



Accounting Qualification

Indirect Tax (IDRX) Reference material

Finance Act 2016 – for assessment 1 January – 31 December 2018

The Association of Accounting Technicians

Reference material for AAT assessment of Indirect Tax

Introduction

This document comprises data that you may need to consult during your Indirect Tax computer-based assessment.

The material can be consulted during the sample and live assessments through pop-up windows. It is made available here so you can familiarise yourself with the content before the test.

Do not take a print of this document into the exam room with you*.

This document may be changed to reflect periodical updates in the computer-based assessment, so please check you have the most recent version while studying. This version is based on Finance Act 2016 and is for use in AAT assessments 1 January – 31 December 2017.

*Unless you need a printed version as part of reasonable adjustments for particular needs, in which case you must discuss this with your tutor at least six weeks before the assessment date.

Contents	Page
Introduction to VAT	3
Rates of VAT	4
Registration and deregistration	6
Keeping business records and VAT records	8
Exempt and partly-exempt businesses	10
Place of supply	11
Tax points	12
VAT invoices	14
Entertainment expenses	18
Vehicles and motoring expenses	19
Transactions outside the UK	20
Bad debts	21
Completing the online VAT Return, box by box	22
VAT periods, submitting returns and paying VAT	24
Special accounting schemes	25
Errors in previous VAT Returns	28
Surcharges, penalties and assessments	29
Finding out more information about VAT	30
Visits by VAT officers	31

Introduction to VAT

VAT is a tax that's charged on most goods and services that VAT-registered businesses provide in the UK. It's also charged on goods and some services that are imported from countries outside the European Union (EU), and brought into the UK from other EU countries.

VAT is charged when a VAT-registered business sells taxable goods and services to either another business or to a non-business customer. This is called output tax.

When a VAT-registered business buys taxable goods or services for business use it can generally reclaim the VAT it has paid. This is called input tax.

Her Majesty's Revenue and Customs (HMRC) is the government department responsible for operating the VAT system. Payments of VAT collected are made by VAT-registered businesses to HMRC.

Rates of VAT

There are three rates of VAT, depending on the goods or services the business provides. The rates are:

- standard – 20%. The standard-rate VAT fraction for calculating the VAT element of a gross supply is 20/120 or 1/6
- reduced – 5%.
- zero – 0%

There are also some goods and services that are:

- exempt from VAT
- outside the scope of VAT (outside the UK VAT system altogether)

Taxable supplies

Zero-rated goods and services count as taxable supplies and are part of taxable turnover, but no VAT is added to the selling price because the VAT rate is 0%.

If the business sells goods and services that are exempt, no VAT is added as they're not taxable supplies and they're also not taxable turnover.

Generally, a business can't register for VAT or reclaim the VAT on purchases if it only sells exempt goods and services. Where some of its supplies are of exempt goods and services, the business is referred to as partially exempt. It may not be able to reclaim the VAT on all of its purchases.

A business which buys and sells only - or mainly - zero-rated goods or services can apply to HMRC to be exempt from registering for VAT. This could make sense if the business pays little or no VAT on purchases.

Taxable turnover

Taxable turnover consists of standard-rated sales plus all reduced-rated and zero-rated sales but excludes the VAT on those sales, exempt sales and out-of-scope sales. If one VAT-registered business acquires another business it immediately absorbs the turnover of that business, whether the acquired business is registered for VAT or not. All VAT decisions must thereafter be made based on the combined turnover.

Change in VAT rate

Generally a business must use the VAT rate applicable from the time of the legislative change, unless payment has already been received or the goods have already been delivered. In these cases a tax point has already been created and the rate applicable will have been set by the tax point.

An exception arises where the goods have been delivered, or otherwise removed by the customer, the supplier has elected to follow the 14-day rule for issuing VAT invoices and the VAT rate increases between the date of delivery of the goods and the issuing of the invoice. In this case it is the new VAT rate which applies.

Immediately after the rate change a business may opt to honour supplies of goods and services at the rate which applied when the contract to supply was agreed, however output tax is still accountable at the new rate.

If the business offers a prompt payment discount and opts to issue a credit note to cover the reduction in payment made by the customer then a change in VAT rate which occurs between the

issue of the original invoice and final payment will not be affected by the change in VAT rate. The rate due on the credit note, issued to account for the reduced payment made, will be fixed by the tax point of the original invoice.

Registration and deregistration

Registration threshold

If, as at the end of any month, taxable turnover for the previous 12 months is more than the current registration threshold of £83,000, the business must register for VAT within 30 days. Registration without delay is required if, at any time, the value of taxable turnover in the next 30 day period alone is expected to be more than the registration threshold.

A business which has trading that temporarily takes it above the VAT threshold of £83,000 but which expects turnover to drop back below the threshold almost immediately can apply to stay unregistered, but the business must be able to prove to HMRC that the momentary increase is a true one-off occurrence.

If trading is below the registration threshold

If taxable turnover hasn't crossed the registration threshold, the business can still apply to register for VAT voluntarily.

Deregistration threshold

The deregistration threshold is £81,000. If taxable turnover for the previous 12 months is less than or equal to £81,000, or if it is expected to fall to £81,000 or less in the next 12 months, the business can either:

- voluntarily remain registered for VAT, or
- ask HMRC for its VAT registration to be cancelled

Failure to register

A business which fails to register when it is required to do so may face a civil penalty. More importantly HMRC will treat the business as though it had registered on time and will expect VAT to be accounted for as if it had been charged. The business has two choices in respect of this VAT, which it has not included in its invoices.

It may either:

- Allow HMRC to treat the invoices as VAT inclusive and absorb the VAT which should have been charged, OR
- Account for VAT as an addition to the charges already invoiced and attempt to recover this VAT from its customers.

Cancellation of VAT registration

A registration must be cancelled if the business is closed down or ceases to make taxable supplies.

If a business is being taken over by a business with a completely different structure, for example an unincorporated business being taken over by an incorporated business or vice versa, the original registration must be cancelled. It will either be replaced by a new registration for the new business, or be subsumed into the registration of the expanded business. In some circumstances the new business may apply for the registration of the business being taken over to be re-allocated to the new business. This may happen because two businesses merge and only one is currently registered. Re-allocation of the existing registration may be the most appropriate method of dealing with VAT registration.

Changes to the VAT registration

Some business changes will necessitate a change in details of the VAT registration, such as a change in the trading name or the address of the business. Other reasons for changes to the registration are a change in main business activities, particularly if this means a significant change to the types of supply, and changes to the business bank account details.

Failure to notify HMRC of changes which either cancel or change registration within 30 days of the relevant change may render the business and its owners liable to a civil penalty.

Keeping business records and VAT records

All VAT-registered businesses must keep certain business and VAT records.

These records are not required to be kept in a set way, provided they:

- are complete and up to date
- allow the correct amount of VAT owed to HMRC or by HMRC to be worked out
- are easily accessible when an HMRC visit takes place, eg the figures used to fill in the VAT Return must be easy to find

Business records

Business records which must be kept include the following:

- annual accounts, including statements of profit or loss
- bank statements and paying-in slips
- cash books and other account books
- orders and delivery notes
- purchases and sales day books
- records of daily takings such as till rolls
- relevant business correspondence

VAT records

In addition to these business records, VAT records must be kept.

In general, the business must keep the following VAT records:

- Records of all the standard-rated, reduced-rated, zero-rated and exempt goods and services that are bought and sold.
- Copies of all sales invoices issued. However, businesses do not have to keep copies of any less detailed (simplified) VAT invoices for items under £250 including VAT
- All purchase invoices for items purchased for business purposes unless the gross value of the supply is £25 or less and the purchase was from a coin-operated telephone or vending machine, or for car parking charges or tolls.
- All credit notes and debit notes received.
- Copies of all credit notes and debit notes issued.
- Records of any goods or services bought for which there is no VAT reclaim, such as business entertainment.
- Records of any goods exported.
- Any adjustments, such as corrections to the accounts or amended VAT invoices.

Generally all business records that are relevant for VAT must be kept for at least six years. If this causes serious problems in terms of storage or costs, then HMRC may allow some records to be kept for a shorter period. Records may be stored digitally especially if that is needed to overcome storage and access difficulties.

Keeping a VAT account

A VAT account is the separate record that must be kept of the VAT charged on taxable sales (referred to as output tax or VAT payable) and the VAT paid on purchases (called input tax or VAT reclaimable). It provides the link between the business records and the VAT Return. A VAT-registered business needs to add up the VAT in the sales and purchases records and then transfer these totals to the VAT account, using separate headings for VAT payable and VAT reclaimable.

The VAT account can be kept in whatever way suits the business best, as long as it includes information about the VAT that it:

- owes on sales, including when fuel scale charges are used
- owes on acquisitions from other European Union (EU) countries
- owes following a correction or error adjustment
- can reclaim on business purchases
- can reclaim on acquisitions from other EU countries
- can reclaim following a correction or error adjustment
- is reclaiming via VAT bad debt relief

The business must also keep records of any adjustments that have been made, such as balancing payments for the annual accounting scheme for VAT.

Information from the VAT account can be used to complete the VAT Return at the end of each accounting period. VAT reclaimable is subtracted from the VAT payable, to give the net amount of VAT to pay to or reclaim from HMRC.

Unless it is using the cash accounting scheme, a business:

- must pay the VAT charged on invoices to customers during the accounting period that relates to the return, even if those customers have not paid the invoices
- may reclaim the VAT charged on invoices from suppliers during the accounting period that relates to the return, even if it has not paid the invoices.

Exempt and partly-exempt businesses

Exempt goods and services

There are some goods and services on which VAT is not charged.

Exempt supplies are not taxable for VAT, so sales of exempt goods and services are not included in taxable turnover for VAT purposes. If a registered business buys exempt items, there is no VAT to reclaim.

(This is different to zero-rated supplies. In both cases VAT is not added to the selling price, but zero-rated goods or services are taxable for VAT at 0%, and are included in taxable turnover.)

Businesses which only sell or supply exempt goods or services

A business which only supplies goods or services that are exempt from VAT is called an exempt business. It cannot register for VAT, so it won't be able to reclaim any input tax on business purchases.

(Again this is different to zero-rated supplies, as a business can reclaim the input tax on any purchases that relate to zero-rated sales. In addition, a business which sells mainly or only zero-rated items may apply for an exemption from VAT registration, but then it can't claim back any input tax.)

Reclaiming VAT in a partly-exempt business

A business that is registered for VAT but that makes some exempt supplies is referred to as partly, or partially, exempt.

Generally, such businesses won't be able to reclaim the input tax paid on purchases that relate to exempt supplies.

However if the amount of input tax incurred relating to exempt supplies is below a minimum 'de minimus' amount, input tax can be reclaimed in full.

If the amount of input tax incurred relating to exempt supplies is above the 'de minimus' amount, only the part of the input tax that related to non-exempt supplies can be reclaimed.

Place of supply

Businesses which make supplies of goods and services to other member states of the EU or to countries outside the EU, or which receive goods and services from other member states of the EU or from countries outside the EU, must apply the “place of supply” rules for both goods and services. Place of supply is important because it drives the amount of VAT, if any, which is to be added to the cost of the services, and the manner in which any VAT is accounted for.

The place of supply is the place, or country, where the supply is made.

The following rules apply to a supplier based in the UK, with no alternative location elsewhere in the EU or outside the EU.

Supplies and receipts of goods

The place of supply for goods is always the country where the goods originate. This applies whether the goods are for the enjoyment of a business customer or a domestic customer.

Supplies and receipts of services

Supplies of services are covered by the “Place of supply of services order” or POSSO. Here the place of supply can be different depending on who the customer is, and whether the supply of services is within, or outside, the EU.

When the customer is a business customer the place of supply is where the customer is.

Should the customer be either:

- a non-business,
- an unregistered business, or
- a registered business, but the supply is of a non-business nature

then the place of supply is the country where the supplier is, irrespective of where the customer is.

Tax points

The time of supply, known 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.

Generally, a registered business must pay or reclaim VAT in the (usually quarterly) VAT period, or tax period, in which the time of supply occurs, and it must use the correct rate of VAT in force on that date. This means knowing the time of supply/tax point for every transaction is important, as it must be put on the right VAT Return.

Time of supply (tax point) for goods and services

The time of supply for VAT purposes is defined as follows.

- For transactions where no VAT invoice is issued, the time of supply is normally the date the supply takes place (as defined below).
- For transactions where there is a VAT invoice, the time of supply is normally the date the invoice is issued, even if this is after the date the supply took place (as defined below).

To issue a VAT invoice, it must be sent (by post, email etc) or given to the customer for them to keep. A tax point cannot be created simply by preparing an invoice.

However there are exceptions to these rules on time of supply, detailed below.

Date the supply takes place

For goods, the time when the goods are considered to be supplied for VAT purposes is the date when one of the following happens.

- The supplier sends the goods to the customer.
- The customer collects the goods from the supplier.
- The goods (which are not either sent or collected) are made available for the customer to use, for example if the supplier is assembling something on the customer's premises.

For services, the date when the services are supplied for VAT purposes is the date when the service is carried out and all the work - except invoicing - is finished.

Exceptions regarding time of supply (tax point)

The above general principles for working out the time of supply do not apply in the following situations.

- For transactions where a VAT invoice is issued, or payment is received, in advance of the date of supply, the time of supply is the date the invoice is issued or the payment is received, whichever is the earlier.
- If the supplier receives full payment before the date when the supply takes place and no VAT invoice has yet been issued, the time of supply is the date the payment is received.
- If the supplier receives part-payment before the date when the supply takes place, the time of supply becomes the date the part-payment is received but only for the amount of the part-payment (assuming no VAT invoice has been issued before this date - in which case the time of supply is the date the invoice is issued). The time of supply for the remainder will follow the normal rules - and might fall in a different VAT period, and so have to go onto a different VAT Return.

- If the supplier issues a VAT invoice more than 14 days after the date when the supply took place, the time of supply will be the date the supply took place, and not the date the invoice is issued. However, if a supplier has genuine commercial difficulties in invoicing within 14 days of the supply taking place, they can contact HMRC to ask for permission to issue invoices later than 14 days and move the time of supply to this later date.
- Where services are being supplied on a continuous basis over a period in excess of a month but invoices are being issued regularly throughout the period. A tax point is created every time an invoice is issued or a payment is made, whichever happens first. A business may issue invoices for a whole 12 month period but only if it is known that payments will be made regularly.
- Goods supplied to a customer on a sale or return basis remain the property of the supplier until the customer indicates they are intending to keep them. If a time limit has been fixed for the sale or return the tax point is:
 - Where the fixed period is 12 months or less – the date the time limit expires
 - Where the fixed period is more than 12 months, or there is no fixed period – 12 months from the date the goods were sent
 - Where the customer adopts the goods before the fixed period has expired – the date the goods are adopted.

A payment made, which is not returnable, normally indicates that the goods have been adopted, however the receipt of a deposit which is repayable if the goods are returned is not an indication of adoption.

VAT invoices

To whom is a VAT invoice issued?

Whenever a VAT-registered business supplies taxable goods or services to another VAT-registered business, it must give the customer a VAT invoice.

A VAT-registered business is not required to issue a VAT invoice to a non-registered business or to a member of the public, but it must do so if requested.

What is a VAT invoice?

A VAT invoice shows certain VAT details of a supply of goods or services. It can be either in paper or electronic form. An electronic invoice (e-invoice) is only valid if it is in a secure format, for example a "pdf".

A VAT-registered customer must have a valid VAT invoice from the supplier in order to claim back the VAT they have paid on the purchase for their business.

What is NOT a VAT invoice?

The following are NOT VAT invoices:

- pro-forma invoices
- invoices for only zero-rated or exempt supplies
- invoices that state 'this is not a VAT invoice'
- statements of account
- delivery notes
- orders
- letters, emails or other correspondence

A registered business cannot reclaim the VAT it has paid on a purchase by using these documents as proof of payment.

What a VAT invoice must show

A VAT invoice must show:

- an invoice number which is unique and follows on from the number of the previous invoice - any spoiled or cancelled serially numbered invoice must be kept to show to a VAT officer at the next VAT inspection
- the seller's name or trading name, and address
- the seller's VAT registration number
- the invoice date
- the time of supply or tax point if this is different from the invoice date
- the customer's name or trading name, and address
- a description sufficient to identify the goods or services supplied to the customer

For each different type of item listed on the invoice, the business must show:

- the unit price or rate, excluding VAT
- the quantity of goods or the extent of the services
- the rate of VAT that applies to what is being sold
- the total amount payable, excluding VAT
- the rate of any cash or settlement discount
- the total amount of VAT charged

If the business issues a VAT invoice that includes zero-rated or exempt goods or services, it must:

- show clearly that there is no VAT payable on those goods or services
- show the total of those values separately

Where a prompt payment discount (PPD) is offered VAT must be accounted for to HMRC on the actual consideration received. The business must decide how to express this on the invoice. It may:

- invoice at the discounted value with VAT on that amount and then issue an additional invoice for the discount plus VAT at the point it becomes clear the customer will not take the discount by paying within the prompt payment period, OR
- invoice for the full value with VAT on that amount and then issue a credit note for the discount plus VAT should the customer pay the discounted value within the prompt payment period, OR
- invoice for the full value of the supply and associated VAT but provide information to the customer which allows it to determine how much to pay if they make payment within the prompt payment discount period. This information must include details of the input tax which they are permitted to recover depending on when they make payment. A warning should be included to the customer that failure to account for the correct amount of VAT is an offence.

Rounding on VAT invoices

The total VAT payable on all goods and services shown on a VAT invoice may be rounded to a whole penny. Any fraction of a penny can be ignored. (This concession is not available to retailers.)

Time limits for issuing VAT invoices

There is a strict time limit on issuing VAT invoices. Normally a VAT invoice to a VAT-registered customer must be issued within 30 days of the basic tax point, which is either the date of supply of the goods or services, subject to the 14 day rule or, if the business was paid in advance, the date payment was received. This is so the customer can claim back the VAT on the supply, if they are entitled to do so.

The 30 day limit for goods starts with the day the goods are sent to the customer or taken by the customer or made available to the customer.

Invoices cannot be issued any later without permission from HMRC, except in a few limited circumstances.

A valid VAT invoice is needed to reclaim VAT

Even if a business is registered for VAT, it can normally only reclaim VAT on purchases if:

- they are for use in the business or for business purposes and
- a valid VAT invoice for the purchase is received and retained*.

*Subject to the rules for VAT invoices for supplies of £250 or less including VAT and for supplies of £25 including VAT or less:

- A simplified invoice for supplies of £250 or less is acceptable as a “valid VAT invoice” for input tax reclaim.
- Supplies of £25 or less including VAT, supported by a simple till receipt, can be assumed to be acceptable as a “valid VAT invoice” for input tax reclaim as long as the business has a reasonable understanding that the supplier is VAT registered.

Only VAT-registered businesses can issue valid VAT invoices. A business cannot reclaim VAT on any goods or services that are purchased from a business that is not VAT-registered.

Where simplified (less detailed) VAT invoices can be issued

Simplified VAT invoices

If a VAT-registered business makes taxable supplies of goods or services for £250 or less including VAT, then it can issue a simplified (less detailed) VAT invoice that only needs to show:

- the seller's name and address
- the seller's VAT registration number
- the time of supply (tax point)
- a description of the goods or services
- the total payable including VAT

If the supply includes items at different VAT rates then, for each different VAT rate, the simplified VAT invoice must also show the VAT rate applicable to the item(s).

Exempt supplies must not be included on a simplified VAT invoice.

There is no requirement for the business making the supply to keep copies of any less detailed invoices it has issued.

Pro-forma invoices

If there is a need to issue a sales document for goods or services not supplied yet, the business can issue a 'pro-forma' invoice or a similar document as part of the offer to supply goods or services to customers.

A pro-forma invoice is not a VAT invoice, and it should be clearly marked with the words "This is not a VAT invoice".

If a potential customer accepts the goods or services offered to them and these are actually supplied, then a VAT invoice must be issued within the appropriate time limit if appropriate.

If the business has been issued with a pro-forma invoice by a supplier it cannot be used to claim back VAT on the purchase. A VAT invoice must be obtained from the supplier.

Advance payments or deposits

An advance payment, or deposit, is a proportion of the total selling price that a customer pays before they are supplied with goods or services. When a business asks for an advance payment or deposit, the tax point is whichever of the following happens first:

- the date a VAT invoice is issued for the advance payment
- the date the advance payment is received

The business must include the VAT on the advance payment or deposit on the VAT Return for the period when the tax point occurs.

If the customer pays any remaining balance before the goods are delivered or the services are performed, another tax point is created when whichever of the following happens first:

- a VAT invoice is issued for the balance
- payment of the balance is received

The VAT on the balance must be included on the VAT Return for the period when the tax point occurs.

VAT does not have to be accounted for if a deposit is either:

- Refunded to the customer in full when they return goods safely, or
- Kept by you as compensation for loss of or damage to the goods.

Discounts on goods and services

If any goods or services supplied by a VAT-registered business are subject to a trade, bulk or other form of discount, VAT is charged on the VAT invoice on the discounted price rather than the full price.

Returned goods, credit notes, debit notes and VAT

For a buyer who has received a VAT invoice

If goods are returned to the seller for full or partial credit there are three options:

- return the invoice to the supplier and obtain a replacement invoice showing the proper amount of VAT due, if any
- obtain a credit note from the supplier
- issue a debit note to the supplier

If the buyer issues a debit note or receives a credit note, it must:

- record this in the accounting records
- enter it on the next VAT Return, deducting the VAT on the credit or debit note from the amount of VAT which can be reclaimed

For a seller who has issued a VAT invoice

If goods are returned by a customer, there are again three options:

- cancel and recover the original invoice, and issue a replacement showing the correct amount of any VAT due, if any
- issue a credit note to the customer
- obtain a debit note from the customer

If the seller issues a credit note or receives a debit note, it must:

- record this in the accounting records
- enter it on the next VAT Return, deducting the VAT on the credit or debit note from the amount of VAT payable

Entertainment expenses

Business entertainment

Business entertainment is any form of free or subsidised entertainment or hospitality to non-employees, for example suppliers and customers. Generally a business cannot reclaim input tax on business entertainment expenses. The exception is that input tax can be reclaimed in respect of entertaining overseas customers, but not UK or Isle of Man customers.

Employee expenses and entertainment

The business can, however, reclaim VAT on employee expenses and employee entertainment expenses if those expenses relate to travel and subsistence or where the entertainment applies only to employees.

When the entertainment is in respect of a mixed group of both employees and non-employees (eg customers and/or suppliers), the business can only reclaim VAT on the proportion of the expenses that is for employees and on the proportion for overseas customers.

Vehicles and motoring expenses

VAT and vehicles

When it buys a car a registered business generally cannot reclaim the VAT. There are some exceptions - for example, when the car is used mainly as one of the following:

- a taxi
- for driving instruction
- for self-drive hire

If the VAT on the original purchase price of a car bought new is not reclaimed, the business does not have to charge any VAT when it is sold. This is because the sale of the car is exempt for VAT purposes. If the business did reclaim the VAT when it bought the car new, VAT is chargeable when it comes to sell it.

VAT-registered businesses can generally reclaim the VAT when they buy a commercial vehicle such as a van, lorry or tractor.

Reclaiming VAT on road fuel

If the business pays for road fuel, it can deal with the VAT charged on the fuel in one of four ways:

- Reclaim all of the VAT. All of the fuel must be used only for business purposes.
- Reclaim all of the VAT and pay the appropriate fuel scale charge - this is a way of accounting for output tax on fuel that the business buys but that is then used for private motoring.
- Reclaim only the VAT that relates to fuel used for business mileage. Detailed records of business and private mileage must be kept.
- Do not reclaim any VAT. This can be a useful option if mileage is low and also if fuel is used for both business and private motoring. If the business chooses this option it must apply it to all vehicles, including commercial vehicles.

Transactions outside the UK

Exports, despatches and supplying goods abroad: charging VAT

If a business sells, supplies or transfers goods out of the UK to someone in another country it may need to charge VAT on them.

VAT on exports of goods to non-EU countries

Generally speaking, the business can zero-rate supplies exported outside the EU, provided it follows strict rules, obtains and keeps the necessary evidence, and obeys all laws.

The term 'exports' is reserved to describe sales to a country outside the EU. Goods supplied to another EU member state are technically known as despatches rather than exports.

VAT on despatches of goods to someone who is not VAT registered in another EU member state

When a business supplies goods to someone in another EU member state, and they are not registered for VAT in that country, it should normally charge VAT.

VAT on despatches of goods to someone who is VAT registered in another EU member state

If, however, goods are supplied to someone who is registered for VAT in the destination EU member state, the business can zero-rate the supply for VAT purposes, provided it meets certain conditions.

Imports, acquisitions and purchasing goods from abroad: paying and reclaiming VAT

Generally speaking, VAT is payable on all purchases of goods that are bought from abroad at the same rate that would apply to the goods if bought in the UK. The business must tell HMRC about goods that it imports, and pay any VAT and duty that is due.

VAT on imports of goods from non-EU countries

VAT may be charged on imports of goods bought from non-EU countries. The business can reclaim any VAT paid on the goods imported as input tax.

VAT on goods acquired from EU member states

If a business is registered for VAT in the UK and buys goods from inside the EU, these are known as acquisitions rather than imports. Usually no VAT is charged by the supplier but acquisition tax, at the same rate of VAT that would apply if the goods were supplied in the UK, is due on the acquisition. This is included in Box 2 of the VAT return. It can be reclaimed as input tax in Box 4 of the VAT return as if the goods were bought in the UK.

Bad debts

When a business can reclaim VAT on bad debts

VAT that has been paid to HMRC and which has not been received from the customer can be reclaimed as bad debt relief. The conditions are that:

- the debt is more than six months and less than four years and six months old
- the debt has been written off in the VAT account and transferred to a separate bad debt account
- the debt has not been sold or handed to a factoring company
- the business did not charge more than the normal selling price for the items

Bad debt relief does not apply when the cash accounting scheme is used because the VAT is not paid to HMRC until after the customer has paid it to the supplier.

How to claim bad debt relief

If the business is entitled to claim bad debt relief, add the amount of VAT to be reclaimed to the amount of VAT being reclaimed on purchases (input tax) and put the total figure in Box 4 of the VAT Return.

Effect of a change in the business

If a business closes down, relief for all outstanding bad debts up to and including the date of closure will need to be claimed, if eligible.

Where a business is acquired as a going concern and the acquiring business takes on the VAT registration of the closing business, it may be possible to transfer the outstanding bad debts from the old to the new business.

Completing the online VAT Return, box by box

The online VAT Return is completed as follows;

Box 1 – VAT due in the period on sales and other outputs

- This is the total amount of VAT charged on sales to customers. It also has to include VAT due to HMRC for other reasons, for example fuel scale charges.
- Include VAT due on a supply of services from another member state of the EC, where the supplier has “zero-rated” the supply.

Box 2 – VAT due in the period on acquisitions from other member states of the EC

- VAT due, but not yet paid, on goods bought from other EU member states, and any services directly related to those goods (such as delivery charges). The business may be able to reclaim this amount, and if so it must be included in the total in Box 4.

Box 3 – Total VAT due (the sum of boxes 1 and 2). This is calculated automatically by the online return

Box 4 – VAT reclaimed in the period on purchases and other inputs (including acquisitions from the EC)

- This is the VAT charged on purchases for use in the business. It should also include:
 - VAT paid on imports from countries outside the EC
 - VAT due (but not yet paid) on goods from other EC member states, and any services directly related to those goods (such as delivery charges) - this is the figure in Box 2.
 - VAT due on a supply of services from a supplier in another member state of the EC where that supply has been “zero-rated” by the supplier. This will be the same amount as entered in Box 1 in respect of the same transaction.

Box 5 – Net VAT to be paid to HMRC or reclaimed (Difference between boxes 3 and 4). This is calculated automatically by the online return

Box 6 – Total value of sales and all other outputs excluding any VAT. Include your box 8 figure.

- Enter the total figure for sales (excluding VAT) for the period, that is the sales on which the VAT entered in Box 1 was based. Additionally, also include:
 - any zero-rated and exempt sales or other supplies made
 - any amount entered in Box 8
 - exports to outside the EC.

The net amount of any credit notes issued, or debit notes received, is deducted.

Box 7 – Total value of purchases and all other inputs excluding any VAT. Include your box 9 figure.

- Enter the total figure for purchases (excluding VAT) for the period, that is the purchases on which the VAT entered in Box 4 was based. Additionally, also include:
 - any zero-rated and exempt purchases
 - any amount entered in Box 9
 - imports from outside the EU.

Box 8 – Total value of all supplies of goods and related costs, excluding any VAT, to other EC member states.

- Enter the total value of goods supplied to another EC member state and services related to those goods (such as delivery charges).

Box 9 – Total value of acquisitions of goods and related costs, excluding any VAT, from other EC member states.

- Enter the total value of goods received from VAT registered suppliers in another EC member state and services related to those goods (such as delivery charges).

VAT periods, submitting returns and paying VAT

VAT Returns for transactions to the end of the relevant VAT period must be submitted by the due date shown on the VAT Return. VAT due must also be paid by the due date.

What is a VAT period?

A VAT period is the period of time over which the business records VAT transactions in the VAT account for completion of the VAT Return. The VAT period is three months (a quarter) unless the annual accounting scheme is used. The end dates of a business's four VAT periods are determined when it first registers for VAT, but it can choose to amend the dates on which its VAT periods end. This is often done to match VAT periods to accounting period ends.

Submitting VAT Returns online and paying HMRC electronically

It is mandatory for virtually all VAT-registered traders to submit their VAT Returns to HMRC using online filing, and to pay HMRC electronically.

Due dates for submitting the VAT Return and paying electronically

Businesses are responsible for calculating how much VAT they owe and for paying VAT so that the amount clears to HMRC's bank account on or before the due date. Paying on time avoids having to pay a surcharge for late payment.

The normal due date for submitting each VAT Return and electronically paying HMRC any VAT that is owed is one calendar month after the end of the relevant VAT period, unless the annual accounting scheme is operated. The normal due date for the return and payment can be found on the return.

Online filing and electronic payment mean that businesses get an extended due date for filing the return of seven extra calendar days after the normal due date shown on the VAT Return. This extra seven days also applies to paying HMRC so that the amount has cleared into HMRC's bank account. However this does not apply if the business uses the Annual Accounting Scheme for VAT.

If the business pays HMRC by Direct Debit, HMRC automatically collects payment from the business's bank account three bank working days after the extra seven calendar days following the normal due date.

If the business fails to pay cleared funds into HMRC's bank account by the payment deadline, or fails to have sufficient funds in its account to meet the direct debit, it may be liable to a surcharge for late payment.

Repayment of VAT

If the amount of VAT reclaimed (entered in Box 4) is more than the VAT to be paid (entered in Box 3), then the net VAT value in Box 5 is a repayment due to the business from HMRC.

HMRC is obliged to schedule this sum for repayment automatically, provided checks applied to the VAT Return do not indicate that such a repayment might not be due. There may be circumstances when the business does not receive the repayment automatically, for instance if there is an outstanding debt owed to HMRC.

Special accounting schemes

Annual Accounting Scheme for VAT

Using standard VAT accounting, four VAT Returns each year are required. Any VAT due is payable quarterly, and any VAT refunds due are also receivable quarterly.

Using the normal annual accounting scheme, the business makes nine interim payments at monthly intervals. There is only one VAT Return to complete, at the end of the year, when either a balancing payment is payable or a balancing refund is receivable.

Businesses can start on the annual accounting scheme if their estimated taxable turnover during the next tax year is not more than £1.35 million. Businesses already using the annual accounting scheme can continue to do so until the estimated taxable turnover for the next tax year exceeds £1.6 million. If the business is taken over as a going concern the acquiring business must assess the use of the annual accounting scheme in the context of the expected and combined turnover of the new business, and must immediately cease using the scheme if that is expected to exceed £1.6m.

Whilst using the annual accounting scheme the business may also be able to use either the cash accounting scheme or the flat rate scheme, but not both.

Benefits of annual accounting

- One VAT Return per year, instead of four.
- Two months after the tax period end to complete and send in the annual VAT Return and pay the balance of VAT payable, rather than the usual one month.
- Better management of cash flow by paying a fixed amount in nine instalments.
- Ability to make additional payments as and when required.
- Join from VAT registration day, or at any other time if already registered for VAT.

Disadvantages of annual accounting

- Only one repayment per year, which is not beneficial if the business regularly requires refunds.
- If turnover decreases, interim payments may be higher than the VAT payments would be under standard VAT accounting – again there is a need to wait until the end of the year to receive a refund.

Cash Accounting Scheme for VAT

Using standard VAT accounting, VAT is paid on sales within a VAT period whether or not the customer has paid. VAT is reclaimed on purchases whether or not the business has paid the supplier.

Using cash accounting, VAT is not paid until the customer has paid the invoice. If a customer never pays, the business never has to pay the VAT. VAT is reclaimed on purchases only when the business has paid the invoice.

Cash accounting can be used if the estimated taxable turnover during the next tax year is not more than £1.35 million. A business can continue to use cash accounting until its taxable turnover exceeds £1.6 million.

The cash accounting scheme may be used in conjunction with the annual accounting scheme but not with the flat rate scheme. If the business is taken over as a going concern the acquiring

business must assess the use of the cash accounting scheme in the context of the expected and combined turnover of the new business, and must immediately cease using the scheme if that is expected to exceed £1.6m.

Benefits of cash accounting

Using cash accounting may help cash flow, especially if customers are slow payers. Payment of VAT is not made until the business has received payment from the customer, so if a customer never pays, VAT does not have to be paid on that bad debt as long as the business is using the cash accounting scheme.

Disadvantages of cash accounting

Using cash accounting may adversely affect cash flow:

- The business cannot reclaim VAT on purchases until it has paid for them. This can be a disadvantage if most goods and services are purchased on credit.
- Businesses which regularly reclaim more VAT than they pay will usually receive repayment later under cash accounting than under standard VAT accounting, unless they pay for everything at the time of purchase.
- If a business starts using cash accounting when it starts trading, it will not be able to reclaim VAT on most start-up expenditure, such as initial stock, tools or machinery, until it has actually paid for those items.
- When it leaves the cash accounting scheme the business will have to account for all outstanding VAT due, including on any bad debts.

Flat Rate Scheme for VAT

If its VAT-exclusive taxable turnover is less than £150,000 per year, the business could simplify its VAT accounting by registering on the Flat Rate Scheme and calculating VAT payments as a percentage of its total VAT-inclusive turnover. There is no reclaim of VAT on purchases - this is taken into account in calculating the flat rate percentage that applies to the business.

The flat rate scheme can reduce the time needed in accounting for and working out VAT. Even though the business still needs to show a VAT amount on each VAT invoice issued, it does not need to record how much VAT it charged on every sale in its ledger accounts. Nor does it need to record the VAT paid on every purchase.

Once on the scheme, the business can continue to use it until its total business income exceeds £230,000. If the business is taken over as a going concern the acquiring business must assess the use of the flat rate scheme in the context of the expected and combined turnover of the new business, and must immediately cease using the scheme if that is expected to exceed £230,000. The flat rate scheme may be used in conjunction with the annual accounting scheme but not the cash accounting scheme.

Benefits of using the flat rate scheme

Using the flat rate scheme can save time and smooth cash flow. It offers these benefits:

- No need to record the VAT charged on every sale and purchase, as with standard VAT accounting. This can save time. But although the business only has to pay HMRC a percentage of its turnover, it must still show VAT at the appropriate normal rate (standard, reduced or zero) on the VAT invoices it issues.
- A first year discount. A business in its first year of VAT registration gets a 1% reduction in the applicable flat rate percentage until the day before the first anniversary of VAT registration.

- Fewer rules to follow, for instance no longer having to work out what VAT on purchases can or cannot be reclaimed.
- Peace of mind, less chance of mistakes and fewer worries about getting the VAT right.
- Certainty. The business always knows what percentage of takings has to be paid to HMRC.

Potential disadvantages of using the flat rate scheme

The flat rate percentages are calculated in a way that takes into account zero-rated and exempt sales. They also contain an allowance for the VAT spent on purchases. So the VAT Flat Rate Scheme might not be right for the business if:

- it buys mostly standard-rated items, as there is no reclaim of any VAT on purchases
- it regularly receives a VAT repayment under standard VAT accounting
- it makes a lot of zero-rated or exempt sales.

Errors in previous VAT Returns

Action to be taken at the end of the VAT period

At the end of the VAT period, the business should calculate the net value of all the errors and omissions found during the period that relate to VAT Returns already submitted - that is, any tax which should have been claimed back is subtracted from any additional tax due to HMRC, and any tax that should have been paid is added. Any deliberate errors must not be included - these must be separately declared to HMRC.

What the business should do next depends on whether the net value of all the errors is less than or greater than the 'error correction reporting threshold', which is the greater of:

- £10,000
- 1% of the box 6 figure on the VAT Return for the period when the error was discovered - subject to an upper limit of £50,000

If the net value of all the errors is less than the error reporting threshold then, if preferred, the errors may be corrected by making an adjustment on the current VAT Return (Method 1).

However, if the value of the net VAT error discovered is above this threshold, it must be declared to HMRC separately, in writing (Method 2).

How to adjust the VAT Return: Method 1

Errors from previous VAT Returns can be corrected by adjusting the VAT amounts on the current VAT Return.

At the end of the VAT period when the errors are discovered, the VAT account of output tax due or input tax claimed is adjusted by the net amount of all errors. The VAT account must show the amount of the adjustment being made to the VAT Return.

If more than one error is discovered in the same exercise, the net value of all the errors is used to adjust the VAT liability on the VAT Return.

Either Box 1 or Box 4 is adjusted, as appropriate. For example, if the business discovers that it did not account for VAT payable to HMRC of £100 on a supply made in the past, and also did not account for £60 VAT reclaimable on a purchase, it should add £40 to the Box 1 figure on the current VAT Return.

How to separately declare an error to HMRC: Method 2

For certain errors a separate declaration is required to the relevant HMRC VAT Error Correction Team in writing about the mistake. The simplest way to tell them is to use Form VAT 652 "Notification of Errors in VAT Returns", which is for reporting errors on previous returns, but the business does not have to use Form VAT 652 - it can simply write a letter instead.

Businesses may, if they wish, use this method for errors of any size, even those which are below the error reporting threshold i.e. instead of a Method 1 error correction. Using this method means the business must not make adjustment for the same errors on a later VAT Return.

Method 2 must always be used if the net error exceeds the error reporting threshold or if the errors made on previous returns were made deliberately.

Surcharges, penalties and assessments

Surcharges for missed VAT Return or VAT payment deadlines

VAT-registered businesses must submit a VAT Return and pay any VAT by the relevant due date. If HMRC receives a return or VAT payment after the due date, the business is 'in default' and may have to pay a surcharge in addition to the VAT that is owed.

The first default is dealt with by a warning known as a 'Surcharge Liability Notice'. This notice tells the business that if it submits or pays late ('defaults') again during the following 12 months - known as the surcharge period - it may be charged a surcharge.

Submitting or paying late again during the surcharge period could result in a 'default surcharge'. This is a percentage of any unpaid VAT owed. Where a correct return is not submitted at all, HMRC will estimate the amount of VAT owed and base the surcharge on that amount (this is known as an assessment – see below).

HMRC assessments

Businesses have a legal obligation to submit VAT Returns and pay any VAT owed to HMRC by the relevant due date. If they do not submit a return, HMRC can issue an assessment which shows the amount of VAT that HMRC believes it is owed, based on HMRC's best estimate.

Penalties for careless and deliberate errors

Careless and deliberate errors will be liable to a penalty, whether they are adjusted on the VAT Return or separately declared.

If a business discovers an error which is neither careless nor deliberate, HMRC expects that it will take steps to adjust or declare it, as appropriate. If the business fails to take such steps, the inaccuracy will be treated as careless and a penalty will be due.

Penalties for inaccurate returns

Penalties may be applied if a VAT Return is inaccurate, and correcting this means tax is unpaid, understated, over-claimed or under-assessed. Telling HMRC about inaccuracies as soon as the business is aware of them may reduce any penalty that is due, in some cases to zero.

Penalty for late registration

Failure to register for VAT with HMRC at the right time may make a business liable to a late registration penalty.

Penalty for failure to disclose business changes

A business which undergoes a change which either cancels the existing registration or otherwise alters the registration details will face a civil penalty if it fails to disclose the changes to HMRC within 30 days of the change.

Finding out more information about VAT

Most questions can be answered by referring to the VAT section of the HMRC website.

VAT Enquiries Helpline

If the answer to a question is not on the HMRC website, the quickest and easiest way is to ring the VAT Enquiries Helpline where most VAT questions can be answered.

Letters to HMRC

The VAT General Enquiries helpline can answer most questions relating to VAT, but there may be times when it is more appropriate to write to HMRC.

This would apply if:

- the VAT information published by HMRC - either on the website or in printed notices and information sheets - has not answered a question
- the VAT General Enquiries helpline has advised the business to write
- there is real doubt about how VAT affects a particular transaction, personal situation or business

If HMRC already publishes information that answers the question, their response will give the relevant details.

Visits by VAT officers

On a control visit to a business a VAT officer can check to make sure that their VAT records are up to date. They also check that amounts claimed from or paid to the government are correct. They examine VAT records, question the business owner or the person responsible for the VAT records, and watch business activity.