

Value added tax (VAT) control account

In this module we are going to look at the value added tax (VAT) control account. We will see:

- what it is used for
- where the entries in the account come from
- what impact the entries in the account have on the VAT liability.

What is it used for?

The VAT control account is used by businesses that are registered for VAT. The account is located in the main ledger. Registered businesses must:

- collect VAT by adding it to the amounts charged to customers for most goods and services, but can
- offset against this the VAT that they have been charged by their suppliers
- pay the VAT balance to Her Majesty's Revenue and Customs (HMRC) – or get a refund if they are owed VAT.

To do this the VAT amounts must be kept separate from the business income and expenditure. This is carried out by maintaining a VAT control account in the main ledger.

The VAT control account records all the VAT on both sales (outputs) and purchases (inputs) so that the balance on the account shows the amount that should be paid to (or claimed from) HMRC.

The details of the business's transactions and the related VAT are recorded on a VAT return, which is sent to HMRC. This is usually carried out every quarter. The information on the VAT return should agree with the amounts recorded in the VAT control account.

Where do the entries come from?

Transactions that include VAT are analysed in the various books of prime entry (where transactions are first recorded) and the VAT element is then posted directly to the VAT control account.

Postings to the VAT control account could come from the following books of prime entry:

- Sales day book
- Purchases day book
- Sales returns day book
- Purchases returns day book
- Cash book
- Petty cash book
- Journal.

Postings to the VAT control account must follow the normal rules of double-entry accounting and will be either debit or credit entries.

Credit entries in the VAT control account

Postings to the credit side of the VAT control account are the amounts of VAT that the business has charged its customers. This VAT does not belong to the business and therefore forms a liability (to

HMRC). That is why these entries are recorded on the credit side – liabilities are always credit balances.

The main credit entries in the VAT control account come from the:

- sales day book – the VAT on the invoices that have been sent to credit customers
- cash book – the receipts from cash sales that include VAT.

There may also be credit entries from the:

- purchases returns day book – the VAT on credit notes that have been received from suppliers. This effectively reduces the impact of the debit entries from suppliers' invoices (see next section).

Debit entries in the VAT control account

Debit entries reduce the amount owing to HMRC. These are the amounts of VAT that the business has had to pay to its suppliers. Because it can offset these amounts against its VAT liability the amounts are posted to the debit side of the VAT control account.

The main debit entries come from the:

- purchases day book – the VAT on credit suppliers' invoices
- cash book – payments to cash suppliers that include VAT
- petty cash book – payments for minor items that include VAT.

There may also be debit entries from the:

- sales returns day book – the VAT on credit notes sent to customers will reduce the VAT liability (in a similar but opposite way to how the purchases returns day book reduces the impact of purchase invoices).

There is also a possibility of postings from the journal. These could be debit or credit entries depending on the reason for the entry. For example, recording the VAT on the write-off of an irrecoverable debt would be a debit entry.

Now your turn

Have a look at the following list of entries into the VAT control account, and decide which side of the account they should be posted to. Then click on the icon to see if you were correct.

Entries	Debit	Credit
VAT from payments in the petty cash book	<input type="checkbox"/>	
VAT from invoices in the purchases day book	<input type="checkbox"/>	
VAT from credit notes in the purchases returns day book		<input type="checkbox"/>
VAT from cash sales receipts in the cash book		<input type="checkbox"/>
VAT from invoices in the sales day book		<input type="checkbox"/>
VAT from credit notes in the sales returns day book	<input type="checkbox"/>	
VAT from irrecoverable debt written off in journal	<input type="checkbox"/>	
VAT from cash payments in the cash book	<input type="checkbox"/>	

Click to display/hide the solution.

What is the impact of entries?

Remember that the balance on the VAT control account should equal the amount owing to HMRC (if it is a credit balance), or the amount owing to the business (if it is a debit balance).

- If the credit entries are greater than the debit entries the impact will be a liability to HMRC.
- If the debit entries are greater this means that HMRC will owe the business money.

The payment to HMRC (or receipt of a refund from HMRC) will be posted from the cash book to the VAT control account and this will clear the earlier balance.

Most businesses have a credit balance on their VAT control account – meaning they will owe VAT to HMRC. Examine the following list of entries in the account and decide which will increase the VAT liability and which will reduce it. Then click on the icon to check that you were right.

Entry	Reduce liability	Increase liability
VAT recorded in purchases day book	<input type="checkbox"/>	
VAT recorded in cash book from cash sales		<input type="checkbox"/>
VAT recorded in sales day book		<input type="checkbox"/>
VAT recorded in petty cash book	<input type="checkbox"/>	
VAT recorded in purchases returns cash book		<input type="checkbox"/>

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