→ Reference Material

Indirect tax

Introduction

- VAT is an indirect tax, which means that the consumer pays a tax levied on a good or service, which the supplier then collects and pays this to HMRC. Income tax is a direct tax as it is charged directly on an individual through their wages.
- VAT is charged by 'taxable persons'; businesses that are or should be registered for VAT. It is collected on behalf of HMRC by the registered businesses.
- Registered businesses charge VAT on sales of most goods or services: output tax
- VAT is also paid on most purchases: input tax. This can be claimed back by registered businesses.
- The VAT is ultimately paid by the final consumer: non-taxable persons.

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Example
A registered business has charged VAT of £3,500 on sales for the last quarter. The same business has paid VAT of £1,800. How much VAT should be payable to or due from HMRC for the quarter?
Output tax £ 3500 Input tax (1800) 1700 Payable to HMRC

Example
During the last quarter a registered business has charged output tax of £4,600. During the same quarter input tax of £5,700 was also paid. How much VAT is payable to or due from HMRC for this quarter?
Output tax £ 4600 → charged on sales Input tax (5700) → paid on purchases (1100) due from HMRC.

Different VAT schemes

There are a variety of VAT schemes that HMRC have designed. Some are to help specific trades, and others to help with the administration burden.

Standard VAT scheme

- This is the scheme which is used by the majority of businesses. This was demonstrated in the example above whereby businesses charge 20% VAT on their sales and can then reclaim any VAT paid on their purchases.
- A VAT return is then completed quarterly and filed electronically. If the VAT charged on sales exceeds the VAT charged on purchases then there will be an amount due to HMRC. If the amount charged on sales is less than the amount paid on purchases then there will be a refund due from HMRC.
- The VAT return must be submitted to HMRC within one month and seven days after the end of the return period.
- Payment for the period must be made electronically and clear HMRC's bank account within the same period. Direct debit payments are taken three working days after this deadline and would therefore be the latest possible payment date.

4 returns per year.

e.g 1

e.g 2

e.g. Qtr end 31 Jan 2013 → Return + payment - HMRC must be by 7th March

10th March

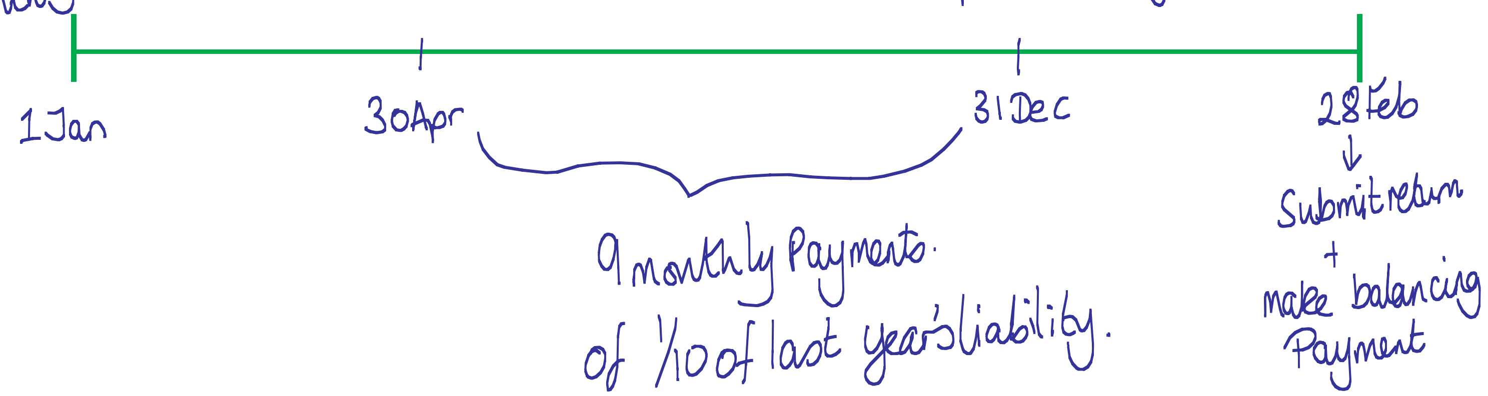
Annual accounting scheme

time!

- This scheme is aimed at smaller businesses and is designed to help reduce the administration burden to a business as only one annual VAT return is required to be completed.
- Regular payments on account - VAT is paid throughout the year in nine monthly or three quarterly installments. This can also help to smooth out the cash flow of a business.

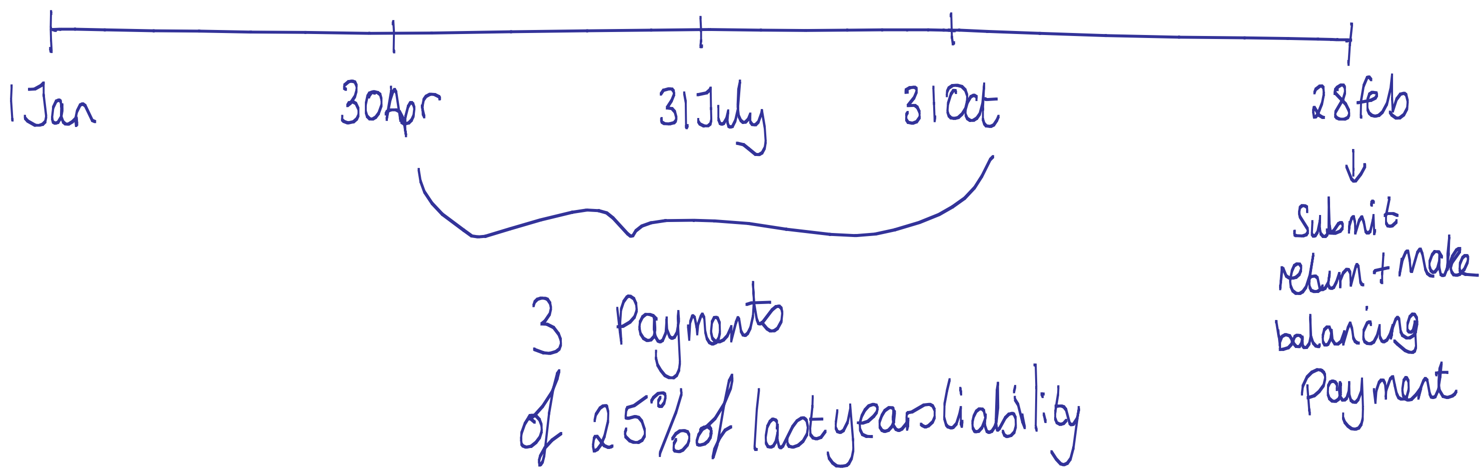
Monthly payments

Timeline to show the installment payment options: → Annual return period ending 31 December



Quarterly Payments

Timeline - Installment payment options → Annual return ends 31 December



How do HMRC decide how much VAT is due on the installments due?

The installments are based on last year's VAT liability or if you have been trading for less than a year the VAT due would be based on an estimate of your VAT liability.

Monthly payments – 1/10 of last year's liability.

Quarterly payments – 25% of last year's liability.

If new Business – Estimate liability

If at the end of the year you have underpaid on your VAT then a balancing payment is made to HMRC. If you have overpaid then a refund would be due from HMRC.

Who can join the scheme?

The first criteria is that the business must be up to date with their VAT returns

- Traders with taxable turnover of up to £1 350 000
- Must leave the scheme expected to exceed £1 600 000 for next 12 months.
- This scheme can also be used in conjunction with the Cash accounting Scheme / Flat rate Scheme — Can't use both

Disadvantages of the scheme

This scheme would not be suitable for businesses that would regularly reclaim VAT from HMRC as they would only get one repayment at the end of the year.

A further downside to the scheme is that if your turnover is decreasing year on year, and the installments are based on last year's liability, then the payments may be higher than if the business were to use the standard scheme.

Advantages of the Scheme.

- 1 VAT return instead of 4 quarterly returns under the Standard Scheme.
- 2 months at end of year to submit return and pay balance due.
- fixed payments - easier budgeting
- Can make extra payments when you choose to.

Cash Accounting Scheme

This scheme enables a business to account for VAT on the basis of payments made and received rather than on the tax point of invoices received and issued.

If using this scheme the business will continue to issue tax invoices, but will also have to maintain:

- tax points for payments in cash
- cash book summarising payments made and received with a separate column outlining the data required for the VAT return.

Who can join the scheme?

The first criteria is that the business must be up to date with their VAT returns

- Traders with taxable turnover of up to £1350 000
- Must leave the scheme when turnover expected to exceed £1600000
- This scheme can also be used in conjunction with the Annual accounting Scheme.

Advantages

- This scheme can help ease cash flow, as payments are not made to HMRC until they are received from the customer. This can be extremely beneficial if your customers are slow to pay.
- Automatic bad debt relief: the VAT is not paid to HMRC until received from the customer; therefore it is not paid to HMRC if it is not received.

Disadvantages

→ Receive Cash at point of Sale

- It is not suitable for businesses with mainly cash sales or zero rated sales, as the VAT cannot be recovered from HMRC until the supplier has been paid. This delays the recovery of input VAT for these traders.

→ Credit basis

due a refund from HMRC

- It is not suitable for businesses with mainly zero rated sales. — Charges VAT at 0%
- Input tax cannot be reclaimed until supplier has been paid – again delaying the recovery of input VAT.

Example	
Which of these businesses would benefit from joining the cash accounting scheme?	
Business description	**Yes/no**
Lynne's bakery makes cakes which it sells to small shops on a cash basis – this is a zero rated activity.	No – Delaying recovery of Input VAT
Sara owns a high street shop which sells directly to the public. All sales are standards rated.	No – Receive Cash immediately – Pay VAT to HMRC Goods bought on Credit → Won't reclaim Until Supplier pay
CP Ltd is a company which manufactures toys and sells onto retail stores. Credit terms of 3 months are given. Last year CP Ltd had bad debts of £60,000.	Yes

Flat rate scheme

- This scheme is designed for small businesses to help them reduce the amount of time they spend accounting for VAT.
- Under this scheme, VAT is still charged and invoices issued at the appropriate rate of VAT, for example standard rated goods are included at 20% on the invoice.
- Input tax would still be paid to suppliers in the normal way based on their invoice values.
- The business operating the flat rate scheme does not need to account for each output or input tax transaction; the business simply pays a set percentage of their turnover directly to HMRC as their VAT liability.

Example

The flat rate percentage for retailers of food and newspapers is 3.5%, and a shop makes total taxable supplies of £47,000.

What would the VAT liability be?

% linked to trade

£	
47000	taxable turnover
9400	add VAT at 20%
56400	Turnover for flat rate Calculation

3.5% x £56400 = £1974 due to HMRC

Who can join the scheme?

- Annual taxable turnover of ...Not more than £150 000 - VAT exclusive figure
- Must leave the scheme when ...turnover exceeds £230 000

Advantages

- **Simplified VAT return** – records do not need to be kept on each individual sale/purchase. Less chance of making a mistake calculating the VAT due.
- **Reduced administration burden –** do not need to make decisions about which input tax can/cannot be reclaimed from HMRC.
- **Easier budgeting –** easier to determine amounts due to HMRC as a fixed % of turnover is paid as VAT.

Disadvantages

- **Repayment businesses would not benefit -** as they would not receive any repayments under this scheme only pay a % of all turnover over to HMRC.

Tax points – When the transaction will hit VAT return.

How does a business determine which tax point to use?

The time of supply, often referred to as the tax point, is the date when a transaction takes place for VAT purposes. This date is not necessarily the date the supply physically takes place. Once the tax point is created, the date then dictates which VAT return the transaction is included within.

Basic tax point

For a business that provides goods, this is usually the date which:

- the supplier sends the goods to the customer or
- the customer collects the goods or
- the goods are made available for use by the supplier.

For a business that provides a service, the basic tax point is:

- the date on which the services are performed – this is normally taken as the date on which services are completed.

Unless:

1. the cash is received earlier
2. the invoice is produced within 14 days of supply of the goods and services.

Actual tax point

The actual tax point can be created before or after the basic tax point.

Actual tax point – advance payments

If a customer pays a deposit for goods (for example, if a customer buys a sofa for £1,000 and £200 is paid up front, and a tax invoice is issued by the supplier) then the actual tax point for the deposit becomes the date the payment was received in advance of the goods being supplied. This is before the basic tax point which is usually when the goods are provided.

Actual tax point ← Basic Tax point → Actual tax point

£200
- Cash Received A
- Invoice issued

Override Basic tax point.

- Goods supplied
- services supplied.

B £800
- Invoice Provided within 14 days.

Override Basic tax point.

Can be extended with authority from HMRC

A beats B

Actual tax point – 14 day rule

If a business issues a VAT invoice up to 14 days after the basic tax point the date of invoice becomes the actual tax point.

Completing the sofa example started above; if the sofa is delivered and a tax invoice is issued 13 days after delivery then the date of the invoice would become the Actual tax point for the remaining £800.

This rule can be varied (with written approval from HMRC)

Example			
Show the actual tax point for the following transactions			
Delivery date	**Payment received**	**Invoice issued**	**Tax point**
10 September Basic	30 September ~~X~~	20 September within 14 days	20 Sept
20 March	8 March	23 March	8 March.
23 October Basic	15 November X	30 October within 14 days	30 Oct
21 November Basic	28 December	10 December	21 November.

19 days after delivery.