An Introduction to VAT

What is VAT?

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

Taxable persons

A taxable person is any person carrying on a business which is, or is required to be registered for VAT and includes the following;

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

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 four categories:

1. Positive rated - taxable at 20% or 5%.
2. Zero rated - including socially or economically important items, e.g. exports, many food items (but not catering), 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. donations, dividends, shares of profit compensation for losses, non UK supplies.

Should I be registered for VAT?

You should notify HMRC when:

- Taxable turnover for the past twelve months exceeds £83,000
- There are reasonable grounds for believing that your turnover for the next 30 days will exceed £83,000

In the first case, notification must be within thirty days of the end of the relevant month. 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 for the period when VAT should have been charged.

It is possible to register for VAT voluntarily provided you have a bona fide business, in order to reclaim VAT on purchases.

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 (cash accounting).
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, particularly if they have significant business credit and supply on a cash only basis.

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. Input tax is only recoverable to the extent that it relates to taxable supplies made or to be made by the business. 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, certain building materials, 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.

VAT returns

VAT returns must be filed online and must normally be submitted every quarter, along with any payment due to HMRC no later than 7 days after the end of the month following the period end. Blank returns are made available online well before the period end so there is ample time to complete and file them by the due date. Make returns and payments on time because there are penalties for late filing and/ or late payment. It will usually be preferable to register to pay by direct debit as that allows a further three working days for payment, and it reduces the risk that payments are overlooked. Businesses with regular repayments may make monthly returns to ease their cash flow. 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. Payments of VAT under the annual accounting scheme are made monthly by direct debit.

De-registering

- 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 £81,000, but this may not be in your interests.

Tax invoices

Specific rules are laid down as to the form and content of tax invoices. A tax invoice is required to show for VAT purposes:

- An identifying sequential number / letter (see note above)
- 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

- 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 or nature of the services, price, 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

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