800 p.a. (inclusive of VAT).

Determine if it is beneficial for Vine Ltd to put up its prices.

1.4 Pre-registration Input VAT

(a) Input VAT incurred prior to registration can be recovered in certain circumstances.

(b) The circumstances in which a trader will be allowed to recover input VAT incurred on goods purchased and services incurred prior to the date of VAT registration are as follows:

- » Inventory & non-current assets must be acquired for business purposes, and not be sold or consumed prior to registration.
- » The goods were not acquired more than four years prior to registration.
- » Services must be supplied for business purposes.
- » The services were not supplied more than six months prior to registration.

1.5 VAT Deregistration

(a) A trader stops being liable to VAT registration when it ceases to make taxable supplies. The trader must notify HMRC within 30 days, and will then be deregistered from the date of cessation or from an agreed later date.

(b) A trader can also request voluntarily VAT deregistration if expected taxable supplies in next 12 months are less than £79,000

Illustration 1

Iris Ltd has been registered for VAT since 1990, and its sales are all standard rated. The company has recently seen a downturn in its business activities, and sales for the years ended 30 June 2015 and 2016 are forecast to be £60,000 and £49,500 respectively.

- Iris Ltd can request that HMRC cancel its VAT registration because its taxable supplies during the following 12-month period will not exceed £79,000.
- This is provided the fall in the value of taxable supplies is not due to the temporary or permanent cessation of taxable supplies.
- The company's VAT registration will be cancelled from the date on which the request is made or from an agreed later date.

(c) There is a deemed supply of business assets such as plant, equipment and trading inventory when a company ceases to be registered for VAT, unless VAT due is ≤ £1,000

(d) If a business disposes of its assets and trade as a going concern no output VAT will be charged as it will be outsaide the scope of VAT. The conditions for this treatment are:
- the business is transferred as a going concern
- no significant break in trading
- same type of trade pursued by transferee
- the transferee is or will become VAT registered

Illustration 2

Daisy is a self-employed builder. She is registered for VAT. The business has been quite successful, and Daisy therefore incorporated her trade into a new limited company on 30 April 2015. All of the business assets were transferred to the new company in return for ordinary share capital.

- No output VAT will have to be charged on the value of inventory and other assets on which VAT has been claimed, since the business is transferred as a going concern.
- The company must be or will be VAT registered
- The company will be able to take over Daisy's VAT registration number.

2 The Tax Point

(a) It is very important to correctly identify the time of supply or tax point, as this determines when output VAT will be due.

(b) The VAT rules that determine the tax point in respect of a supply of goods are as follows:

» The basic tax point is the date goods are made available to the customer or service completed.

» If an invoice is issued or payment received before the basic tax point, then this becomes the actual tax point.

» If an invoice is issued within 14 days of the basic tax point, the invoice date will usually replace that in (a).

3 Output VAT and Input VAT

3.1 Major points

There are several important exam points regarding output VAT and input VAT as follows:

(a) VAT is only chargeable on the net amount where a discount is offered for prompt payment.

(b) Relief for irrecoverable (impaired) debts is only available if the output VAT has been accounted for and paid and debt is over six months old as measured from the time that payment was due. The relief is claimed as input VAT on the VAT return

(c) Input VAT cannot be recovered in respect of business entertainment of UK customers or on motor cars (unless they are used 100% for business purposes).

(d) Input VAT cannot be recovered in relation to private use by a proprietor of a business

EXAMPLE 4

Rose Ltd is registered for VAT, and its sales are all standard rated. The following information relates to the company's VAT return for the quarter ended 31 March 2015:

(1) Standard rated sales amounted to £120,000. Rose Ltd offers its customers a 5% discount for prompt payment.
(2) Standard rated purchases and expenses amounted to £35,640. This figure includes £480 for entertaining UK customers.
(3) On 15 March 2015 the company wrote off irrecoverable debts of £2,000 and £840 in respect of invoices due for payment on 10 May and 5 December 2014 respectively.
(4) On 31 March 2015 the company purchased a motor car at a cost of £16,450 for the use of a salesperson, and machinery at a cost of £21,150. Both these figures are inclusive of VAT. The motor car is used for both business and private mileage.
(5) Unless stated otherwise, all of the above figures are exclusive of VAT.

Calculate the VAT payable for the quarter ended 31 March 2015.

3.2 The refund of VAT

The refund of VAT that has been overpaid is subject to a four-year time limit.

4 Motor Expenses

(a) Input VAT can be recovered where fuel is used for private mileage (either by a sole trader or an employee), but output VAT must be accounted for. Output VAT is calculated according to a scale charge based on the cars CO_2 emissions.

Note: The scale charge, which is VAT inclusive, will be given to you in the examination.

(b) Provided there is some business use, input VAT can be fully recovered in respect of repairs to a motor car.

Example 5

Poppy Plc is to provide one of its directors with a company motor car which will be used for both business and private mileage.
The company will pay for all the running costs of the motor car, including petrol and repairs. The relevant quarterly scale charge is £445 for quarter to 31 March 2015 based on the cars CO_2 emission rating.

State the VAT treatment of the cost of petrol and repairs for the quarter to 31 March 2015.

5 VAT Returns

(a) VAT returns are normally completed on a quarterly basis. Each return shows the total output VAT and total input VAT for the quarter to which it relates. All businesses are now required to file VAT returns and make VAT payments online. VAT returns must be filed online and electronic payment made by one month and seven days after the end of the VAT return period. For example for the quarter ended 30 June 2015 a business has until 7 August 2015 to file its VAT return online and electronically make its VAT payment

Illustration 3
For the quarter ended 31 March 2015 Buttercup Ltd had output VAT of £12,400 and input VAT of £7,100.

Buttercup Ltd's VAT return for the quarter ended 31 March 2015 should be submitted by 7 May 2015. VAT of £5,300 (£12,400 - £7,100) is payable, and this is due by 7 May 2015 when the VAT return is submitted..

(b) Because VAT is a self-assessed tax, HMRC make control visits to VAT registered traders. The purpose of a control visit is to provide an opportunity for HMRC to check the accuracy of VAT returns.

(c) A business may choose to submit monthly returns but would only do so if it received regular VAT repayments. This would arise where the business had standard rated purchases and expenses but made zero rated sales and hence always had more input tax than output tax and therefore would claim a repayment.

(d) If a trader's VAT liability exceeds £2,000,000 over a 12 month period; they must make monthly payments on account of the VAT liability.

6 VAT Invoices

A VAT registered trader making a supply to another taxable person must issue a VAT invoice within 30 days of the relevant tax point. A VAT invoice must contain certain information.

Illustration 4

Daffodil Ltd only sells goods, and at present issues sales invoices that show (1) the invoice date and invoice number, (2) the type of supply, (3) the quantity and a description of the goods supplied, (4) Daffodil Ltd's name and address, and (5) the name and address of the customer. The company does not offer any discount for prompt payment.

Daffodil Ltd wants to know the additional information that it will have to show on its sales invoices in order that these are valid for VAT purposes.

The following information is required:

» the VAT registration number;

» the tax point;

» the rate of VAT for each supply;

» the VAT-exclusive amount for each supply;

» the total VAT-exclusive amount;

» the amount of VAT payable.

7 The Default Surcharge

A new penalty system is being introduced over a period of years for the late filing of VAT returns and late payment of tax. This system has not yet been implemented by HMRC and hence the examiner has stated that it will be the existing penalty / default surcharge system that will continue to be examined in the 2015 examinations.

(a) A default occurs if a VAT return is not submitted on time or a payment of VAT is made late.

(b) On the first default, HMRC serve a surcharge liability notice on the trader. The notice specifies a surcharge period, starting on the date of the notice and ending on the twelve-month anniversary of the end of the VAT period to which the default relates.

(c) If the trader has a further default during the surcharge period there are two consequences:

» the surcharge period is extended to the twelve-month anniversary of the VAT period to which the new default relates

» if the default involves the late payment of VAT, then the trader will be subject to a surcharge penalty.

(d) There is therefore no surcharge penalty where a late VAT return involves the repayment of VAT.

(e) The rate of surcharge penalty depends on the number of defaults in the surcharge period:

Default in the surcharge period	*Surcharge as a percentage of the VAT unpaid at the due date*
First	2%
Second	5%
Third	10%
Fourth or more	15%

Surcharge penalties at the rates of 2% and 5% are not made for amounts less than £400.

Where the rate of surcharge is 10% or 15%, the minimum surcharge is £30.

(f) In order to escape from the surcharge liability period, a trader must submit four consecutive quarterly VAT returns on time and also pay any VAT due on time.

Example 6

Bluebell Ltd has submitted its VAT returns as follows:

Quarter ended	*VAT paid (£)*	*Date submitted*
30 September 2013	3,100	5 December 2013
31 December 2013	21,300	2 March 2014
31 March 2014	4,300	25 April 2014
30 June 2014	7,600	24 July 2014
30 September 2014	1,900	25 October 2014
31 December 2014	3,200	27 January 2015
31 March 2015	6,900	16 May 2015

Bluebell Ltd paid the VAT due on the same date that the VAT returns were submitted.

State the consequences for Bluebell Ltd of the late submission of the VAT returns.

8 Penalties and Interest

8.1 Failure to notify liability for registration or change in the nature of supplies by persons exempted from registration

There will be a standard penalty based on a percentage of the VAT lost during the period from when the notification should have been made until it is actually made.

The actual penalty payable is linked to the taxpayers behaviour.

(a) There will be no penalty where the taxpayer has a reasonable excuse for the failure to notify

(b) There will be a penalty of 30% of the tax unpaid where there is non-deliberate failure to notify

(c) There will be a penalty of 70% of the tax unpaid where there is deliberate failure to notify

(d) There will be a penalty of 100% of the tax unpaid where there is deliberate failure to notify with concealment

However a penalty will be substantially reduced where a taxpayer make a disclosure, especially when this is unprompted by HMRC.

8.2 Errors in a VAT return

A trader that makes an error in a VAT return that results in the underpayment of VAT can be subject to a standard penalty for submission of an incorrect return and penalty interest. There are three different situations:

(a) Net errors of less than a de-minimis can be voluntarily disclosed by a trader. Correction is made by simply entering the errors on the next VAT return. There maybe a penalty for submission of an incorrect return, but no interest charged.

(b) Net errors of more than the de-minimis can be voluntarily disclosed by a trader. In this case the trader must disclose the errors separately to HMRC. Penalty interest will be charged, and there may be a penalty for submission of an incorrect return.

(c) Errors may be discovered as a result of a control visit. Both a penalty for submission of an incorrect return and penalty interest can be charged.

(d) The de-minimus level is the greater of

» £10,000 and

» 1% × turnover (subject to on upper limit of £50,000)

8.3 Submission of an incorrect return leading to:

- an understatement of VAT liability
- a failure of inflated claim for repayment of tax

The amount of penalty is based on the amount of tax understated, but the actual penalty is linked to the taxpayer behaviour, as follows:

(a) there will be no penalty where a taxpayer simply makes a mistake.

(b) there will be a moderate penalty (up to 30% of the understated tax) where a tax payer fails to take reasonable care.

(c) there will be a higher penalty (up to 70% of the understated tax) if the error is deliberate.

(d) there will be an even higher penalty (up to 100% of the understated tax) where there is also concealment of the error.

A penalty will be substantially reduced where the taxpayer makes disclosure, especially unprompted disclosure to HMRC.

Example 7

Blanche Ltd has made an error relating to understated output VAT of £8,500 on the VAT return, for quarter to 31 December 2014. Blanche Ltd has turnover for the quarter of £700,000.

How should this error be disclosed to HMRC and what penalties and interest will be charged by HMRC?

9 The Cash Accounting and Annual Accounting Schemes

(a) The cash accounting and annual accounting schemes are both available to small businesses.

(b) The cash accounting scheme enables a trader to account for output VAT on a cash basis. The scheme will normally be beneficial where an extended period of credit is taken by customers, and it also results in automatic bad debt relief. The disadvantage is that input VAT will only be recovered in relation to when payments are made.

Illustration 5

Violet Ltd gives its customers a 30-day credit period, but pays for most of its expenses in cash. Violet wants to know what conditions must be satisfied before it will be permitted to use the cash accounting scheme, and the implications of using the scheme.

1. Violet Ltd will be able to operate the cash accounting scheme provided its expected taxable turnover for the next 12 months does not exceed £1,350,000.
2. In addition, the company must be up-to-date with its VAT returns and VAT payments.
3. The scheme will result in the company's tax point becoming the date that payment is received from customers.
4. This will delay the payment of output tax, and also provides for automatic bad debt relief should a customer not pay.
5. Since Violet Ltd pays in cash for its expenses, the company's recovery of input VAT will not be affected
6. Stay in scheme until annual taxable turnover reaches £1,600,000

(c) The advantage of the annual accounting scheme is mainly administrative, since a trader only has to make one VAT return each year. Payments on account of the annual VAT liability are normally required. It will also allow easier budgeting for cashflow.

Illustration 6

Crocus Ltd wants to know the advantages of the annual accounting scheme, and when it will be permitted to join. The company's annual turnover is £450,000.

1. Crocus Ltd can apply to use the annual accounting scheme provided its expected taxable turnover for the next 12 months does not exceed £1,350,000.
2. In addition the company must be up-to-date with its VAT returns and payments.
3. However, Crocus Ltd will only be able to use the annual accounting scheme if it has been VAT registered for 12 months. (Businesses with a turnover of less than £150,000 can join the annual accounting scheme as soon as they register for VAT and new businesses may base their payments on account (see below) on their estimated VAT liability)
4. Under the scheme only one VAT return is submitted each year. This is due within two months of the end of the year.
5. Nine monthly payments are made on account, each being 10% of the previous year's VAT, in months 4 to 12 of the period with any balancing payment being made with the VAT return, or they may choose to pay quarterly instead
6. Stay in scheme until annual taxable turnover reaches £1,600,000

10 Flat rate scheme

(a) The flat rate scheme is optional. It simplifies the way in which small businesses calculate their VAT liability.

(b) The scheme can be used if the expected taxable turnover for the next 12 months does not exceed £150,000. The business can stay in the scheme if turnover is ≤ £230,000. Turnover is determined by the method used to determine the VAT whilst in the scheme, that is cash basis or invoice basis.

(c) Under the flat rate scheme, a business calculates its VAT liability by simply applying a flat rate percentage (given by HMRC based on trade sector) to total income inclusive of VAT and any exempt supplies. This removes the need to calculate and record output VAT and input VAT.

(d) The flat rate percentage is applied to the gross total income figure, with no input VAT being recovered.
The percentage varies according to the type of trade that the business is involved in, and will be given to you in the examination.

(e) VAT at the rate of 20% is still treated as being charged where a supply is made to another VAT registered business, and in this case a VAT invoice must still be issued.

Illustration 7

a. Snowdrop Ltd has annual sales of £120,000, all of which are standard rated and are to the general public. The company's standard rated expenses are £6,000 p.a. These figures are inclusive of VAT. The relevant flat rate percentage for Snowdrop Ltd's trade is 15%. Using the normal basis of calculating its VAT liability, Snowdrop Ltd will have to pay VAT as follows:

	£
Output VAT (120,000 × 20/120)	20,000
Input VAT 6,000 × 20/120)	(1,000)
VAT payable	19,000

If Snowdrop Ltd uses the flat rate scheme then it will pay VAT of £18,000 (120,000 × 15%). There is a VAT saving of £1,000 (19,000 – 18,000) in addition to the simplified administration. As none of Snowdrop Ltd's customers are VAT registered, there will be no need to issue VAT invoices.

b. Primrose Ltd has annual sales of £96,000, of which 50% are standard rated and 50% are zero-rated. All of the company's sales are to VAT registered businesses. The company's standard rated expenses are £30,000 p.a. These figures are inclusive of VAT. The relevant flat rate percentage for Primrose Ltd's trade is 6%. Using the normal basis of calculating its VAT liability, Primrose Ltd will have to pay VAT as follows:

	£
Output VAT (96,000 x 50% x 20/120)	8,000
Input VAT (30,000 x 20/120)	(5,000)
VAT payable	3,000

If Primrose Ltd uses the flat rate scheme then it will pay VAT of £5,760 (96,000 × 6%). Although the flat rate scheme will result in simplified administration, it is not beneficial as additional VAT of £2,760 (5,760 – 3,000) is payable and Primrose Ltd would still have to issue VAT invoices as its customers are registered for VAT.

11 Group VAT Registration

(a) Two or more companies can register as a group for VAT purposes. They must be under common control of a third company and resident in the UK

(b) The group is treated for VAT purposes as if it were a single company registered for VAT on its own.

(c) A representative member of the group is appointed and this company is responsible for completing and submitting a single VAT return and paying the VAT on behalf of the group.

(d) All companies in the VAT group are jointly and severally liable for any VAT liabilities of the group.

(e) The advantages of group VAT registration are:

» No VAT is accounted for on transactions between group members within the VAT group

» Only one VAT return is submitted for the group; therefore an administrative advantage.

» The group can choose which companies to include or exclude. It would be beneficial to exclude a company making zero rated sales as it would then be able to continue making monthly returns to get the improved cash flow of monthly VAT repayments.

(f) The disadvantages of group VAT registration are:

» The limits for Cash and Annual Accounting schemes will apply to the group as a whole and not on an individual company basis.

» Joint and several liability of each company in the group

» Possible administration issues collecting information to be passed on to the representative member

12 UK businesses trading within and outside the European Union.

UK businesses frequently trade with companies/individuals within other European Union (EU) and non EU countries. The VAT treatment of exports and imports must be appreciated on these transactions.

12.1 Supply of goods

(a) Trading with **non EU** countries

» Exports

- The supply of goods is zero rated

» Imports

- The importation of goods involves UK VAT being paid directly to HMRC at point of entry into the UK.
- This is treated as normal input VAT
- Regular importers can defer this payment of VAT under the duty deferment scheme if the UK business provides HMRC with a bank guarantee. The VAT on the import is accounted for on a monthly basis.

(b) Trading with EU countries

(i) Exports (Dispatches)

- When a UK VAT registered business supplies goods to another VAT registered business within the EU the supply is zero rated.
- If the customer does not have a VAT registration the UK supplier will charge UK VAT at the rate in force at the time of the supply.

(ii) Imports (Acquisitions)

- The VAT registered EU supplier will zero rate the transaction and the UK VAT registered business will "self supply" under the reverse charge system for the VAT on its VAT return.
- 'Self supply' effectively means the UK VAT registered business will calculate UK VAT on the acquisition and declare it as output VAT on the VAT return.
- This VAT can then be reclaimed as input VAT, that is the VAT contras out and there is no VAT cost.
- The only time there will be a VAT cost is if the business makes some exempt supplies as the exempt part of the business cannot reclaim input VAT.

12.2 Supply of Services

- To overseas business customer = outside scope of VAT
- To overseas non business customer = standard rated
- Service from an overseas business = Self supply / reverse charge system applies as above

EXAMPLE 8

BW Ltd a UK VAT registered UK business acquires £12,000 of goods from its suppliers in the United States of America (Non EU) and £20,000 of goods from its supplier in Germany (EU) in the quarter to 31 March 2015.

In the same VAT quarter BW Ltd exported £50,000 to a VAT registered customer in France (EU) and £10,000 of goods to a non VAT registered individual in Latvia (EU).

Discuss the VAT implications of the above transactions. (All transactions are stated exclusive of VAT)

You should now review the following part of the Finance Act 2014 technical article written by the F6 examining team - VAT section, plus VAT parts 1 and 2 articles, plus article on Motor Cars

You may now attempt Practice Questions 39 to 41