

# Common VAT problems

Once you understand the basics, VAT is reasonably straightforward. But there are some areas where it is easy to make mistakes. These can lead to stringent penalties, and ignorance is no defence. In this briefing, we assume you understand the basics and concentrate on some of the more unexpected pitfalls. It 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. Generally every transaction must be shown in your VAT return if the 'tax point' (the point at which VAT is accountable) falls within that particular 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 issue a VAT invoice up to 14 days after the basic tax point, the date the invoice was issued becomes the tax point. It is possible to agree an extension to the '14-day rule' by making an application to HM Revenue & Customs (HMRC).
- If you receive a VAT invoice up to 14 days after the basic tax point, you can assume the invoice date is the tax point, unless the invoice shows a separate tax point date.

- With continuous supplies, the tax point occurs when a VAT invoice is issued or payment is made — whichever is earlier.

**1.2** As a buyer, you cannot reclaim the input 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 input VAT on a supplier's invoice, but fail to pay the supplier within six months you normally have to repay the VAT.

**1.3** Relief is available for **bad debts**.

- The invoice must be more than six months overdue and be written off in a specific VAT bad debt account.

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- Customers no longer need to be told 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 net VAT they owe by applying a flat-rate percentage to their turnover.

- The flat-rate percentage depends on your trading sector, so if your net VAT payments are generally a low percentage of turnover this scheme may not be of benefit.
- Tax invoices must still be issued, but will not be used to calculate the VAT payable.
- To qualify, annual turnover (excluding VAT) must be less than £187,500 (including exempt and zero-rated supplies). VATable turnover (excluding VAT) must be less than £150,000.

#### 1.6 With the **annual accounting scheme** only one VAT return is submitted each year. Nine

monthly interim VAT payments are made based on an estimate of the total annual VAT bill. A balancing payment is made when the annual return is submitted.

- Any business under the threshold of £1.35 million can apply to use the scheme from the date of VAT registration.
- The leaving threshold is £1.6 million.

## 2 Getting the paperwork right

### 2.1 Proper **VAT invoices** must be issued for supplies to VAT-registered businesses.

- A full VAT invoice should include a unique identifying number; the supplier's name; address and VAT number; the customer's name and address; 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 and amount of goods or services; unit price; the 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 (eg pro-forma invoices), which show the same details, they must clearly state 'Not a VAT invoice'.

### 2.2 If you make **retail sales** under £250 (including VAT), you can issue customers with a 'less detailed' VAT invoice.

- This must show your name, address and VAT number; the date of supply; a description of the supplies; the amount (including VAT) and the VAT rate charged.

### 2.3 To reclaim the input VAT paid to suppliers, **VAT invoices** must be retained.

- 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 cannot reclaim the VAT charge.

- Input VAT can only be reclaimed by the recipient of the supply.
- Consider settling the net value only. It may be worthwhile for the third party to pay the VAT portion of the invoice and then reclaim it in their own right.

### Post and packaging

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

- If UK delivery is offered as an optional extra, VAT will be due on the charge.
- If the goods are for export, or leave from outside the UK, you should 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.
- 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.

### 2.5 Watch out for **arithmetical errors**.

- If you are given an invoice which does not show VAT as a separate item, confirm the items are VATable and check 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**. However, this would make the buyer liable for any past tax overdue, so they may prefer to set up a new VAT registration.

- Unless the buyer is retaining the vendor's VAT number, the vendor must retain their VAT records. In this case, the buyer must be given full information so they can comply with their VAT duties.

## 3 Discounts and part exchange

**3.1 Discounts** can be problematic. The VAT payable on a supply depends on how the discount is offered.

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

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

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

### Tax yes, VAT no

One problem is the gap between what the VAT rules allow a business as expenditure and the rules applied for other taxes. In general, any expenditure 'wholly and exclusively for business purposes' is deductible for direct tax purposes.

Before you can reclaim input VAT, expenditure must be directly attributable to the VATable supplies you are making. Your supplies might be VATable at the standard, reduced, or zero rates of VAT, or be services that are outside the scope of the tax but with VAT recovery rights (ie not exempt). If you cannot attribute your expenditure to the VATable supplies you are making, there will be a VAT cost due.

## 4 Unreclaimable tax

**4.1** Input VAT cannot be reclaimed on supplies for **personal (non-business) use**.

- If goods or services are bought for both business and non-business use, the input VAT may be apportioned with only the business element recovered, subject to the normal rules. Or, recovered in full on the entire purchase of goods provided output VAT is declared on a self-supply of the non-business element.

**4.2** Input VAT can be reclaimed on some of the supplies made **to employees** including on:

- The actual costs of employees' subsistence when travelling on business (excluding any flat-rate expenses).
- Any free meals that may be provided.
- VAT can also be reclaimed on the cost of business mileage paid to employees using their own vehicles. See VAT Notice 700/64 for the calculation that must be used.

Generally VAT cannot be reclaimed on any free accommodation that is provided. However, if employees have to be given domestic accommodation wholly for a business purpose HMRC may agree to VAT claims being made.

**4.3** There are strict rules applied to **sole traders, partners** or **directors**.

- They cannot reclaim VAT on free meals at work. But subject to normal rules can claim for subsistence expenses while on business trips.

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

- VAT on business entertainment for third parties can never be reclaimed.
- Reclaims may be allowed for VAT related to staff entertainment. The entertainment must have a discernible business purpose.
- Where the entertainment is for both employees and outsiders, it may be possible to reclaim some VAT.

**4.5** Generally, a business cannot reclaim VAT on supplies purchased in order to make **exempt sales**.

- Small amounts may be reclaimed, if within certain set limits. The calculation of recoverable VAT in this instance is complex. Get expert advice.

➔ To find a VAT adviser, contact the Institute of Indirect Taxation on 01883 730658 or enquiries@theiit.org.uk.

## 5 Overseas VAT issues

**5.1 Imports** of goods from another **EU** country ('acquisitions') will generally be free of any VAT charge.

- The supplier must show the customer's UK VAT number on their sales invoice.
- UK output VAT must be self-charged and declared in Box 2 of the relevant VAT return covering the date of the supply (known as Acquisition Tax). However, as long as the purchase is used to make VATable supplies the Box 2 VAT can be reclaimed as input VAT in the same return.

**5.2 Imports** of goods from **outside the EU** attract import VAT, at UK rates, which is payable on entry. Subject to the normal rules this can be reclaimed as input VAT. The import may also attract Customs duty which is also collected by HMRC.

- Customs duty is not recoverable.
- To reclaim import VAT, a VAT certificate C79 must be held.
- Payment of both import VAT and duty can be deferred which can speed through entry of goods into the UK.

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

- VAT should be added to sales invoices unless a valid domestic EU VAT number is quoted on the invoice. If a customer is not VAT registered, VAT must be charged on the sale. Such sales could give rise to EU registration requirements if sales volumes exceed local limits.

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

- VAT will be due on the sale unless evidence is held that the goods have left the UK within specified time limits.

**5.5 Trade** with the EU requires submission of statistical returns known as **Intrastat** and EC Sales Listings. Intrastat returns are required if the value of arrivals (purchases or EU imports) or dispatches (EU sales) exceeds the £260,000 threshold whereas EC Sales Listings are always required.

- If dispatches or arrivals are below the Intrastat threshold declarations are only required in boxes 8 and 9 of the VAT return.
- If they go above the threshold, a supplementary declaration will be required.

## 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 though they have been sold as VATable supplies, with output VAT due on the value. There are some exceptions.

- There is no output VAT due on individual free samples given to customers.
- One-off business gifts costing less than £50 (excluding VAT) do not attract output 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.

**6.5** The sale of a business as a going concern may be VAT-free. Specific rules apply.

## 7 Help and advice

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

**7.2** Ask your **VAT adviser** how your business is affected by VAT rules. It is always advisable to check the VAT implications of a situation and the options available to you. If doubts remain, you can safeguard your position by getting a decision in writing from HMRC.

**7.3** Contact the **HMRC National Advice Service** (0845 010 9000 or [www.hmrc.gov.uk](http://www.hmrc.gov.uk)).

- HMRC will only be bound by any ruling if all the facts have been disclosed.

## 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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