

Common VAT problems



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Once they understand the basics, many businesses find VAT reasonably straightforward. But there are some tricky areas where it is easy to make mistakes. These can give rise to stringent penalties, and ignorance is no defence. In this briefing, we assume you know about the basics of VAT and concentrate on some of the more unexpected pitfalls. The briefing covers:

- Timing and paperwork problems.
- Unreclaimable VAT.
- Exceptions for unusual supplies.
- Where to get help and advice.

1 Getting the timing right

Timing is crucial. Every transaction must be shown in your VAT return if the 'tax point' (the point at which VAT is accountable) falls within your VAT return period, whether or not payment has been received.

1.1 The tax point is usually **the date goods were supplied** or services completed (the 'basic tax point'). There are some variations.

- If a VAT invoice is issued or payment is made before the basic tax point, the date of invoicing or payment becomes the tax point, whichever is the earlier.
- If you, as a supplier, issue a VAT invoice up to 14 days after the basic tax point, the date at which the invoice was issued becomes the tax point. This reflects application of the '14-day rule'. A VAT Business Advice Centre may agree an extension to the 14-day rule.
- If you, as a buyer, receive a VAT invoice up to 14 days after the basic tax point, you

can assume that the invoice date is the tax point, unless the invoice shows a separate tax point date.

- With continuous supplies, there is a tax point when a VAT invoice (eg when you are billed for electricity or gas) is issued or payment is made — whichever is earlier.
- 1.2** As a buyer, you cannot reclaim the VAT you paid without a valid **VAT invoice** (see **2.1**).
- If you pay your supplier in advance, you cannot reclaim the VAT element of the payment without a valid VAT invoice.
 - If you reclaim VAT on an invoice from your supplier, but fail to pay the supplier within six months from the due date you normally have to repay the VAT.
- 1.3** You can claim relief later for VAT paid on

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bad debts.

- The invoices must be more than six months overdue and you must have written them off in your accounts.
- You must write off debts in a specific VAT bad debt account but no longer need to tell customers in writing that bad debt relief claims are being made.

1.4 In practice, many small businesses use the cash accounting scheme.

- VAT returns are based on payments made and money received during the period, regardless of where the tax points fall.
- Generally, any business with a turnover of less than £1.35 million can apply to join.

1.5 The flat-rate scheme allows small firms to calculate the VAT they owe by applying a flat-rate percentage to their turnover.

- The flat-rate percentage depends on your trade sector, so if your VAT payments as a percentage of turnover generally work out low, you could lose out.

- You must continue to issue tax invoices to your customers, but need not record details of invoices issued or received.
- To qualify, your annual turnover (excluding VAT) must be less than £187,500 (including exempt and zero-rated supplies). Your taxable turnover (excluding VAT) must be less than £150,000.

1.6 With the annual accounting scheme you only need to file one VAT return each year. You make nine monthly interim VAT payments based on an estimate of your total annual VAT bill with the balancing payment due when you submit your return.

- Businesses with a turnover of up to £1.35 million may apply to use the system.
- Any business under the threshold can use the scheme from the date of VAT registration.
- The leaving threshold is £1.6 million.

2 Getting the paperwork right**2.1 You must issue full VAT invoices when you supply to VAT-registered businesses. It is easy to get this wrong.**

- A full VAT invoice should include a unique identifying number and your name, address and VAT number and your customer's name and address. It should also include the invoice date, the tax point, the date of issue (if this is different from the tax point), the type of supply (such as sale or rent), a description of the nature and amount of the goods or services, your cash discount rate, the VAT rate, the total excluding VAT, the VAT amount and the total payable.
- VAT invoice numbers must be sequential, with no unexplained gaps.
- Duplicate invoices must be clearly marked.
- If you issue other documents (such as pro-forma invoices), which show the same details as a VAT invoice, they must be clearly marked 'Not a VAT invoice'.

2.2 If you make retail sales and a customer asks for a VAT invoice, you may be able to use a simpler alternative.

- For retail sales under £100 (including VAT), you can issue a 'less detailed' VAT invoice. This shows your name, address and VAT number, the date of supply, a description of the goods or services, the amount (including VAT) and the VAT rate charged.

2.3 You must keep VAT invoices for purchases, to reclaim the tax you have paid to your suppliers.**Post and packaging**

A Provided that the contract is for 'delivered goods', **delivery charges** are usually taxed at the same rate as the product. This applies even if you show a separate charge on your price list or invoice.

- If delivery is offered as an optional extra on goods delivered within the UK, VAT will be due on the delivery charge.
- If the goods are intended for outside the UK, or start their journey outside the UK, you may need to take advice.

B Packaging is normally taxed at the same rate as the contents.

- If you make a separate charge for packaging, this will always attract VAT.

C The treatment of **bundled supplies** depends on whether there is a mixed or composite supply.

- Mixed supplies may contain components liable to different VAT rates.
- The basic rule is that you work out the total VAT liability in proportion to the value of each component.
- Composite supplies have one VAT liability based on the main component.

- If you lose a VAT invoice, you must get a duplicate invoice from your supplier.
- If an invoice shows product codes rather than descriptions, you must also keep a copy of the supplier's product list.

2.4 If you settle an invoice on behalf of a **third party**, you will not be able to reclaim VAT.

- VAT can only be reclaimed by the recipient of the supply.
- Consider settling the net value only. It may be worthwhile for third parties on whose behalf you settle bills to pay the VAT and then reclaim it in their own right.

2.5 Watch out for **arithmetical errors**.

- If you are given a less detailed invoice which includes VAT but does not show it as a separate item, confirm the items purchased are subject to VAT and calculate what you can reclaim by multiplying the amount on the invoice by 7/47, not by 17.5 per cent.

2.6 If you sell your business, the buyer can apply to retain your **VAT registration number**.

- You must retain your VAT records upon the sale of the business, unless the buyer is retaining your VAT number. In this case, you must provide information to the buyer so they can comply with their VAT duties.

3 Discounts and part exchange

3.1 **Discounts** can be problematic. The VAT you pay depends on how the discount is offered.

Tax yes, VAT no

One problem is the gap between what the VAT rules allow a business as expenditure and the rules applied by HM Revenue & Customs (HMRC). In general, any expenditure 'wholly and exclusively for business purposes' is tax deductible for HMRC purposes.

If you are going to reclaim VAT, expenditure must also be directly attributable to the taxable supplies you are making. These must be goods or services that are taxable at either the standard, reduced, or zero rates of VAT, or services that are outside the scope of the tax but permit VAT recovery on related costs (ie not exempt). If you cannot attribute your expenditure to the taxable supplies you are making, you will be treated as the end-consumer.

- If you give an unconditional discount (such as a sale or trade discount), VAT is based on the discounted value of the full sale.
- The same applies if you offer a discount for prompt payment — even if the customer does not pay promptly.

➔ For more information see The VAT Guide (Notice 700) from HM Revenue & Customs (www.hmrc.gov.uk).

3.2 VAT is calculated on the full value of any **part-exchange** or **barter** transactions.

- You must calculate the VAT as if the transaction had been entirely for cash (ie purchases and sales at the full price). VAT invoices must be issued accordingly.

4 Unreclaimable tax

4.1 You cannot reclaim VAT on supplies for **personal (non-business) use**.

- If you buy goods or services for both business and non-business use, you may apportion the VAT between them. You can only recover VAT on the business element, subject to the normal rules.
- Or, you can recover VAT on the purchase of all the goods, and then account for VAT on the non-business element as a supply for personal use.

4.2 You can only reclaim VAT on some of the supplies you make **to employees**.

- You can reclaim VAT on the actual costs of employees' subsistence when travelling on business.
- If you pay flat-rate expenses, however, you will not be able to reclaim the tax.
- You cannot generally reclaim VAT on free domestic accommodation you provide.
- You can reclaim VAT on the cost of business mileage paid to employees using their own vehicles. See VAT Notice 700/64 for the calculation you must use.

4.3 There are particularly strict rules about supplies to **sole traders, partners** or **directors**. The rules are less generous than those which apply to ordinary employees.

- You cannot reclaim VAT on free meals at work. But you can for subsistence expenses while on business trips (but not for entertaining).

4.4 The treatment of **entertainment** varies, according to who is being entertained.

- You cannot reclaim VAT on business entertainment.
- You may be able to reclaim VAT related to

staff entertainment. The entertainment must have a discernible business purpose, such as teambuilding.

- Where the entertainment is for both employees and outsiders, it may be possible to reclaim some VAT.
- 4.5** You cannot usually reclaim VAT on supplies purchased in order to make **exempt sales**.
- Small amounts may sometimes be reclaimed, within certain set limits. The calculation of recoverable VAT in this instance is complex. Get expert advice.

5 Overseas VAT issues

5.1 Imports of goods from another **EU** country ('acquisitions') would generally be zero-rated for VAT purposes.

- You must provide your UK VAT number to the supplier.
- You must account for UK VAT in your VAT return. But as long as you are making taxable supplies you can reclaim the VAT in the same return.

5.2 Imports of goods from **outside the EU** attract VAT, at UK rates, on entry and may also attract Customs duty.

- Customs duty is not recoverable.
- To reclaim the VAT, you need to have VAT certificate C79 issued by HM Revenue & Customs (HMRC) after importation.
- You may be able to defer paying the VAT.

5.3 Exports of goods to VAT-registered buyers in other **EU** countries ('dispatches') do not usually attract VAT.

- You will need to get a valid domestic EU VAT number from each customer and quote this on invoices. If your customer is not VAT registered, you must charge UK VAT on the sale. This could give rise to EU registration requirements if your sales volume there is high enough.

5.4 Exports of goods to countries **outside the EU** are zero-rated.

- You will need evidence that the goods have left the UK within certain time limits.

5.5 If you trade with the EU you are required to supply details of your transactions. The system used to collect such details is known as **Intrastat**. The information you must declare depends on whether the value

of your arrivals (purchases or imports) or dispatches exceed the £260,000 threshold.

- If your dispatches or arrivals fall below the threshold you only have to declare the value in boxes 8 and 9 on your VAT return.
- If they go above the threshold, you must also submit a supplementary declaration giving more detailed information.

5.6 The rules on the import and export of **services** are complicated, so take advice.

6 Watch out

VAT must be charged in a number of familiar situations outside the normal run of business.

6.1 Business gifts are usually treated as taxable supplies, with VAT due on the value. There are some exceptions.

- There is no VAT on individual free samples given to customers.
- One-off business gifts costing less than £50 (excluding VAT) do not attract VAT. The £50 limit applies to all gifts made to the same person within a 12 month period.
- Gifts of services are not liable to VAT.
- Gifts of goods to charities for sale or export are zero-rated.

6.2 As a general rule, VAT must be charged on all **sales to employees**.

6.3 If you take items for **personal use** on which you have accounted for VAT, this counts as a sale (see **4.1**).

- If you pay nothing, VAT is charged on the cost (normally the market cost).
- Special rules apply to cars and fuel.

6.4 The **sale of business assets** is normally treated in the same way as any other sale.

7 Help and advice

7.1 Include VAT records as part of your regular **review** with your accountant.

7.2 Contact the HMRC **National Advice Service** (0845 010 9000).

- They will not be responsible for giving advice unless all the facts are disclosed. In the case of queries which cannot be answered with reference to a notice or leaflet, both the request for advice and the reply are given in writing.

Further help

There are other Directors' Briefing titles that can help you. These briefings are referred to in the text by name, such as **Insolvency**.

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