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UK Value Added Tax (VAT)

VAT registered businesses act as unpaid tax collectors and are required to account promptly and accurately for all the tax revenue collected by them. The UK VAT system is policed by HM Revenue & Customs (HMRC) with heavy penalties for breaches of the legislation.

Ignorance is not an acceptable excuse for not complying with the rules

We highlight below some of the areas you need to consider if you plan to do business with or in the UK. However, it's important to seek specific professional advice appropriate to your circumstances, as it can be a complex area.

What is VAT?

Broadly speaking, a transaction is within the scope of VAT if there is a supply of goods or services by a UK taxable person (individual or business) to either a registered business or directly to a consumer based in the UK.

For the sale of products made in the UK, in some circumstances, even if sales are made to overseas customers, the transaction will fall under the scope of VAT.

There are specific rules around the "place of supply" for telecommunications, broadcasting and electronically supplied services (TBES). See more information on our website here and here.

Inputs & Outputs

Businesses charge VAT on their sales. This is known as output VAT and the sales are referred to as outputs. Similarly, VAT is charged 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 sale on behalf of HMRC and must be regularly paid over to them.

The input VAT on the goods and services *purchased* can be deducted from the amount of output tax owed.

Please note that certain categories of input tax can never be reclaimed, for example business entertainment.

Supplies

Taxable supplies are mainly either standard rated (usually 20%) or zero rated (0%).

In addition there is a reduced rate of 5%, which applies to a small number of specific taxable supplies.

Exempt Supplies

There are certain supplies that are not taxable and these are known as exempt supplies.

There is an important distinction between exempt and zero rated supplies if your business is making:

- Only exempt supplies: you cannot register for VAT and therefore cannot recover any input tax
- Zero rated supplies: you should register for VAT as your supplies are taxable (but at 0%) and recovery of input tax is allowed

When a business makes both exempt and standard rated supplies, it uses the "Partial Exemption Method" to determine how much of the shared VAT on overheads (e.g. rent, administrative staff costs etc.) is to be reclaimed.

Is registration necessary?

If you are a UK resident business, you are required to register for VAT if the value of your taxable supplies exceeds a set annual figure (currently £85,000).

If you are making supplies below the limit you can apply for voluntary registration. This would allow you to reclaim input VAT, which could result in a repayment of VAT if your business was principally making zero rated supplies.

If your business is not UK resident but is making taxable supplies in the country, you may need to register for VAT from the first £1 in sales, as the registration threshold does not apply to traders established outside the UK.

If you have not yet started to make taxable supplies but intend to do so, you can apply for registration in some cases. This way, input tax on start-up expenses can be recovered.

What comes next?

Administration

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. This must be completed within one month of the end of the period it covers (except for those on the annual accounting scheme who have two months – see overleaf).

Businesses that make zero rated supplies and who receive repayments of VAT may find it beneficial to submit monthly returns.

Annual Accounting Scheme

Businesses with expected annual taxable supplies not exceeding £1,350,000 may apply to join the annual accounting scheme where they will make monthly or quarterly payments of VAT but will only have to complete one VAT return at the end of the year.

Record Keeping

It's important that a VAT registered business maintains complete and up to date records. This includes details of all supplies, purchases and expenses. In addition, a VAT account should be maintained. This is a summary of output tax payable and input tax recoverable by the business. These records should be kept for 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. Therefore, from time to time a VAT officer will come and inspect the business records. This is known as a control visit.

The VAT officer will want to ensure that VAT is applied correctly and that the returns and other VAT records are properly written up. That is not to say, however, that you should assume that in the absence of any errors being discovered, your business has been given a clean bill of health.

Offences & Penalties

HMRC have wide powers to penalise businesses that ignore or incorrectly apply the VAT regulations. Penalties can be levied for:

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

Cash Accounting Plan

If your annual turnover is less than £1,350,000 you can account for VAT on the basis of the cash you pay and receive, rather than on an invoice basis.

Retail Plans

There are special plans for retailers, as it can be impractical for retailers to maintain all the records required for a registered trader.

Flat Rate Plan

This is a plan allowing businesses with taxable revenues not exceeding £150,000 and total revenue not exceeding £230,000 to pay VAT as a percentage of their total revenue. Therefore, no specific claims to recover input tax need to be made. The aim of the scheme is to simplify the way small businesses account for VAT, but for some businesses it can also result in a reduction in the amount of VAT payable.

Is the UK VAT regime more favourable than elsewhere?

VAT is fundamentally the same in any territory in Europe, in that so long as you are in a standard rated industry with full entitlement to reclaim your input VAT, then any VAT charged to your business in the course of its trading activity should be recoverable.

However, the UK VAT system has the benefit of being one of the oldest, most transparent and therefore robust VAT environments in Europe. The rate of 20% is one of the lowest within the EC territories too.

UK VAT just got digital

Making Tax Digital for VAT (MTDfV) is now law and digital VAT returns will be required in the UK from 1 April 2019. MTDfV is the first phase of the HMRC landmark Making Tax Digital (MTD) regime, which will ultimately require taxpayers to move to a fully digital tax system. HMRC hope that keeping records digitally will result in more timely and accurate recordkeeping, helping to prevent errors associated with manual processes.

What's new?

Under the new rules, businesses with revenue above the VAT threshold (currently £85,000) must keep digital records for VAT purposes and provide their VAT return information to HMRC using compatible software. Software providers are currently working with HMRC to ensure their software meets the MTD filing requirements.

The new rules have effect from 1 April 2019, where a taxpayer has a 'prescribed accounting period' which begins on or after that date.

HMRC is piloting MTDfV during 2018, ahead of its introduction in April 2019. Keeping digital records and making quarterly updates will not be mandatory for taxes other than VAT before April 2020, although businesses below the VAT threshold which have voluntarily registered for VAT can opt in.

How we can help

Ensuring that you comply with all the VAT regulations is essential. We can assist you in a number of ways including:

- tailoring your accounting systems to bring together the VAT information accurately and quickly
- ensuring your business is VAT efficient and adequate finance is available to meet your VAT liability on time
- providing assistance with the completion of VAT returns
- negotiating with HMRC in reaching settlements if disagreements arise
- advising as to whether any of the available plans may be appropriate for you

Updated April 2018. The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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