



Value Added Tax (VAT)

VAT is a tax on consumer expenditure and is ultimately paid by the final customer. Most business transactions involve the supply of goods or services and VAT is payable if they are made:

- a) in the United Kingdom
- b) by a taxable person
- c) in the course or furtherance of business and are not specifically exempted or zero-rated

VAT is collected by HM Revenue & Customs and is normally payable quarterly.

Registration

There are two different types of registration - compulsory and voluntary:

Compulsory

A person who makes taxable supplies becomes liable to be registered if:

- a) At the end of any month, the value of his taxable supplies in the period of one year then ending has exceeded the registration limit, which is frozen at £85,000 until 31 March 2024.
- b) At any time, there are reasonable grounds for believing that the value of his taxable supplies in the next 30 days will exceed the £85,000 limit.
- c) If, where a business carried on by a taxable person is transferred as a going concern, the taxable supplies for the twelve months prior to the transfer exceed £85,000.

In the most common situation, i.e. (a) above, the person must notify HMRC of the liability within 30 days of the end of the month in which the value of the taxable supplies first exceeded £85,000. If, for example, the value of the taxable supplies first exceeded £85,000 in the twelve months to 31 March, then HMRC must be notified by 30 April and VAT registration would commence on 1 May.

Voluntary

In certain circumstances, it is possible to register on a voluntary basis for VAT even though the value of taxable supplies may never exceed £85,000. This is normally only beneficial where the majority of supplies are being made to customers who are themselves VAT registered. Note the special rules for businesses supplying services in the Construction Industry.

The other situation in which a voluntary registration might be beneficial is where the supplies are all zero-rated and no VAT is charged on the transaction. All VAT suffered by the trader on expenses can be reclaimed from HMRC.

In summary, the advantages and disadvantages of a voluntary registration are as follows:

Advantages

- Enables input VAT suffered to be reclaimed;
- A VAT number can give the impression that a business is larger than it actually is which sometimes can increase the possibility of obtaining work.

Disadvantages

- The requirement to prepare VAT returns on a quarterly basis and to submit them and if applicable pay over the VAT due within one month of the quarter end - is the amount of work involved worth it for the input VAT that can be reclaimed?
- HMRC may periodically visit the business (about every five years but depends upon the risk of errors) to ensure that VAT is being properly accounted for. There may be penalties for incorrect returns.
- Where most of the customers cannot reclaim VAT, such as domestic consumers, your prices will be uncompetitive compared to non-VAT registered suppliers.

Taxable Persons and Supplies

Taxable Persons

It should always be remembered that it is a person that is registered for VAT and not a business. If a person has two separate different businesses, both with taxable supplies of £50,000, then that person will be required to be registered for VAT and account for VAT at the appropriate rate on the total supplies of £100,000.

It is possible to mitigate the effect of VAT by having one of the businesses operated by a limited company or by a partnership with a relative, but professional advice needs to be taken since HMRC have the power to treat the two businesses as one if strict criteria are not met as they may argue that a single business has been deliberately fragmented to keep below the £85,000 threshold.

Taxable Supplies

Taxable supplies are all supplies made by a business either to a third party or to the trader himself (goods for own use), which are not exempt supplies. Taxable supplies therefore include zero-rated supplies.

The major categories of exempt supplies are:

- Land (but not buildings)
- Insurance
- Postal services
- Betting, gaming and lotteries
- Finance
- Education
- Health and welfare

It is important that at the outset of a business, a trader establishes the VAT status of any supplies being made to avoid mistakes, e.g. the services of a physiotherapist are exempt, whilst the services of an acupuncturist are standard rated.

Tax Rates

There are three rates of VAT:

1. 20% - the standard rate of VAT, applying to any sales of standard-rated goods or services
2. 5% - for certain supplies of fuel and power
3. Zero-rated - the four main areas of zero-rated goods are:
 - Food and agriculture (but excluding pet food and most catering)
 - Printed matter, including books and newspapers
 - Young children's clothing and footwear
 - Passenger transport (but excluding hire cars, taxis and parking)

Any VAT charged by the business, whether at 20% or 5% is known as output VAT and the total charged or collected in the VAT quarter is payable to H M Revenue & Customs.

Note that during the COVID-19 pandemic the VAT rate for the hospitality sector, holiday accommodation and tourist attractions was temporarily reduced to 5% until 30 September 2021. From 1 October 2021 the rate increases to 12.5% until it reverts to 20% from 1 April 2022.

Input VAT

Input VAT is the VAT that you are charged on your business purchases and expenses (the other persons output VAT) and is normally recoverable in full by a trader who only makes standard rated or zero-rated supplies.

Businesses that make some exempt supplies (known as partially exempt businesses) have different recovery rules.

The total input VAT suffered in the quarter is deducted from the output VAT charged or collected and the difference is either the amount of VAT due to HMRC or the amount repayable by HMRC.

The majority of input VAT is recoverable but there are special rules for:

- cars
- petrol supplied for private usage;
- business entertaining;
- goods sold under a VAT second-hand scheme.

To reclaim VAT, you have been charged as input VAT, you must hold valid evidence that you have received a taxable supply, which normally means a valid VAT invoice from a registered trader showing his VAT number and the amount of VAT charged.

Special VAT Reverse Charge for the Construction Industry

From 1 March 2021 new rules have been introduced for supplies by sub-contractors operating in the Construction Industry.

Where the supplies are made within the Construction Industry Scheme (CIS), typically by sub-contractor bricklayers, plumbers and electricians supplying to main contractors their invoices no longer show output VAT. Instead, the VAT is accounted for by the main contractor to whom they are supplying their services.

The subcontractor would however charge VAT on any invoices to end users such as domestic householders and would continue to be able to recover input VAT on invoices for materials, motor expenses and other overheads.

So, if electrician Eddie is invoicing Big Builder Ltd for £10,000 of work in May 2021 his invoice would not show £2,000 output VAT. Instead Big Builder Ltd would account for £2,000 input VAT and £2,000 VAT thereby collecting VAT on behalf of HMRC.

This new system was introduced as some sub-contractors were allegedly charging 20% VAT but not accounting for it to HMRC, so called "missing trader" fraud. The new system puts the onus on the main contractor to account for the VAT.

Quarterly or Monthly VAT returns

As mentioned earlier, as part of the Making Tax Digital project, most VAT registered businesses above the registration threshold will need to keep their accounting records in a digital format and update HMRC quarterly from April 2019.

Where the trader is likely to be reclaiming VAT from HMRC they are able to opt to make monthly VAT returns to improve business cash flow. This will often be beneficial for businesses making zero-rated supplies and sub-contractors in CIS to whom the VAT reverse charge applies.

Penalties

There are penalties for errors in VAT returns. More details can be found at the HMRC website: <https://www.gov.uk/vat-returns/surcharges-and-penalties>



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