Section 2:
VAT

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Disclaimer

This guide is designed to alert you to some of the major issues you should be considering. It is not a replacement for professional advice tailored to your precise needs and circumstances.

You should always seek the advice of a suitably qualified professional before acting on any of the advice.

And if you would like to speak to us about any of the issues covered in this guide, please feel free to give us a call or drop us an email.

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* **Please note that any limits mentioned in this section are correct as of April 2016 – you will need to check the current limits with us before entering onto any of these schemes.**

2 Introduction

Any VAT you charge on supplies you make (whether services or products) is called your **Output VAT** (but your customers will reclaim this as their Input VAT).

Similarly, any VAT you incur on business expenditure is called your **Input VAT**.

As at April 2016 there are three rates of VAT:

- A standard rate of 20%
- A reduced rate of 5% - e.g. gas and electricity, children's seating
- A zero rate – applied to goods which are socially or economically important eg most food, books, newspapers, public transport, children's clothing

Any supply which is VATable will have one of these rates applied to it.

However, some supplies are exempt from VAT which means that no VAT is payable (for example insurance, postage, finance, education and health). But if the supplies you make (your sales) are exempt then you won't be able to recover any VAT on any business expenditure which you incurred when making the supply.

Where a supply is exempt from VAT, it should still be included on your VAT return.

And there are also supplies which are 'outside the scope' of VAT – this means they're not treated as a supply of goods or services and so aren't chargeable to VAT and aren't included on your VAT return.

For a list of the major categories see below.

Please note that this list is not exhaustive. Also, seemingly similar supplies can have different categorisations – for example biscuits are standard rated but cakes are zero rated. Please don't ask us why!

And beware, VAT on non-staff entertaining is not reclaimable – even if you've been charged it.

Standard	Zero	Exempt	Outside of scope
Restaurant food Hot takeaways Partly+ coated biscuits and shortbread Decorated ginger bread men Sweetened cereal and muesli bars Crisps and nuts (salted) Ice cream / frozen yogurt, arctic rolls Bottled water Fruit juice Confectionery Alcoholic drinks Taxi fares Commercial buildings Pet food	Public transport (buses, trains etc) Taxis Food* Books Newspapers and magazines Clothes and shoes for babies and children Charity shop sales of donations Plain nuts and tortilla chips Frozen meals Water and sewerage Seeds Drugs Caravans and houseboats New homes Protective equipment	Insurance Postage and stamps Bank charges and interest Entrance to museums and zoos Subscriptions to non-profit bodies Tamar Bridge toll Art Education Betting, bingo, lottery Medical treatment and healthcare Sports facilities Postal services Second sale+ houses Second hand car sales	Wages Drawings Loan repayments On-street parking Council Tax Business Rates MOT's Gratuities Charitable donations
All supplies of goods and services are assumed standard rated, unless otherwise designated.	* Bread, cakes, cream cakes, teacakes, caramel shortbread, Jaffa cakes, flapjacks, plain cereal cakes, milk and milk drinks, coffee and tea.		

2.1 When to register for VAT

A business must register for VAT when cumulative turnover for the previous twelve months exceeds the VAT threshold (as at 2016/17 this is £83,000). This is known as the 'twelve month' test.

To check the current VAT threshold limits go to '**https://www.gov.uk/vat-registration-thresholds**'

You must also register for VAT if you believe your turnover may exceed the VAT threshold (£83,000) within the next 30 days. This is known as the '30 day test'.

If you are late in registering for VAT, you may be liable for interest and penalties in addition to the VAT which you should have paid on time. As a rule of thumb, the later the registration the greater the penalties. So it's really important to stay on top of your bookkeeping so you have access to real time information and don't miss the registration deadline.

You may also register voluntarily for VAT even if your turnover is likely to be below the VAT threshold. For example, this could be advantageous where your business has incurred significant VAT on business expenses and wishes to re-claim this in order to ease cash flow.

2.2 Reclaiming VAT on expenses incurred before registration

If you have already started trading and then subsequently register for VAT, you may be able to reclaim the VAT on pre-registration expenditure.

2.2.1 Pre-registration VAT on goods:

You can reclaim VAT on goods purchased up to four years before you were registered for VAT provided they were bought by you as the 'person' who is now registered for VAT, they are used for your VATable business purposes, are still held by you or have been used in something which you have made but continues to be used in your business.

For example, you could reclaim the VAT on any stock you purchased prior to registration and which you still hold at the date of registration.

However, you can't reclaim the VAT on any petrol which you purchased prior to registration, because this has been 'consumed' and is no longer in existence at the registration date.

Please note that a change of policy by HM Revenue & Customs has recently come to light. The taxman may argue for a restriction in the recovery of input tax where goods have been purchased some time prior to registration though within the four year window mentioned above. There appears to be some contention at the moment as to whether HM Revenue & Customs are correct to adopt this stance.

2.2.2 Pre-registration VAT on services:

You can reclaim VAT on services purchased up to six months before you were registered for VAT provided they were bought by you as the 'person' who is now registered for VAT and they are used for your VATable business purposes.

Be careful that the tax point of any expenses being claimed are within the last six months!

2.3 VAT administration

2.3.1 To register for VAT

You can either register by downloading the relevant VAT application forms and sending them by post or you can register on line.

By post

If you require a copy of the form, please let us know.
Once completed, the form needs to be sent to:
National Registration Service
HM Revenue & Customs
Deansgate
62-70 Tettenhall Road
Wolverhampton
WV1 4TZ

On-line

To register on-line, go to 'https://online.hmrc.gov.uk/registration' and follow the information on-screen.

2.3.2 Who should you issue a VAT invoice to

If you are a seller registered for VAT you must give a buyer who is registered for VAT a VAT invoice for any standard-rated or reduced-rated items sold.

If you are a retailer, you do not need to issue a VAT invoice or receipt unless asked to do so by the buyer.

A VAT registered supplier may be fined if they do not issue a VAT invoice when asked to do so by a VAT registered buyer.

2.3.3 What to include on a VAT invoice

You'll use a full VAT invoice for most transactions. You can use:

- a modified invoice for retail supplies over £250
- a simplified invoice for retail supplies under £250 - and for other supplies under £250 from 1 January 2013

Include the following on your invoice, depending on which type you use:

Invoice information	Full invoice	Simplified invoice	Modified invoice
Unique invoice number that follows on from the last invoice	Yes	Yes	Yes
Your business name and address	Yes	Yes	Yes
Your VAT number	Yes	Yes	Yes
Date	Yes	No	Yes
The tax point (or 'time of supply') if this is different from the invoice date	Yes	Yes	Yes
Customer's name or trading name, and address	Yes	No	Yes
Description of the goods or services	Yes	Yes	Yes
Total amount excluding VAT	Yes	No	Yes
Total amount of VAT	Yes	No	Yes
Price per item, excluding VAT	Yes	No	Yes
Quantity of each type of item	Yes	No	Yes
Rate of any discount per item	Yes	No	Yes
Rate of VAT charged per item - if an item is exempt or zero-rated make clear no VAT on these items	Yes	Yes (1)	Yes
Total amount including VAT	No	Yes (1)	Yes

(1) If items are charged at different VAT rates, then show this for each.

Usually VAT invoices must be issued within 30 days of the date of supply or the date of payment (if you're paid in advance).

You don’t have to show all amounts on your invoices in sterling. If you issue VAT invoices in a foreign currency or language, you must:

- show the total VAT payable in sterling on your VAT invoice if the supply takes place in the UK
- be able to provide an English translation of any invoice within 30 days if asked to do so by a visiting VAT officer

To convert to sterling you can:

- use the market selling rate at the time of supply
- use the European Central Bank’s rate - from 1 January 2013
- use HMRC’s period rates of exchange - the rates usually stay the same for each calendar month
- apply to HMRC to use a different method to account for the VAT

You don’t need to issue a VAT invoice if:

- your invoice is only for exempt or zero-rated sales within the UK
- you’re giving goods as a gift
- you sell goods under a VAT second-hand margin scheme
- your customer operates a self-billing arrangement

2.3.4 Time of supply

The tax point (or 'time of supply') for a transaction is the date the transaction takes place for VAT purposes.

You need to know this because, for example:

- it's included on VAT invoices
- it tells you which VAT period the transaction belongs to
- it tells you which VAT Return to put the transaction on

The tax point can vary, but is usually the following:

Situation	Tax point
No invoice needed	Date of supply
VAT invoice issued	Date of invoice
VAT invoice issued 15 days or more after the date of supply	Date the supply took place
Payment or invoice issued in advance of supply	Date of payment or invoice (whichever is earlier)
Payment in advance of supply and no VAT invoice yet issued	Date payment received

The date of supply is:

- for goods - the date they're sent, collected or made available (eg installed in the customer's house)
- for services - the date the work is finished

If you use the VAT Cash Accounting Scheme, the tax point is always the date the payment is received.

There are different tax point rules for:

- certain trades - like barristers, building and construction
- where the supply is not a 'sale' – eg business items taken for personal use

Sometimes, one sale can give rise to 2 or more tax points - eg where the customer pays a deposit in advance, and then a final payment.

2.3.5 Records to keep for VAT

Records you must keep include:

- copies of all invoices you issue
- originals of all invoices you receive (pdf copies are fine)
- self-billing agreements - this is where the customer prepares the invoice
- name, address and VAT number of any self-billing suppliers
- debit or credit notes
- import and export records
- records of items you can’t reclaim VAT on - eg business entertainment
- records of any goods you give away or take from stock for your private use
- records of all the zero-rated, reduced or VAT exempt items you buy or sell
- a VAT account

You must also keep general business records such as bank statements, cash books, cheque stubs, paying-in slips and till rolls.

If you use the Cash Accounting Scheme you must use these records to match them against your payment records and receipts.

If you are a retailer you don’t have to issue VAT invoices unless a customer asks for one. Keep a copy if you do. Retailers can issue ‘simplified invoices’ for supplies under £250.

When you return goods to a supplier or a customer returns goods to you, the balance of payment can be settled with a credit or debit note. Record these in your accounts and keep any original notes.

2.3.6 Filing your VAT return online

Since 1st April 2012 it has been a requirement to file your VAT returns online.

To register to file your VAT returns on-line, go to **https://online.hmrc.gov.uk/registration** and follow the instructions on screen.

You will then need to go online each quarter to file your VAT return.

Depending on which software you are using, you may be able to file your VAT return directly from the software.

2.3.7 Filing deadlines

The deadline for submitting your VAT return online is usually one calendar month and 7 days after the end of a VAT accounting period.

To help you keep on top of the deadlines, you can go to your online account and tick to receive email reminders of your VAT return being due.

2.3.8 Payment deadlines

All VAT payments must now be made electronically.

Direct debit

Once you are registered to file your returns on-line, you can then also register to pay by direct debit. This method normally gives you an extra three days before any VAT payment due is taken from your bank account and the money will be taken from your account around the 10th or 12th of the month.

To pay by direct debit, log in on-line to your VAT account (once you have received your user ID and password) and you will see an option to set up payments by direct debit.

Please note that you need to do this well in advance of the return being due to enable HMRC to set up the direct debit in time. We would recommend doing this at least two weeks before filing your return on-line.

Please also note that if you submit your VAT return after the due date, then HMRC will collect the direct debit payment on the third working day after the return is received, and this will give rise to a default surcharge issue.

Other payment methods

To see when you will need to make your payment using other electronic payment methods go to **https://www.gov.uk/vat-payment-deadlines**.

Electronic payments other than direct debits must be with HMRC one calendar month and 7 days after the end of a VAT accounting period.

Depending on the payment method, you will normally need to make payment by the 5th of the month to enable the payment to reach HMRC by 7th of the month.

2.3.9 Surcharges and penalties

Surcharges

A late VAT Return or payment is known as a ‘default’.

If you’re turning over more than £150,000 then on the first occasion that you are late submitting a VAT return, or you pay the tax late on a return, then a default surcharge liability notice is generated. This means that VAT returns and payments need to be submitted on time for the next 12 months otherwise an escalating penalty takes effect, based on the unpaid tax liability by the due date.

If you’re turning over less than £150,000 then on the first occasion you are late you’ll get a polite letter reminding you that you are late. If you are late again within 12 months then you’ll get a default surcharge liability notice and then the escalating penalties.

HM Revenue and Customs (HMRC) will write explaining any surcharges and what happens if you default again. Surcharges are a percentage of the tax paid late. HMRC estimate this if they don’t have your return - this is known as an ‘assessment’.

Default	Surcharge if turnover is less than £150,000	Surcharge period
1st	No surcharge but if you default within 12 months you enter a surcharge period	None, but if you miss another VAT deadline within 12 months of the issue of a help letter you will formally enter the surcharge system.
2nd	No surcharge but you enter a surcharge period	12 months
3rd	2% (or no surcharge if it’s less than £400)	12 months from the date of the most recent default
4th	5% (or no surcharge if it’s less than £400)	12 months from the date of the most recent default
5th	10% or £30 (whichever is more)	12 months from the date of the most recent default
6th or more	15% or £30 (whichever is more)	12 months from the date of the most recent default

Default	Surcharge if turnover is £150,000 or more	Surcharge period
1st	No surcharge but you enter a surcharge period	12 months
2nd	2% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
3rd	5% (or no surcharge if it's less than £400)	12 months from the date of the most recent default
4th	10% or £30 (whichever is more)	12 months from the date of the most recent default
5th	15% or £30 (whichever is more)	12 months from the date of the most recent default
6th or more	15% or £30 (whichever is more)	12 months from the date of the most recent default

There's no surcharge if you submit a late VAT Return and you have no tax to pay or you're due a VAT repayment.

If you want to appeal a surcharge you need to write to:

Default surcharge review team
Crownhill Court
Tailyour hill
Crownhill Plymouth
PL6 5BZ

Penalties

HMRC can charge you a penalty (between 15% and 100% of the unpaid amount owed) if your VAT Return is inaccurate.

You can download a copy of HMRC's penalty document at **https://www.gov.uk/government/publications/compliance-checks-penalties-for-inaccuracies-in-returns-or-documents-ccfs7a**

You can be charged a penalty of up to £400 if you submit a paper VAT Return, unless HMRC have told you you're exempt.

2.3.10 Charging VAT to Charities

As a VAT-registered business, you can sell certain goods and services to charities at the zero or reduced rate of VAT. It's your responsibility to check the charity is eligible, and to apply the correct rate.

Community amateur sports clubs (CASCs) don't qualify for VAT reliefs for charities.

To make sure the charity is eligible, ask them for:

- evidence that they're a charity
- a written declaration or 'certificate' confirming they meet the conditions for the particular VAT relief

The charity should give you either:

- their Charity Commission registration number
- a letter of recognition from HM Revenue and Customs (HMRC) if they're not registered with the Charity Commission for England and Wales (eg if they're a Scottish or Northern Irish charity)

Charities are legally required to give you an eligibility certificate when you supply eligible building or construction services to them at zero VAT. The certificate must contain specific information.

A declaration is not legally required for other items you sell at the zero or reduced rate, but you should ask for one to prove the charity is eligible for the relief. You must keep the completed declarations for at least 4 years.

You may be able to apply the reduced VAT rate when you sell fuel and power in certain circumstances to an eligible charity.

You may be able to apply zero VAT when you sell the following to an eligible charity:

- advertising and items for collecting donations
- aids for disabled people
- construction services
- drugs and chemicals
- equipment for making 'talking' books and newspapers
- lifeboats and associated equipment, including fuel
- medicine or ingredients for medicine
- resuscitation training models

You may also be able to zero-rate some other medical and veterinary equipment when you sell it to:

- certain health bodies, eg NHS Trusts
- not-for-profit research institutions
- charities that provide institutional care, or medical or surgical treatment for chronically sick or disabled people
- charities that provide transport services for disabled people
- charities that provide rescue or first aid services to humans or animals
- someone buying it specifically for donation to one of these bodies

The money used to buy the equipment must be from charitable or donated funds. This should be stated on the eligibility declaration.

The eligible items include:

- medical, veterinary and scientific equipment
- ambulances
- goods for disabled people
- motor vehicles for medical use
- rescue equipment
- resuscitation training dummies

2.4 What VAT scheme should you register for

There are various VAT schemes which may be advantageous for you.

2.4.1 Cash accounting

Overview

With the cash accounting VAT scheme, you only pay over VAT on outputs when your customer pays you and conversely, you only reclaim VAT on inputs when you pay for a supply.

This can be very advantageous from a cash flow perspective, especially if your debtors take longer to pay you than you take to pay your creditors.

Eligibility

You can use the cash accounting scheme if your estimated VATable turnover for the next year is below £1.35million*. Your total VATable turnover includes everything which isn't VAT exempt.

Once you start using the cash accounting scheme you can continue until your turnover reaches £1.6million* or until you are no longer eligible to be in the scheme – see below for when you can't use cash accounting.

However, you must use standard VAT accounting for the following transactions:

- where the payment terms of a VAT invoice are 6 months or more
- where a VAT invoice is raised in advance
- buying or selling goods using lease purchase, hire purchase, conditional sale or credit sale
- importing goods from within the EU
- moving goods outside a customs warehouse

You can't use cash accounting if:

- you use the VAT Flat Rate Scheme - instead, the Flat Rate Scheme has its own cash-based turnover method
- you're not up to date with your VAT Returns or payments
- you've committed a VAT offence in the last 12 months - eg VAT evasion

How to join and leave

You join the scheme at the beginning of a VAT period and can start to use this scheme as soon as you register for VAT.

You do not have to tell HMRC that you are changing from standard VAT accounting to cash VAT accounting. However you do need to be very careful to make sure that you account for all your VAT correctly on outstanding sales and purchase invoices – otherwise you could end up accounting for VAT on these invoices twice.

You can leave the scheme at any time, but you must leave if you're no longer eligible to use it. You should leave at the end of a VAT accounting period.

You don't have to tell HMRC you've stopped using it, but you must pay HMRC any outstanding VAT (whether your customers have paid you or not). You can ask for an extra 6 months to pay this.

Return and payment deadlines

Check your VAT Return and payment deadlines in your VAT online account.

Your VAT online account tells you:

- when your VAT Returns are due
- when the payment must clear HM Revenue and Customs' (HMRC) account

The deadline for submitting the return online and paying HMRC are usually the same - 1 calendar month and 7 days after the end of an accounting period. You need to allow time for the payment to reach HMRC's account.

VAT should be paid electronically – either direct debit or internet banking.

Advantages

Cash accounting for VAT means you don’t have to pay any VAT due to HMRC until your customers have paid you – but conversely you can’t claim any VAT on supplier invoices until you have paid your suppliers.

This scheme will be better for you if you extend credit to your customers and your VAT supplies exceed your VAT purchases.

However if you are in a business where customers pay straight away (eg a restaurant or shop) then you will need to standard account for VAT rather than cash account.

2.4.2 Annual accounting

Overview

Usually, VAT-registered businesses submit their VAT Returns and payments to HM Revenue and Customs 4 times a year.

With the Annual Accounting Scheme you:

- make advance VAT payments towards your VAT bill - based on your last return (or estimated if you're new to VAT)
- submit 1 VAT Return a year

When you submit your VAT Return you either:

- make a final payment - the difference between your advance payments and actual VAT bill
- apply for a refund - if you've overpaid your VAT bill

The scheme wouldn't suit your business if you regularly reclaim VAT because you'll only be able to get 1 refund a year (when you submit the VAT Return).

Eligibility

You can join the Annual Accounting Scheme if:

- you're a VAT-registered business
- your estimated VAT taxable turnover is £1.35 million* or less in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- your business is part of a VAT registered division or group of companies
- you're not up to date with your VAT Returns or payments
- you're insolvent

You must leave the scheme if:

- you're no longer eligible to be in it
- your VAT taxable turnover is (or is likely to be) more than £1.6 million* at the end of the annual accounting year

You can join the scheme when you register for VAT or at a later date.

How to join and leave

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 AA and send it to the address on the form (or use VAT600 AA/FRS to apply for the Flat Rate Scheme at the same time)

Confirmation you've joined the scheme is sent to your VAT online account (or in the post if you don't apply online).

You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave. From this date, you must account for your VAT in the usual way.

HM Revenue and Customs
Annual Accounting Registration Unit
Imperial House
77 Victoria Street
Grimsby
DN31 1DB

You have to wait 12 months before you can re-join the scheme.

Return and Payment deadlines

There are 12 months in your accounting period. Your VAT return is due once a year, 2 months after the end of your accounting period.

You must make advance payments towards your VAT bill (either monthly or quarterly) during your accounting period and a final payment when you submit your VAT Return.

Payment	Deadline
Monthly	Due at the end of months 4, 5, 6, 7, 8, 9, 10, 11 and 12
Quarterly	Due at the end of months 4, 7 and 10
Final payment	Within 2 months of month 12

How much to pay

Each payment is either 10% of your estimated VAT bill (monthly payments) or 25% (quarterly payments). The amount is based on previous VAT returns (or estimated if you're new to VAT).

HMRC will write telling you when your instalments are due and how much they'll be.

The final payment (known as a 'balancing payment') is the difference between your advance payments and the actual VAT bill confirmed on your VAT Return.

You may be due a VAT refund if you've overpaid HMRC.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.

You also need to let HMRC know if your turnover is likely to be much higher or lower than the previous year or if your VAT payable is likely to increase by more than 10% since the last time your instalments were calculated.

Advantages

This scheme cuts down on the amount of paperwork to be completed and also gives you two months at the end of the year to pay any underpayments rather than just one month.

However, the amounts paid are calculated based on your previous year's turnover and so if your turnover is decreasing you may end up paying more VAT during the year than necessary.

2.4.3 Flat rate

Overview

Usually, how much VAT a business pays or claims back from HM Revenue and Customs (HMRC) is the difference between the VAT they charge customers and pay on their purchases.

With the Flat Rate Scheme:

- you pay a fixed rate of VAT over to HMRC
- you keep the difference between what you charge your customers and pay over to HMRC
- you can't reclaim the VAT on your purchases - except for certain capital assets over £2,000

Eligibility

You can join the Flat Rate Scheme if:

- you're a VAT-registered business
- you expect your VAT taxable turnover to be less than £150,000* (excluding VAT) in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- you committed a VAT offence in the last 12 months, e.g. VAT evasion
- you joined (or were eligible to join) a VAT group in the last 24 months
- you registered for VAT as a business division in the last 24 months
- your business is closely associated with another business
- you've joined a margin or capital goods VAT scheme

You can't use the scheme with the Cash Accounting Scheme. Instead, the Flat Rate Scheme has its own cash-based method for calculating the turnover.

You must leave the scheme if:

- you're no longer eligible to be in it
- on the anniversary of joining, your turnover in the last 12 months was more than £230,000* - or you expect it to be in the next 12 months
- you expect your total income in the next 30 days alone to be more than £230,000*

How to join and leave

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 FRS and send it to the address on the form (or use VAT600 AA/FRS to apply for the Annual Accounting Scheme at the same time)
- send a pdf of the completed form to **frsapplications.vrs@hmrc.gsi.gov.uk**
- apply over the phone on 0300 200 3700

Confirmation you've joined the scheme is sent to your VAT online account (or in the post if you don't apply online).

You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave.

HM Revenue and Customs
Imperial House
77 Victoria Street
Grimsby
Lincolnshire
DN31 1DB

You must wait 12 months before you can re-join the scheme.

HMRC will notify you in writing if your application is successful.

The letter will tell you the date you can start to use the scheme. This will normally be from the start of the VAT period following receipt of your application. If you request an earlier or later start date, HMRC will consider all the facts including the timing of your application and your compliance record. HMRC will not normally allow you to go back and use the scheme for periods for which you have already calculated your VAT liability.

How much to pay

With the flat rate scheme you calculate your VAT payable based on a flat rate percentage of your VAT inclusive turnover.

To see the flat rate percentage which applies to your industry go to **https://www.gov.uk/vat-flat-rate-scheme/vat-flat-rates**

Alternatively HMRC show more detail at **http://www.hmrc.gov.uk/manuals/frsmanual/frs7300.htm**

You will need to choose the rate most appropriate for your industry – HMRC will not be able to give you guidance as to which is the right rate. Make sure you note down your rationale for choosing a particular industry – you may need this if HMRC challenge your choice at a later date.

If it's your first year of being VAT registered, you will also get an additional 1% reduction in the rate which is applicable until the first anniversary of your being VAT registered.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.

Advantages

You will still need to raise VAT sales invoices and you will not be able to reclaim VAT on any purchases you make. But this scheme could potentially simplify enormously your accounting for VAT and may save you significant amounts of money if you do not have many VATable supplies.

As an example, if you invoice £100k plus VAT of £20k and have expenses of £20k excluding VAT of £4k, then under standard VAT accounting you would pay over VAT of £16k (£20k less £4k).

If you assume that the flat rate for your industry is 10%, then you would pay over VAT of £12,000 (VAT inclusive turnover of £120,000 * 10%).

As well as the financial saving, you also won't need to worry as to whether you have the correct documentation for any VAT you are reclaiming.

The scheme also allows you to reclaim all input VAT on any capital purchases which individually cost you more than £2,000 including VAT.

2.5 Overseas VAT

If you sell, supply or transfer goods out of the UK to someone in another country you may need to charge VAT on them.

Generally speaking, you can zero-rate supplies exported outside the European Union (EU), or sent to someone who's registered for VAT in another EU country.

If you sell goods or services to someone in another EU country, who isn't VAT registered, you charge VAT in the normal way. Sales to another country inside the EU are called 'dispatches' or 'removals'. 'Exports' describes sales to a country outside the EU.

The rules on selling goods and services abroad are complex.

If you have a specific query related to selling goods or services either inside or outside of the EU please feel free to get in touch.

2.6 Issues to be aware of

VAT is a complex subject and you need to be careful that you account for it correctly. The list below covers some of the common VAT pitfalls which you ought to be aware of – please note that this list is by no means exhaustive.

2.6.1 VAT on cars

Generally you can’t reclaim the VAT on cars unless you buy a car purely for business use (e.g. a pool car or taxi) in which case you can reclaim the VAT in full. Similarly you can’t reclaim the VAT on the car’s accessories unless you can show that they have a business use.

VAT on vans is recoverable – however it isn’t always easy to determine when a vehicle is a car or when it is a van!

If you lease a car for business purposes you can generally only reclaim 50% of the VAT. The only exceptions are as follows:

- there is no private usage of the vehicle in which case you can reclaim 100%.
- you are leasing a car for use in a chauffeur/tax service business, a driving school or a self-drive car hire business – then you can reclaim 100% of the VAT in full.

VAT on repairs can be reclaimed in full as long as the vehicle has some business use and the invoices are in the company’s name and paid by the company.

If you are VAT registered partnership or sole trader you may be able to reclaim some of the VAT incurred on car repairs/servicing provided you can demonstrate there has been some business use of the vehicle in question.

2.6.2 VAT on fuel

You have four different options for reclaiming the VAT on fuel:

1. Reclaim 100% of the VAT – but all the fuel must have been used for business purposes.

2. Reclaim all of the VAT and pay VAT on the proportion of fuel not used for business. The fuel can be used for business and non-business purposes. The repayment is made by applying a 'fuel scale charge' to your quarterly tax return and paying this amount over to HMRC with any other VAT due.

3. Reclaim the business proportion of the VAT. You must keep detailed records of business and private mileage. You will also need to hold on to relevant petrol receipts. If you pay a mileage allowance for business miles travelled, you can reclaim the VAT on the fuel element of this allowance. The fuel only element must be similar to the HMRC guidelines for mileage payments for company cars.

4. Not reclaim any VAT. This can be useful if your mileage is low and/or you use the fuel for both business and non-business. As you are not claiming any VAT you do not need to keep detailed mileage records for VAT purposes (although you will still need these to claim business mileage in your accounts).

2.6.3 VAT on parking

Be careful with VAT for parking – multi-storey car parks include VAT at 20% but on-street parking meters and pay-and-display car parks are not subject to VAT!

2.6.4 VAT on staff business expenses

If you have to send your staff away on business, then you can claim the VAT element of any expenses they incur – but this must be on actual expenditure rather than any overnight allowance.

2.6.5 VAT on business entertaining

Generally you cannot reclaim VAT on business entertainment expenses. The person being entertained may be an existing customer, a potential customer or any other person who is not an employee. The following are not employees for VAT business entertainment purposes:

- pensioners and former employees
- job applicants and interviewees
- non-employee shareholders

Business entertainment expenses include:

- food and drink
- accommodation - eg hotels
- theatre and concert tickets
- sporting events and facilities
- entry to clubs and nightclubs
- use of capital assets such as yachts and aircraft
- payments made to third party business entertainment organisers
- free samples
- business gifts
- when you provide entertainment or hospitality only for the directors or partners of your business (but it's worth noting that if all staff are included you can reclaim the VAT)

2.6.6 VAT on staff entertaining

Whilst VAT on business entertainment is not allowable, VAT on staff entertaining is.

But be careful when it comes to the Christmas party – you can reclaim the VAT relating to the function but be careful as there may be a restriction depending on the number of guests your staff bring.