An introduction to VAT

A guide for clients

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An introduction to VAT

This article looks at VAT for beginners including rates and schemes

If you're expecting your turnover to exceed £82,000 this year, then you're probably having mixed feelings.

On the one hand reaching this figure, the VAT registration threshold, is a sign of success. Many consider this a moment when their fledgling venture can truly be called a real business for the first time.

On the other hand, achieving this level of turnover means getting to grips with VAT rules and regulations. How much additional work this entails will depend on the type of goods and services you buy and sell as well as the location of your customers.

VAT rates

VAT registered businesses charge VAT on every sale. There are 3 rates:

Name	Rate	Main use
Standard rate	20%	Applies to most goods and services
Reduced rate	5%	Used for domestic fuel and power as well a number of safety and mobility products.
Zero rate	0%	Books, newspapers, children's clothes and shoes

In addition some products and services are exempt.

Who pays?

If a VAT registered business sells to other VAT registered businesses, then each party in the chain charges and reclaims the VAT paid. If they sell direct to a consumer, the consumer bears the cost.

Registering for the first time

As soon as you hit the £82,000 VAT taxable turnover, that is the total value of everything you sell that isn't exempt from VAT, you need to register. Unlike the tax year, which has fixed start and end dates, your VAT year is a rolling 12 month period. It will start from the date when you went over the threshold.

When you register, which most businesses can do online, you'll receive a VAT registration certificate which confirms:

- your effective date of registration – the date you went over the threshold
- your VAT number
- when to submit your first VAT return and payment.

When you have received this, you are officially VAT registered. The next step is to decide which type of VAT accounting scheme to choose.

Flat rate scheme

This scheme is designed to reduce the cost of VAT compliance. Businesses with a turnover of less than £150,000 (excluding VAT) are eligible to pay a fixed rate of VAT. The rate you pay depends on the sector your business operates in but is generally between 4% and 14.5%. Rates for different types of business are on the government website.

Important characteristics of the scheme include:

- you keep the difference between what you charge your customers and pay HMRC
- you can't reclaim the VAT on your purchases - although you may be able to on certain capital assets over £2,000
- a 1% discount on flat rate VAT can be claimed during your first year of registration.

Cash accounting scheme

This scheme allows you to pay VAT when you get paid, rather than when you invoiced. To be eligible to use this scheme your VAT taxable turnover must be £1.35 million or less. In this scheme you pay VAT on your sales when your customers pay you. You then reclaim VAT on your purchases when you have paid your supplier.

Things to note:

- you can leave the scheme at any time if you are not benefitting from it or are struggling with the accounting requirements
- outstanding tax must normally be paid within 6 months of leaving the scheme.

Annual accounting scheme

The annual accounting scheme allows you to make advanced VAT payments over the year. Like the cash accounting scheme estimated taxable turnover should be no more than £1.35m to use this scheme.

Important features:

- you complete a single, annual VAT return
- it is possible to combine the annual accounting scheme with other schemes.

Other VAT schemes

If you're a retailer selling a range of items with different VAT rates or a business dealing in second hand goods, VAT gets a lot more complicated. There are various schemes to help simplify matters, but it is crucial to pick the right one for your business.

VAT margin schemes tax the difference between what you paid for an item and how much you sold it for. This can be a useful scheme if you sell second hand goods, works of art or antiques.

VAT retail schemes allow you to calculate VAT once for each VAT return rather than for each individual sale. You can use a VAT retail scheme alongside the cash accounting and annual accounting scheme but not with the flat rate scheme.

Common problems

Although retailers selling many different products have the most difficulty in getting their VAT returns right, problems can affect every type of business.

The following are just a few examples of common problems businesses run into with regards to VAT:

- taking goods for personal use
- gifts and entertainment at work
- company cars and fuel
- property sales and transactions.

Volunteering for VAT

You can apply for VAT registration even if your turnover is below the threshold. This is often favoured by small businesses who want to appear more established than they really are.

Recent changes to VAT rules

A change in the place of supply rules came into effect from 1 January 2015. This means that VAT on digital services (such as apps, online auctions and internet connections) within the EU will be paid in the consumer's country rather than the supplier's.

The VAT rate will also be that of the consumer's country. For example, if a UK business sells e-books to a consumer in Germany they will have to pay VAT at the German rate of 19%.

What this means for businesses

The new rules mean that businesses that sell digital services in the EU need to register and pay VAT in each EU country they export to.

To circumnavigate this, the government has introduced the VAT Mini One Stop Shop (MOSS). This service allows businesses to submit a quarterly VAT MOSS return and payment to HMRC. HMRC will then send the relevant part of the return and any payment to relevant tax authority.

Getting it right

VAT reporting and deadlines are taken very seriously by HMRC. Late filing as well as late payments count as a default and surcharges are added.

If you have any queries please contact **John Elliott**.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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