General Principles of VAT
VAT is a tax on consumer expenditure and is collected on business transactions and imports.

The basic principle is to charge VAT at each stage in the supply of goods and services (output tax).

If the customer is registered for VAT and uses the supplies for business purposes, they will receive credit for this VAT (input tax).

VAT Registration – Do I Need to Register?
The current VAT registration limit (from 1 April 2017) is £85,000. This means that businesses with a gross taxable turnover exceeding £85,000 should register.

Not all businesses must be registered for VAT but, if you are in business making taxable supplies, you will be required to be registered by HM Revenue & Customs if, at the end of any calendar month, the value of taxable supplies made in the previous 12 months exceeds the annual registration threshold. Alternatively, you must register for VAT immediately if at any time there are reasonable grounds for believing that the value of taxable supplies to be made in the next 30 days on their own will exceed the annual registration limit.

It is possible to register for VAT voluntarily if your gross turnover is below the registration limit. Many businesses choose to register for VAT voluntarily for an assortment of reasons. If a business has mainly zero rated sales, VAT registration could be beneficial due to being able to reclaim VAT made on expenses of the business, putting the business in a VAT repayment situation. VAT registration may be decided on so that competitors and customers are not aware of the lower turnover of the business which may make them appear less “professional” than other VAT registered businesses.

Penalties for Failure to Register
HM Revenue & Customs may penalise you if you fail to notify them at the correct time that you should have registered for VAT.

The amount of the penalty will depend on the amount of VAT due and how late you were in telling them that you should have registered.

The penalty is worked out as a percentage of the VAT due from when you should have registered to the date HM Revenue & Customs receive your notification, or become fully aware that you were required to be registered. The rate of penalty depends on how late you were in registering.

<table>
<thead>
<tr>
<th>If you registered:</th>
<th>Then the penalty rate will be:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not more than 9 months late</td>
<td>5%</td>
</tr>
<tr>
<td>More than 9 months late but not more than 18 months late</td>
<td>10%</td>
</tr>
<tr>
<td>More than 18 months late</td>
<td>15%</td>
</tr>
</tbody>
</table>

There is a minimum penalty of £50.

It is possible to have the penalty reduced depending on how much assistance you give HM Revenue & Customs. They refer to this assistance as the “quality of disclosure” or as “telling, helping, giving”.

How to Register for VAT
To register for VAT you will need to fill in one or more forms and submit them to HM Revenue & Customs for approval. Most applications for VAT registration are now completed online. Which form you use and the number of forms you need to complete will depend on your own particular circumstances. Most businesses only need to complete one form. Exceptions include partnerships, where you need to complete one extra (simple) form listing details of the partners, and registering a group of companies.
Rates of VAT – Which Rate Applies to my Business?
This depends on the type of services provided by your business.

You will need to establish which VAT rate category your taxable supplies fall into. You may need to do this on an individual sales basis, depending on your business. There are four choices for VAT purposes. These are Reduced rate supplies (5%), Zero-rated supplies (0%), Exempt supplies (not included), or Standard-rated supplies (20%).

There are currently eleven groups which qualify for the reduced rate of VAT. This means instead of charging the standard 20% VAT for goods and services provided, the reduced rate of 5% is charged.

The eleven groups include domestic fuel and power charges, charges on installation of energy saving materials, sale of children’s car seats, the sale of smoking cessation products, and residential conversions, alterations and renovations.

There are currently sixteen categories of zero-rated supplies. This means the VAT charged on the supply of goods and services is 0%.

The sixteen groups include charges for food, sewerage and water supplies, sale of books, talking books for the blind, construction of buildings, protected buildings, international services, transport, caravans and houseboats, gold, bank notes, drugs, medicines and aids for the handicapped, import and exports, tax-free shops, charities and clothing and footwear.

Exempt supplies - there are essentially fifteen groups which fall into the Exempt from VAT category. If your business provides exempt goods or services, it is not possible to reclaim any input VAT back on expenses directly related to the provision of the goods or services.

If your business makes purely exempt supplies it is not possible to register for VAT. If your business makes exempt supplies alongside taxable supplies (at either reduced, zero or standard rated) it will be necessary for your business to run a partial exemption scheme which apportions the input VAT claimable between those used wholly for provision of exempt supplies (which CANNOT be reclaimed on the VAT return), and for the provision of taxable supplies (which CAN be reclaimed on the VAT return). The remaining residual VAT (which covers other joint sundry costs e.g. heat & light, stationery etc) is then split using a previously agreed % between claimable and non-claimable input VAT.

However, where your exempt input tax is insignificant you can treat it as if it were taxable input tax and recover it in full if its total value is less than a prescribed amount.

You can be treated as fully taxable in any tax period if the value of your exempt income is not more than:

- £625 per month on average AND
- Half of your total input VAT in the relevant period.

The exempt groups are land, insurance, postal services, betting, gaming and lotteries, finance, education, health and welfare, burial and cremation, trade unions, sport, works of art, fund raising events by charities and other qualifying bodies, cultural services, supplies of goods where input tax cannot be deducted, and investment services.

Any business activities which do NOT fall into either reduced rate, zero rate, or exempt supplies are deemed to be standard rated, and should include a charge at the standard rate of VAT which is currently 20%.

As you can see, it is vital to establish exactly which supply type your business falls into to avoid under/over declarations of VAT.
**VAT Schemes – Should I Use One?**

As well as applying the correct VAT rate to taxable supplies made, it is also necessary to consider if there is an appropriate VAT scheme to be enrolled on.

**Flat Rate Scheme**

If you have a net turnover of £150,000 or less per annum you may register to use a flat rate scheme. By using the Flat Rate Scheme you pay VAT as a fixed percentage of your VAT inclusive turnover. The actual percentage you use depends on your type of business.

Generally you don’t reclaim any of the VAT that you pay on business expenditure, although you may be able to claim back VAT on capital assets worth more than £2,000. Once you join the scheme you can stay on it until your business income is more than £230,000.

**For example:**

A fish and chip shop would charge VAT of 20% on its takings, but would only pay over 12.5% of those takings to HM Revenue & Customs VAT.

There are currently 55 trade classes established by HM Revenue & Customs with Flat Rate percentages already agreed. It is down to the business themselves to decide which class they fit into, and therefore which flat rate percentage is applicable to their income.

From 1 April 2017, FRS businesses must also determine whether they meet the definition of a limited cost trader, which will be included in new legislation.

Businesses using the scheme, or thinking of joining the scheme, will need to decide whether they are a limited cost trader.

A limited cost trader could be defined as one whose VAT inclusive expenditure on goods is either:

- less than 2% of their VAT inclusive turnover in a prescribed accounting period
- greater than 2% of their VAT inclusive turnover but less than £1,000 per annum if the prescribed accounting period is one year.

Businesses confirmed as being limited cost traders should use the new 16.5% rate.

You can use either of the following two schemes if your estimated VAT taxable turnover during the next tax year is not more than £1.35 million.

Once you start using either scheme you can do so until your VAT taxable turnover reaches £1.6 million.

**Annual Accounting Scheme**

Using the Annual Accounting Scheme, you pay VAT on account throughout the year in nine monthly or three quarterly installments. These installments are based on the VAT you paid in the previous year. If you have been trading for less than a year, the installments are based on an estimate of your VAT liability.

You only need to complete one VAT Return at the end of the year. If you have not paid enough VAT on account you make a balancing payment to HM Revenue & Customs, if you have overpaid, you can claim a refund.

**Cash Accounting Scheme**

Usually VAT is payable when an invoice is issued. In contrast, using the Cash Accounting Scheme, you do not need to pay VAT until your customer has paid you. But you also cannot reclaim VAT on your purchases until you have paid for them.

Cash accounting can be beneficial for your cash flow especially if your customers are slow to pay. It is even more useful if you have bad debts. Under standard accounting for VAT, you have to pay the VAT on the debt even if you never receive the payment from your customer. Using the Cash
Accounting Scheme, you do not pay the VAT if your customer never pays you. The Cash Accounting Scheme may not be for you if you regularly reclaim more VAT than you pay, or if you buy a lot of goods and services on credit.

Second Hand Goods Scheme
The second hand goods scheme exists for traders who tend to buy their goods from members of the public and sell their goods to other members of the public. They are therefore not charged input tax on their purchases. Under the second hand goods scheme, a trader only accounts for VAT on the PROFIT made between buying the goods and selling the goods onwards. If the sale is made at a loss, there is no VAT to pay. Full records of all purchases and sales must be kept to comply with the second hand goods scheme.

Global Accounting Scheme
Under the global accounting scheme, it is possible for traders to take the second hand goods scheme a step further. Whereas with the second hand goods scheme each individual item must be recorded, the margin on the global accounting scheme is calculated as the difference between sale proceeds of all the items sold in the period, less purchase cost of all the goods purchased in the period.

Retail Scheme
At its very simplest, a Retail Scheme will take as its starting point the cash in the till, which may have been adjusted for one or two items as per the specific Retail Scheme. The use of a retail scheme is wholly at HM Revenue & Customs discretion.

Trading in the EU and the Rest of the World
The 28 countries of the EU make up a huge market of potential customers and suppliers for your business. There is less admin involved in acquisitions (goods imported into the UK) and dispatches (goods exported from the UK) to and from other EU countries than with countries in the rest of the world.

For VAT purposes, you should record goods sold to and bought from other EU countries on your VAT return. VAT is a tax charged on goods used in the EU, so if goods are exported outside the EU VAT isn’t charged.

VAT Records – What Do I Need to Keep?
Business records must be kept for a minimum of 6 years. The business records should be made up of:
- Records of all the standard-rated, reduced-rated, zero-rated and exempt goods and services that you buy or sell
- Copies of all sales invoices you issue
- All purchase invoices for items you buy
- All credit notes and debit notes you receive
- Copies of all credit notes and debit notes you issue
- Any self-billing agreements you make as a supplier
- Copies of self-billing agreements you make as a customer and name, address and VAT registration number of the supplier
- Records of any goods you give away or take from stock for your private use including rate and amount of VAT
- Records of any goods or services bought for which you cannot reclaim the VAT, such as business entertainment
- Any documents dealing with special VAT treatment, such as reliefs or zero-rating by certificate
- Records of any goods you export
- Records of any taxable self-supplies you make - for example if you sell cars and you use one of your cars in stock for business purposes
- Any adjustments such as corrections to your accounts or amended VAT invoices

A VAT account
**VAT Returns - How Often do I Submit VAT Returns?**

It is possible to submit VAT returns on a monthly, quarterly, or annual basis. It depends on the type of business you are in, and on agreements made between yourself and HM Revenue & Customs.

All VAT returns must be submitted electronically.

**Ways to Pay – How and When?**

As all VAT returns have to be submitted online from April 2012, HM Revenue & Customs have deemed that all payments must also be received electronically. Payment should be with HM Revenue & Customs and funds cleared with them by the 7th day of the month following the end of the VAT period.

For Example:

If your VAT quarter end was 31 December, payment would have to be with HM Revenue & Customs and cleared by 7 February.

There are various payment methods:

- paying via direct debit (3 days additional grace given, whereby the direct debit is taken automatically from your bank account on the 10th of the following month)
- payment via bank giro credit book
- payment using internet banking
- payment over the telephone using a debit or credit card (credit card usage will incur a fee)
- payment by CHAPS transfer (fee applicable but payment is made on the same day)

**Will my VAT Records be Inspected by HM Revenue & Customs?**

HM Revenue & Customs Officers will visit taxable persons from time to time. The visits will usually be by prior appointment, although HM Revenue & Customs reserve the power to enter premises used by businesses to impact the premises themselves and any goods found on them.

In the past, registered traders could expect their first control visit within three years of registration. Visits are now more targeted and a “low risk” trader may not have his first visit for many years. Businesses that receive cash takings or work in complicated areas may be regarded as “high risk” and could therefore expect to be visited more regularly than their “low risk” counterparts.

Businesses that continually submit VAT returns late, miss payments, or submit what appear to be incorrect or inconsistent returns can expect to be targeted more frequently than would otherwise be the case.

**What Happens During a Visit?**

Visiting VAT officers will discuss various aspects of your business with you. They will examine your business records and, where appropriate, inspect the premises and any goods on the premises.

They will also take some details of supplies made to, or by, you. This is so they can check the correct tax treatment in your supplier or customer records. On some occasions this will be the main purpose of the visit. If this is the case, the VAT officer will tell you when making the appointment.

At the end of the visit, the VAT officer will:

- review with you the work carried out during the visit
- explain any areas of concern they have identified, discuss them with you and agree any future action needed
- explain any adjustments they need to make to the VAT payable
- tell you if you have overpaid or underpaid
Afterwards, if you or HM Revenue & Customs think it is necessary, HM Revenue & Customs will write to you with a summary of the visit, along with any rulings, agreements or recommendations.

What Happens if I Make a Mistake on My VAT Return?
It is essential that you keep accurate records, and that your VAT Returns are completed correctly. If you find that you’ve made mistakes in a return that you’ve already submitted, you must correct them.

If the error is the greater of:

- £10,000, or
- 1% of the box 6 figure on your VAT return for the period when you discover the error – subject to an upper limit of £50,000

You must report this to HM Revenue & Customs separately and in writing using form VAT652 “Notification of Error in VAT return”.

If the error is less than this amount you may correct the error by making adjustments on your next VAT return. You must also inform HM Revenue & Customs of the adjustment in writing either by use of form VAT652 or by letter.

The letter must include:

- how the error happened
- the VAT period when the error was made
- whether it was an error on input or output VAT
- how you worked out the error
- how much VAT was under or over-declared
- whether you are claiming a refund of an overpayment
- the total amount of the error.

The information will be held on file by HM Revenue & Customs. Should you receive a VAT visit this will confirm to the visiting officer that you are complying with your VAT obligations of correcting and reporting errors on an unprompted basis.

Penalties for Errors, Surcharges and Interest
HM Revenue & Customs have an established penalties regime for errors made on VAT returns.

They are:

<table>
<thead>
<tr>
<th>Reason for Penalty</th>
<th>Penalty</th>
<th>Possible reduced Penalty for unprompted Disclosure</th>
<th>Possible reduced Penalty for unprompted disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Careless action</td>
<td>30%</td>
<td>0%</td>
<td>15%</td>
</tr>
<tr>
<td>Deliberation but not concealed action</td>
<td>70%</td>
<td>20%</td>
<td>35%</td>
</tr>
<tr>
<td>Deliberation and concealed action</td>
<td>100%</td>
<td>30%</td>
<td>50%</td>
</tr>
<tr>
<td>Error in HMRC assessment</td>
<td>30%</td>
<td>0%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Penalties will be made by assessment within 12 months of the date on which the inaccuracy is corrected. It is possible to appeal against a penalty, a decision not to suspend or the terms of a suspension.
**Will I Be Fined if I Submit Late Return and/or Payment?**
Late submissions and payments of VAT will create Default Surcharges. If your turnover is £150,000 or more you will be ‘in default’ if by the due date:

- HM Revenue & Customs has not received your VAT return
- Payment of the VAT due has not cleared in HM Revenue & Customs’ bank account.

The first time a default occurs HM Revenue & Customs will issue a surcharge liability notice. This notice is the beginning of the Default Surcharge period, which will last for the next 12 months. If, in that 12 month period there are further late submissions and/or payments, the surcharge penalties are as follows:

<table>
<thead>
<tr>
<th>Number of defaults during current surcharge period</th>
<th>% of unpaid VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2%</td>
</tr>
<tr>
<td>2</td>
<td>5%</td>
</tr>
<tr>
<td>3</td>
<td>10%</td>
</tr>
<tr>
<td>4 or more</td>
<td>15%</td>
</tr>
</tbody>
</table>

Similarly, if your turnover is less than £150,000 HM Revenue & Customs has an established table of penalties in place.

HM Revenue & Customs will send you a letter offering help and support. If you decide again within a 12 month period HM Revenue & Customs will send you a “Surcharge Liability Notice” explaining you are now in a 12 month surcharge period.

If you default within this period you may also have to pay a “default surcharge” in addition to your VAT liability. These surcharges increase if additional defaults occur:

<table>
<thead>
<tr>
<th>Default</th>
<th>Surcharge % of unpaid VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No surcharge – help letter issued</td>
</tr>
<tr>
<td>2</td>
<td>No surcharge – Surcharge Liability Notice issued</td>
</tr>
<tr>
<td>3</td>
<td>2% (unless under £400, in which case you won’t be charged a surcharge at this rate)</td>
</tr>
<tr>
<td>4</td>
<td>5% (unless under £400, in which case you won’t be charged a surcharge at this rate)</td>
</tr>
<tr>
<td>5</td>
<td>10% (unless it is less than £30, in which case you will be charged £30)</td>
</tr>
<tr>
<td>6+</td>
<td>15% (unless it is less than £30, in which case you will be charged £30)</td>
</tr>
</tbody>
</table>

**Cancelling VAT Registration**
Once a business is registered for VAT, it is not a given that the business will remain registered for VAT. In certain situations a business may be required to deregister or may voluntarily deregister.

A business must deregister from VAT if:

- The business is sold
- The business changes status – say from a sole trader to a limited company
- The business ceased to make taxable supplies.

Voluntary deregistration is possible where a business is expected to make taxable supplies in the next 12 months of less than £80,000. If HM Revenue & Customs does not accept your request to cancel your VAT registration, you will have to continue charging and accounting for VAT.

**VAT is a very involved tax. Rules and regulations change on an almost daily basis, and it can be incredibly difficult to keep up with the current issues.**
These notes are intended for general information only. No responsibility is accepted for any action taken or refrained from in consequence of the contents of these notes. Please contact us for advice before acting.