UKTraining

A Comprehensive Guide to UK VAT

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This book is intended to provide an essential guide to VAT as it is operated in the UK.

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PREFACE

This book is intended for those who deal with value added tax in businesses, be it in the capacity of directors, company accountants, sales and purchase ledger administrators or external advisers. The objective is to provide, as the title implies, a comprehensive guide to the areas of VAT most commonly encountered in a business.

In writing the book and selecting topics for inclusion, we have drawn on the many questions put by delegates attending seminars on VAT. We thank those delegates and trust that the book will provide answers to these questions and anticipate many others.

All examples in this book use the rate of 20%.

CHAPTER 1

THE PRINCIPLES OF VAT

Introduction

This chapter provides a broad overview of the principles of VAT. The topics covered are:

- The scope of VAT
- VAT rates
- Output tax
- Input tax
- Administration

The scope of VAT

A transaction between two parties falls within the scope of UK VAT if it fulfils all of the following criteria:

- The place of supply is within the UK.
- It is a supply made by a taxable person.
- It is a supply made in the course of business.

Each country within the European Union (EU) has a VAT system. The principles of VAT throughout the EU are broadly consistent. In any transaction involving two parties who belong in different countries, it is necessary to determine the place of supply. The same may apply even when the two parties belong in the same country but the supply is performed in a different country, involves an intermediary, relates to land in a different country or relates to transport.

If the place of supply is determined to be outside the UK, the transaction does not fall within the scope of UK VAT. For these purposes, the UK includes the Isle of Man but does not include the Channel Islands or Gibraltar. The territorial waters of the UK extend twelve nautical miles from the coastline.

A taxable person is defined as any person who is registered for VAT or required to be so registered. This is explained further in chapter 2, as is the concept of a supply made in the course of business.

If a transaction falls within the scope of UK VAT, the supplier potentially has to add VAT to the value of the supply.

VAT rates

A transaction may fall within the scope of VAT and yet VAT need not be charged. There are four types of supply: standard-rated, reduced-rated, zero-rated and exempt.

The standard rate is the rate at which any supply within the scope of VAT must be charged unless it specifically falls into any of the other three categories.

Comprehensive details of the classes of supply which are zero-rated, exempt or reduced-rated are given in chapter 3. The reduced rate applies to domestic fuel and power and a number of other supplies. Common zero-rated supplies include books,

food and children's clothes, while the most frequently encountered exempt supplies are residential property supplies, insurance and education.

The difference between zero-rated and exempt supplies is that zero-rated supplies fall to be regarded as taxable supplies, whereas exempt supplies do not. This means that a business making only exempt supplies usually need not register for VAT and cannot reclaim the input tax it incurs in the course of making supplies.

Output tax

If a business supplies standard-rated goods, it must add VAT to the net amount of its supply. This is known as output tax and it must be paid over to HMRC with its next return.

There is usually an assumption that, for a supply to take place, one party must provide goods or services in return for a consideration, or payment. The payment need not be in the form of money: for example, an organisation publishes a newsletter which is funded by advertising. It gives certain customers free advertising if they supply it with free goods in return. Both parties have a VAT liability – one has supplied advertising for payment in kind, the other has supplied goods and received free advertising in return. The organisation publishing the newsletter would base its VAT liability on its usual market price for placing advertisements.

There is no supply if the customer has a genuine option as to whether to make payment for the goods or services issued. This principle is best illustrated by gratuities in restaurants, which are not a supply for VAT purposes if they are freely given. In this case, the restaurant would account for VAT only on the amount paid for the meal. This would not be the case with a compulsory service charge, but restaurants which issue a bill specifying an optional service charge need not account for VAT on this service charge provided the customer has a genuine option as to whether or not to pay it.

In some cases, a business must account for output tax even if there is no payment – for example business gifts, samples of goods and private use of the business's own goods and services. Services, as opposed to goods, supplied free of charge do not, however, attract VAT.

Input tax

The output tax charged by a supplier is the customer's input tax which can be reclaimed with the customer's next return, assuming that taxable supplies are made.

Businesses which make a mixture of taxable and exempt supplies are known as partially exempt. Special rules exist for the reclaim of input tax by partially exempt businesses.

The criteria for the reclaiming of input tax, including details of the records which must be retained, are outlined in chapter 7. Certain input tax cannot be reclaimed – principally on the purchase of cars and on business entertainment.

Administration

VAT in the UK is administered by H.M. Revenue & Customs (HMRC). Until 2005 the responsible body was H.M. Customs & Excise, which also dealt with import and excise duties; this then merged with the Inland Revenue, which had administered other taxes such as income tax, capital gains tax, corporation tax, inheritance tax and stamp duty land tax.

Every registered person must submit a return at pre-defined intervals. VAT periods usually last three months, though some businesses opt to complete monthly returns and small businesses may do so annually. There are penalties for late submission of returns and for underpayment of VAT.

Returns are sent to the VAT Central Unit in Southend-on-Sea. VAT officers deal with the administration of VAT in their own areas, and businesses can expect to be visited from time to time. It is not possible to say how frequently VAT inspections take place, as this varies from business to business according to size, nature and compliance record. Since 1st April 2009, an officer of HMRC has been able to enter a person's business premises and inspect the premises, assets and documents if the inspection is reasonably required to check the person's VAT position. There is no power to enter any part of the premises which is used solely as a dwelling. The inspection may take place at any time agreed to by the occupier, or at any reasonable time provided that the occupier has been given seven days' notice. Visits may be carried out unannounced with the authorisation of senior HMRC officers and a tribunal.

HMRC issue guidance in the form of public VAT notices, and these can be found on its website. It should be borne in mind that these notices, although undoubtedly an excellent source of information, are not themselves the law but are only an

interpretation of the law – except where a paragraph is preceded by the words 'The following paragraph has the force of law.' They are amended from time to time in the light of tribunal decisions. Businesses can keep themselves up to date by reading the regular Revenue & Customs Briefs which announce changes in policy.

CHAPTER 2

REGISTERING FOR VAT

Introduction

This chapter gives guidance to businesses which are not yet registered for VAT and need to familiarise themselves with the rules for registration. The topics covered are:

- How businesses are defined
- Advantages and disadvantages of voluntary registration
- Compulsory registration
- Exemption from registration
- Artificial separation of businesses
- Deregistration – rules and consequences
- Overseas businesses

How businesses are defined

Only businesses can register for and charge VAT. The concept of what constitutes a business is difficult to outline with any certainty, as VAT legislation does not give any comprehensive definition. Hence the term 'business' is based on guidance given by HMRC and by case law.

It is often in the interests of a person to prove that he or she is in business. This is because there are certain potential benefits in registering voluntarily for VAT, as outlined below. HMRC may by contrast argue that a person is not in business and is therefore unable to register and take advantage of the benefits.

An important principle is continuity. A person making one-off supplies would clearly not be in a position to argue that he or she is in business – occasional car repairs for friends, the sale of a stamp collection, the sale of an individual's main residence are examples which come to mind. By contrast, the occasional car repairs may develop from a hobby into a more continuous and businesslike activity, as might the trading in stamps. There may come a point where it can be argued that this is a business, and the business may then become eligible to register for VAT.

There is no requirement for a business to be profit-making. It is sufficient for it to be making taxable supplies for a consideration, be conducted on sound business principles and be a 'serious undertaking earnestly pursued'. This may allow loss-making businesses to register, even if they are viewed from some angles as a hobby. There may be some apparent inconsistency here, as such businesses may be told that their trading losses are disallowable for income tax purposes as they are not carrying on a trade on a commercial basis with a view to realising profits. Nevertheless, they may be able to reclaim their input tax.

The case *Lymington Power Boat Charter* involved a couple who purchased a yacht, ostensibly for charter. But in a three-year period there were only six charters with a gross income of £8,250. In this period the couple personally used the boat for 93 days. It was held that they had simply gone through the motions of setting up a business which was only a device for tax relief, and they were ordered to repay input tax of £213,334.

Non-profit making organisations such as charities may make taxable supplies. A donation freely given is clearly not a taxable supply, but sales of goods from charity shops are taxable. They are zero-rated if the goods were donated to the charity; the sale of purchased goods is standard-rated subject to the nature of the goods being sold. Charities may also make taxable supplies of catering. Members' clubs make

taxable supplies of subscriptions, though it is necessary to look behind the subscription and establish what the members are receiving in return: if, for example, the subscription allows the members to take advantage of educational classes, it is exempt from VAT, education itself being an exempt supply.

Government bodies are generally outside the scope of VAT because they are required by statute to levy taxes and rates and the services they are obliged to perform are therefore not taxable supplies. Nevertheless, not all their activities are covered by their statutory obligations, and taxable supplies may result. A local authority *(Metropolitan Borough of Wirral, 1995)* was required to account for VAT on the charges it levied for an information service, as a private sector company could also have supplied these services. Not to require the local authority to account for VAT would have given it an unfair competitive advantage. Television licences are outside the scope of VAT, but the sale of books and DVDs by the BBC are taxable supplies, albeit zero-rated in the case of books.

A sole trader operating several distinct business activities in his or her own name is covered by one VAT registration. Clearly, if this were not the case, it would be possible to circumvent the registration rules by artificially splitting businesses. Likewise, a partnership requires only one VAT registration.

Advantages and disadvantages of voluntary registration

Many businesses whose turnover falls below the level at which VAT registration is compulsory nevertheless choose to register for VAT. Any business which makes taxable supplies, but not exempt supplies alone, may register voluntarily. The greatest benefit of voluntary registration is the ability to reclaim input tax.

The above also applies to businesses which make supplies outside the scope of VAT under the place of supply rules but which would be taxable supplies if they were made in the UK. For example, a UK business whose activities consisted solely of arranging the purchase of holiday homes in a different country might be liable to register for VAT in the country in which the property were situated, but it would not have to register for UK VAT. Nevertheless, by registering for VAT in the UK it would gain the right to reclaim UK input tax, despite not actually charging any VAT in the UK. Its return would consist of a repayment claim only.

There are other non-quantifiable benefits. Firstly, a VAT number may lend a measure of credibility to the business. A customer or supplier may be more willing to trade with the business if a VAT number is present. Secondly, a VAT registration imposes discipline on

a business. A non-registered sole trader or partnership need bring its books up to date only once a year for the purposes of the income tax return. A non-registered limited company has to file its annual accounts before the filing deadline which is nine months from the balance sheet date for a private company under the Companies Act 2006; there is an obligation under company law for companies to keep accounting records capable of showing the financial position at any time (s386 Companies Act 2006), but in reality very few checks are carried out, and shareholders do not even have an automatic right to inspect accounting records. A VAT registration changes all this and obliges the business to bring its records up to date at least every three months, unless it submits annual returns.

Of course, the obvious disadvantage of registering for VAT is the obligation to charge VAT. This does not matter if all the business's customers are themselves VAT-registered, since they can reclaim the VAT charged. But if any customers are non-registered businesses or private individuals, they have no right of reclaim and consequently suffer an increase of 20% in their prices. If the business makes largely zero-rated supplies, which includes exporters and those making supplies to traders in other countries in the European Union, this will not be an issue.

A further disadvantage of voluntary registration is that the same obligations to submit timely returns and account for the correct amount of VAT apply to all registered businesses whether they registered voluntarily or compulsorily. Likewise, the same penalties apply. This need not be a concern if the business is confident in its procedures.

Compulsory registration

This works in two ways.

Firstly, a business which is not already registered must register if at the end of any month (the 'relevant month') its taxable supplies – the total of any standard-rated, reduced-rated or zero-rated supplies but excluding any exempt supplies – for the last twelve calendar months exceed the registration threshold. It must notify HMRC of this fact within 30 days of the end of the relevant month and will be required to start charging output tax from the first day of the next month but one after the relevant month.

Secondly, a business which has good reason to believe that its taxable supplies in the next 30 days alone will exceed the registration threshold must register. It must notify

HMRC by the end of the thirty-day period, and its registration will be effective from the beginning of that period.

If a business has submitted its application for registration but has not yet received a VAT number by the date on which it must begin charging VAT, it must not send out VAT invoices. Instead, it must charge the gross amount including VAT, but not showing VAT separately on any invoice. Once it has received a VAT number, it can replace the previous invoices with VAT invoices. Given that applications for registration are often not processed within the target period of fifteen days, this means that a business customer is unfairly deprived of the opportunity to reclaim input tax until a VAT invoice is issued. Many suppliers will therefore delay charging VAT until they have a VAT number, thus running the risk that the customer will then be unable to pay, while the supplier still has to pay the VAT over to HMRC.

HMRC will accept an application for registration which is backdated by up to four years. This would be useful if a business had incurred research and development costs and then commenced making taxable supplies. Past input tax would be reclaimable. It is important to specify the wish to backdate the registration at the time of submitting the application, as HMRC will not accept a subsequent revision of the effective date.

Exemption from registration

Businesses whose taxable supplies exceed the registration threshold may nevertheless be able to claim exemption from registration. This may be possible if the business can prove to the satisfaction of HMRC that its taxable supplies in the twelve months beginning on the date it would normally have to register are unlikely to exceed the deregistration threshold which is generally marginally below the registration threshold.

Businesses making only zero-rated supplies may choose not to register for VAT, subject to the approval of HMRC. This course of action is not necessarily advisable, as the business will lose the right to reclaim input tax.

Artificial separation of businesses

HMRC have the power to prevent the artificial separation of business activities carried on by two or more persons. They must consider how closely bound the persons are by financial, economic and organisational links, and if appropriate they may make an order to the effect that the persons are considered to be one for VAT registration purposes.

A sole trader supplying mobile phones makes annual taxable supplies of £12 million to registered customers and gains new non-registered customers to whom he or she intends to make annual taxable supplies of £30,000. He or she sets up a new limited company which will make supplies to these customers and remain below the registration threshold.

HMRC will almost certainly make an order to the effect that the limited company is to be regarded as the same person as the sole trader. It will therefore have to charge output tax on all its taxable supplies.

In the above example, the sole trader retains a controlling influence over the company, and this is a common reason for an order. If the same premises are used by two entities, this would also be taken into account: in one case (*TSD & Mrs M E Williams*), a husband and wife carrying on business as a café and bread shop from the same premises were deemed to be a partnership and not two sole traders although in another (*Trippitt*), the wife of a publican who provided bed and breakfast and paid 35% of her income to her husband was deemed to be running a business in her own right

Deregistration – rules and consequences

A business which ceases making taxable supplies must advise HMRC within 30 days of the date of the last taxable supply, which will normally be the date from which its registration ceases to have effect.

Otherwise, a business which can satisfy HMRC that its taxable supplies in the next twelve months will not exceed the deregistration threshold may opt to deregister.

In either case, the reclaim of subsequent input tax is not necessarily prevented. If an invoice is received for services after the date of deregistration, input tax can be reclaimed provided the services relate to taxable supplies made before deregistration.

A business which deregisters is liable to account for output tax on the market value of its assets, including land, on hand at close of business on the last day of registration. This is because those assets were purchased – and input tax incurred – on the understanding that it would use them in order to make taxable supplies.

Assets on which no input tax was incurred can be excluded from the claim, as can assets on which the input tax was 'blocked'. If the resultant output tax on the remaining assets is no more than £1,000, the business need not account for it.

Overseas businesses

Since 1st December 2012 businesses which are not established in the UK, that is, they do not have a place of business in the UK which has both the technical and the human resources capable of making and receiving supplies, have been required to register for VAT even if the supplies fall below the UK threshold.

CHAPTER 3

CHARGING OUTPUT TAX

This chapter explains the different rates of VAT which apply to supplies. The topics covered are:

- Differences between zero-rated and exempt supplies
- Supplies for no consideration
- Trade promotion
- Reverse charge on supplies of mobile telephones etc
- Categories of zero-rated supplies
- Categories of exempt supplies
- Categories of reduced-rated supplies
- Transfer of going concern

Differences between zero-rated and exempt supplies

No output tax is charged on zero-rated or exempt supplies. In the eyes of most customers, there is therefore no difference between them – no input tax is available for reclaim. Certain customers who use a special method for their partial exemption may need to distinguish zero-rated purchases from exempt purchases.

For the supplier, however, there is a very important difference: zero-rated supplies are 'taxable supplies' whereas exempt supplies are not. Businesses which make taxable supplies may reclaim the related input tax; those which make exempt supplies may not.

All businesses incur input tax on overheads in the form of computer costs, heat and light, stationery, professional fees, premises costs among many other items. A business which makes solely zero-rated supplies – a bookseller or bus operator, for example – may register for VAT and reclaim all of its input tax. A business which makes solely exempt supplies – for example an insurance broker or a medical practice – may not reclaim any of its input tax. The rules for businesses which make a mixture of taxable and exempt supplies – known as partially exempt businesses – are covered in chapter 8.

Supplies for no consideration

A general rule of VAT is that, in order for a supply to be within the scope of VAT, some consideration, or payment, must be given in return. There are limited exceptions to this rule.

A business may periodically make gifts to customers, suppliers or employees. These may consist of wine at Christmas, executive presents or long-service and retirement awards to staff. In principle, business gifts fall within the scope of VAT. Any gifts of goods where the donor had the right to reclaim the input tax on purchase are included; it therefore follows that gifts of money are excluded.

Such gifts are ignored for VAT purposes if the total cost to the donor, net of VAT, of such gifts to the donee within a twelve-month period is no more than a value published by HMRC. If the cost exceeds this value, the donor must account for VAT on the whole value of the gift and not just the excess over this value. The value for accounting for VAT is measured by reference to what it would cost the donor to buy identical goods; in most cases this would equate to the actual cost of acquiring the gift.

Input tax on business gifts can always be reclaimed, even if the business does not have to account for output tax under the *de minimis* rule.

Business gifts to charities are zero-rated.

Revenue & Customs Brief 51/10 announced an important change to the VAT treatment of samples. In the case of *EMI*, the ECJ defined a sample as 'a specimen of a product which is intended to promote the sales of that product and which allows the characteristics and qualities of that product to be assessed without resulting in final consumption, other than where final consumption is inherent in such promotional transactions'. This does not include discontinued items as they cannot be used to promote sales; it might include a small glass of wine, as it allows the qualities of the wine to be assessed, but not a bottle of wine, which would be taxed as a business gift.

Where businesses provide samples free of charge, none of them are subject to VAT. This contrasts with the position before the *EMI* case, which was that only one sample of an identical item per customer was free of VAT. Subject to the time limits for correction of errors, businesses which have accounted for VAT under the old rules may make a claim for repayment.

There is also a deemed supply if a business acquires goods, reclaims the input tax but then puts those goods to permanent private use rather than selling them or using them in the business. This rule is to prevent tobacconists smoking their own stock, for example, and gaining a VAT advantage. The business must account for output tax on the value of the goods.

The rules for goods taken into temporary private use are more complex. For example, a business may purchase a van and allow an employee to use it privately. HMRC have the discretion to ignore insignificant private use; assuming that the private use is significant, the business generally has two choices: to apportion the initial input tax and not claim the percentage which relates to private use; or to reclaim all input tax and account for a percentage as output tax.

This latter method is known as the *Lennartz* mechanism (*Lennartz v Finanzamt München III, 1995*) and is the method preferred by most businesses. HMRC seek to limit the *Lennartz* mechanism to new capital assets, though it has been held that it can apply to a major refurbishment. The first step is to calculate the taxable costs, which will include depreciation on a straight-line basis, repairs and other running costs, but will not include exempt costs such as insurance, or costs outside the scope of VAT such as MOT and vehicle excise duty. These costs need to be recalculated for every VAT period.

The second step is to calculate the value on which VAT is due, which is:

The taxable costs x private use proportion

The private use proportion can be calculated on any fair and reasonable basis. Clearly the most accurate method for a vehicle would be to keep detailed mileage records.

With effect from 13th August 2007, a business may claim input tax in full on the purchase of a home computer for use by an employee only if the computer is necessary for the performance of the employee's duties. HMRC take the view that in these circumstances any private use will be negligible (Revenue & Customs Brief 55/07).

Trade promotion

Retailers sometimes run 'buy one get one free' offers. No adjustment is necessary for VAT purposes – VAT is simply accounted for on the price paid.

Vouchers can pose a more complex problem. If a business issues vouchers free of charge which can later be redeemed against certain purchases, there is no VAT at the time of issue. When the voucher is actually redeemed against goods, however, the business treats this as a business gift and may have to account for output tax subject to the *de minimis* rule.
Note that a free voucher redeemed against services, as opposed to goods, will carry no VAT implications.

Gift vouchers are issued by retailers for a payment by the customer. The payment for the voucher itself is disregarded for VAT purposes unless the payment exceeds the face value of the voucher, in which case VAT is due on the excess. When the voucher is redeemed against goods or services, the face value is treated as if it were a cash payment and VAT is due in the normal way. This therefore means that no VAT is due when gift vouchers are redeemed against zero-rated items such as books and children's clothes.

If a manufacturer gives cash back payments to its customers, perhaps when specified volumes have been purchased, this is seen as a reduction in the amount of the original taxable supply. The manufacturer may reduce its output tax and the customer must reduce its input tax (Revenue & Customs Brief 8/2007).

Reverse charge on supplies of mobile telephones etc

'Missing trader fraud' is an increasing problem for the UK Government and is estimated to cost HMRC between £2 billion and £3 billion a year. It involves a chain of suppliers, one of whom does not account for the VAT charged to its customer. Commonly, the

chain involves an initial supplier in a different EU country who zero-rates the sale of goods under the EU sales rules; this means that his or her customer has no need to reclaim any input tax and can fraudulently charge VAT to the next business in the chain and abscond with this VAT.
Since 2003, there has been an obligation on businesses receiving supplies of telephones, computers and similar equipment including chips, chargers and software to check the integrity of their supply chain. A business is not expected to go beyond what is reasonable but should nevertheless verify certain details of its supplier, for example by requesting to see the certificate of incorporation and VAT registration certificate and cross-checking with HMRC, obtaining a trade reference or credit check, or visiting the supplier's premises. One trader who was unwittingly caught up in a supply chain containing a missing trader was told by HMRC that the £13 million that was owed would not be repaid, although the trader fought the case and ultimately won.

Additionally, for all supplies of mobile phones and microprocessors made from one VAT-registered business to another VAT-registered business, provided the VAT-exclusive invoiced value is £5,000 or more, the supplier must not charge VAT. The invoice must make it clear that it is the customer's responsibility to account for the VAT. The supplier needs to obtain the VAT registration number of the customer and use it to complete a quarterly reverse charge sales list, and suppliers are strongly advised to verify the VAT registration numbers of any new customers.

Customers simply pay the supplier the net amount of the invoice. However, they should adjust their returns by calculating VAT at 20% of the invoice and adding this to box 1. They will then also add it to box 4, meaning that there is no net effect on the VAT payable. The net purchase must be recorded in box 7 but not box 6.

Mobile phones which are supplied on a 'pay as you go' basis are covered by these provisions. However, phones supplied with an airtime contract are not. Communication devices such as blackberries come under the general definition of mobile phones, but electronic storage media, MP3 players and GPS systems do not.

It should be stressed again that these provisions do not apply to invoices under £5,000, nor do they apply to any sales to customers who are not VAT-registered.

Categories of zero-rated supplies

There are sixteen categories of supplies which are zero-rated under the VAT Act 1994. Zero-rating is a transitional arrangement which has remained in force throughout the life of the EU's Sixth Directive (the 'Harmonisation Directive') and its successor,

Directive 2006/112/EC. It is permitted provided that zero-rating was in force on 1st January 1991. The implications of this are that the UK Government may not introduce zero-rating to any supplies other than those already zero-rated, and zero-rating may be withdrawn. The lack of power by the UK Government to apply the zero-rating as it would wish is illustrated by the need to introduce a VAT refund scheme for churches carrying out certain repairs, rather than zero-rating at source.

The categories are listed below, with the headings bulleted.

- Food

Zero-rating applies to food for human consumption, animal feeding stuffs, live animals and seeds for the production of food. Within these categories there are certain exceptions.

Catering is standard-rated. This includes food for consumption on the premises on which it is supplied, or hot food for consumption off those premises. Until 30th September 2012, "hot food" meant food which, or any part of which, has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature. From 1st October 2012, "hot food" is food which, or any part of which, is hot at the time it is provided to the consumer and:

a) has been heated for the purposes of enabling it to be consumed hot,
b) has been heated to order,
c) has been kept hot after being heated,
d) is provided to a customer in packaging that retains heat, whether or not the packaging was primarily designed for that purpose, or in any other packaging that is specifically designed for hot food, or
e) is advertised or marketed in a way that indicates that it is supplied hot.

Something is "hot" if it is at a temperature above the ambient air temperature, and something is "kept hot" after being heated if the supplier stores it in an environment which provides, applies or retains heat, or takes other steps to ensure it remains hot or to slow down the natural cooling process.

Up until 30th September 2012, communal areas for eating and drinking were not included when deciding whether food is consumed on the premises on which it is supplied. From 1st October 2012 the premises on which food is supplied include any area set aside for the consumption of food by that supplier's customers, whether or not the area may also be used by the customers of other suppliers.

Supplies of cold buffet platters can be seen as zero-rated supplies of cold takeaway food or as standard-rated catering, dependent upon the facts. Finger buffets advertised as intended for local offices have been seen as catering, whereas sandwiches available for taking away from the shop were seen as cold food.

Certain foods are always standard-rated. They include ice-creams and similar products which are edible while frozen. Confectionery is standard-rated: this includes chocolates, sweets and biscuits wholly or partly covered with chocolate – but not cakes, which are zero-rated. A jaffa cake was held to be a cake and therefore zero-rated (*United Biscuits (UK) Ltd*). Savoury snacks such as potato crisps, roasted and salted nuts are standard-rated; in *Procter &* Gamble, Pringles were held by the Court of Appeal to be crisps despite the fact that they are not made predominantly of potato flour. The Court said that a child would be able to determine the fact that they are crisps. Beverages fall into two categories: standard-rated beverages include alcoholic drinks, fruit juice, sports nutrition drinks, bottled water and carbonated drinks, while tea, coffee, cocoa and milk are zero-rated.

Live animals are zero-rated only if they are of a kind generally used as food for human consumption or yield such food. Therefore cattle, sheep, poultry, rabbits, honey bees and most fish are zero-rated. Horses, bumble bees and goldfish are standard-rated. The actual use is irrelevant: sheep sold for shearing and rabbits sold as pets are still zero-rated.

- Sewerage services and water

Water is zero-rated unless supplied for industrial use or in the form of bottled mineral water, which are standard-rated. Sewerage and the emptying of residential septic tanks are zero-rated, but the unblocking of drains is standard-rated, as is the emptying of industrial septic tanks and the removal of waste other than foul water or sewerage.

- Books etc

Printed matter is zero-rated. This includes books, newspapers, leaflets, brochures, music and maps. It excludes plans and drawings for agricultural purposes, and posters supplied separately. It also excludes text supplied electronically. If educational books are supplied together with CDs, the supply is usually apportioned between the zero-rated and standard-rated elements unless there is clear interaction between the book and the CD and the latter cannot realistically be used independently, in which case there is a single zero-rated supply.

- Talking books for the blind and handicapped and wireless sets for the blind

Talking books supplied to the Royal National Institute for the Blind, the National Listening Library and similar charities are zero-rated. This includes magnetic tape adapted for the recording of speech for the blind and severely handicapped. Additionally, the supply to a charity of wireless sets entirely for loan to the blind is zero-rated.

- Construction of buildings etc

The sale or rental of land and buildings is usually exempt but some such transactions are zero-rated.

The first grant of a major interest in a residential or charitable building is zero-rated. This covers dwellings; buildings used for a 'relevant residential purpose' (RRP); and buildings used for a 'relevant charitable purpose' (RCP). RRP buildings include children's homes, school pupil or student accommodation, care homes and armed forces accommodation. RCP buildings are those used by a charity for its charitable purposes; this does not include business use, and therefore charities which use a building to make supplies, such as shop sales, do not qualify. If the same parts of a building are used for both charitable and business purposes, RCP status applies as long as the total business use does not exceed 5%.

The grant of a major interest includes the sale of the freehold or the grant of a lease exceeding 21 years. As the zero-rating applies only to the first grant of a major interest, there can be only one zero-rating per property. Once a zero-rated 999-year lease has been granted, therefore, the subsequent sale of the freehold will be exempt. No zero-rating is allowed for buildings which has merely been extended, although the first grant of a major interest in a building which has been converted from non-residential to residential use qualifies for zero-rating.

If the sale qualifies for zero-rating, all input tax incurred by the person constructing the building may be reclaimed except for that on non-building materials such as carpets or electrical goods.

Construction work, which includes any work carried out on land and buildings, is usually standard-rated, with some exceptions which are zero-rated or reduced-rated.

The supply of construction services and related building materials is zero-rated as long as it relates to a new dwelling, RRP building or RCP building. Professional fees do not

qualify for zero-rating unless supplied by the builder. Non-building materials such as carpets or electrical goods do not qualify for zero-rating.

- Protected buildings

A protected building is one which is designed to remain or become a dwelling or a number of dwellings or is intended for use solely for a relevant residential or charitable purpose, and is a listed building or scheduled monument.

The first sale of a protected building which has been substantially reconstructed is zero-rated.

- International services

Work on goods obtained, acquired within or imported into the EU for the purposes of being worked on and then exported is zero-rated. Note that the terms 'import' and 'export' mean movement to and from the EU, and not simply between countries within the EU. The goods must be re-exported within a reasonable time after the work is completed. Alterations and repairs are normally covered by the zero-rating, but not inspection, testing or valuation, or repairs which have only become necessary as a result of the use of the goods while they are within the EU.

Any person arranging the export of goods as an intermediary can zero-rate his or her services, as can a person arranging the supply of services made outside the EU.

- Transport

Freight services are standard-rated. Passenger transport, however, is zero-rated in any vehicle, ship or aircraft designed to carry no fewer than ten passengers, irrespective of the number of passengers actually carried. There are certain exceptions including pleasure flights, transport within airport car parks and places of entertainment which are standard-rated. Rides on miniature railways are not seen as passenger transport and are therefore standard-rated, as are donkey rides.

Repairs and maintenance of ships and aircraft are zero-rated provided that they are not for recreational use and, in the case of ships, are of a gross tonnage of at least 15 tons or, in the case of aircraft, of a weight of not less than 8,000 kilogrammes. Maintenance includes testing of parts and components. The supply of parts and equipment for such purposes is also zero-rated, as indeed is the supply of the ship or aircraft itself, subject to the above conditions relating to use and weight.

For supplies of aircraft made on or after 1st January 2011, zero-rating is no longer based on the weight of the aircraft. Zero-rating is available only where the aircraft is to be used by airlines operating for reward chiefly on international routes.

- Caravans and houseboats

Until 5th April 2013, supplies of caravans exceeding the limits of size permitted for use on roads of a trailer drawn by a motor vehicle having an unladen weight of less than 2,030 kilogrammes were zero-rated. From 6th April 2013, zero-rating applies to caravans which exceed the limits of size of a trailer permitted to be towed on roads by a motor vehicle having a maximum gross weight of 3,500 kilogrammes and which were manufactured to standard BS 3632. This is designed to apply to caravans which are intended for continuous all year round accommodation. Supplies of houseboats designed as places of permanent habitation and not capable of being adapted for independent self-propulsion are zero-rated. Accommodation in caravans and houseboats is standard-rated. Fees charged by site owners in respect of first-time connection to electricity and gas are zero-rated. If goods are supplied with the caravan or houseboats, any items which would normally be incorporated into a new house, such as sinks, baths and toilets, are zero-rated, but loose items such as crockery and furniture are standard-rated.

- Gold

Supplies of gold between Central Banks are zero-rated, as are supplies of gold between a Central Bank and a member of the London Bullion Market.

- Bank notes

The issue by a bank of a note payable to bearer on demand is zero-rated.

- Drugs, medicines, reliefs for people with disabilities etc

Drugs prescribed by a doctor or dentist and dispensed by a pharmacist are zero-rated, as are drugs supplied by dispensing doctors. Excluded are drugs supplied during the course of care within a hospital or nursing home – this forms part of the exempt supply of care.

Supplies of aids to disabled persons, including stair lifts, computer equipment, wheelchairs, artificial limbs and heart pacemakers, are zero-rated.

Zero-rating applies to the supply to a disabled person of certain adaptation services. Broadly, these consist of the installation of ramps, the widening of doorways, the provision, extension or adaptation of bathrooms, and the installation of lifts and alarm systems. Kitchen or bedroom adaptations are not included. Note that the work must be invoiced to the disabled individual or to a charity and not to a local authority. The term 'disabled person' is interpreted strictly and specifically does not include persons who are frail and elderly but not disabled, or persons suffering a temporary incapacity such as a broken leg.

- Imports, exports etc

The rules for exports and imports are discussed in a separate book, UK VAT and International Trade – the Complete Guide.

- Tax-free shops

Before 1st July 1999, travellers between EU countries were able to purchase goods free of VAT. This has now been abolished. Any sales of goods at a port or airport in the UK are liable to VAT in the normal way. Sales on board a ship or aircraft on a journey between EU countries are liable to VAT in the country of departure.

The interpretation of the 'country of departure' was considered in *Kohler* by the ECJ, which held that, if a cruise ship puts into harbours, each time it does so a new point of departure is created. This is the case even if no passenger is allowed to join or leave the cruise at these locations and the stops are purely for sightseeing.

- Charities etc

A charity may zero-rate goods donated to it but not goods which it has purchased. Supplies to charities may also be zero-rated: these include talking books and wireless sets for the blind and disabled, business gifts to charities, lifeboats, goods used in connection with collecting monetary donations, medicinal products, substances to be used for medical or veterinary research, and advertising.

Advertising is defined as the right to make known an advertisement by means of any medium of communication with the public; the making known of an advertisement by means of such a medium; the services of design or production of such an advertisement; and closely related goods such as films or recorded cassettes. However, advertising cannot be zero-rated if the members of the public who are reached through the medium are selected by or on behalf of the charity. Nor can the advertising be used to create a website which is the charity's own; and a method of advertising which is not

a supply of someone else's advertising time or space is also excluded from zero-rating. HMRC Brief 25/10 confirmed that pay-per-click charity advertising is zero-rated.

Goods used in connection with the collection of monetary donations include lapel stickers, collecting boxes, pre-printed letters appealing for money, pre-printed collection envelopes and stewardship envelopes.

Suppliers making zero-rated supplies to charities often have to ascertain whether zero-rating is appropriate. In the cases of talking books and wireless sets for the blind and disabled, lifeboats and medicinal products, the charity must give the supplier a declaration that the goods are to be used for the specified purpose. Example forms can be found in Notice 701/6. In the case of advertising and goods used in connection with collecting monetary donations, the supplier is responsible for determining the VAT liability of the supplies made, and it is recommended that the charity gives the supplier a declaration that the conditions are fulfilled. Notice 701/58 contains a suggested form of declaration.

- Clothing and footwear

Clothing and footwear designed for young children and suitable only for young children are zero-rated. The accepted size limits are listed in VAT Notice 714, although these can be exceeded if it can nevertheless be shown that the garment is designed for a person under the age of fourteen. An item is deemed suitable only for young children if it is held out for sale for young children. All parties in the chain – manufacturers, wholesalers and retailers – should demonstrate on labelling, packaging, signs or advertising that the clothing is intended for young children. In particular, retailers need to keep children's clothing apart from adult clothing.

Protective boots and helmets for industrial use are zero-rated provided that they meet certain safety standards and are not supplied to an employer for use by employees. Supplies from manufacturers to wholesalers and from wholesalers to retailers can be zero-rated.

Motor cycle and pedal cycle helmets meeting safety standards are zero-rated.

Categories of exempt supplies

There are fifteen categories of supplies which are exempt under the VAT Act 1994. The categories are listed below, with the headings bulleted.

- Land

Broadly, with certain standard-rated and zero-rated exceptions, the sale or rental of land and buildings is exempt.

The sale or rental of land and buildings is exempt, with some zero-rated and standard-rated exceptions.

The sale of the freehold of a new or uncompleted freehold building used for commercial purposes is standard-rated. A 'new' building is one which is within the first three years since its completion date.

Options to tax a specific property allow vendors or landlords to convert exempt property transactions into standard-rated ones. The purpose is to allow the reclaim of input tax incurred by the vendor or landlord on the upkeep of the property and other related costs.

Options to tax are disapplied if the building is to be used for residential or charitable purposes. Supplies relating to such buildings are exempt unless they fall within the zero-rated categories. Otherwise, an option to tax, once made, cannot be revoked for 20 years or until the taxpayer has not held an interest in the property for six years.

Certain supplies are standard-rated by law. They include car parking, hotel and holiday accommodation, gaming and fishing rights, sports facilities, pitches for caravans and camping, self-storage facilities and hairdressers' chair rentals.

- Insurance

Insurance services are exempt from VAT.

- Postal services

Postal services supplied by the Post Office are exempt. However, since 31st January 2011 services which Royal Mail is not required to make under a licence duty, such as those made by Parcelforce, as well as services provided on terms and conditions that have been freely negotiated, are subject to the standard rate of VAT.

Postage stamps are exempt if supplied at or below face value, but first day covers are standard-rated.

- Betting, gaming and lotteries

Money taken by bookmakers and casinos is exempt. Admission to premises is standard-rated, as is money taken by gaming machines such as jackpot machines. Pinball machines were unintentionally removed from the definition of gaming machines for a while, and therefore takings became exempt, but the standard-rating was restored on 1st November 2006. An essential element in the definition of a gaming machine is that it involves both an element of chance and an element of skill.

- Finance

The following finance-related supplies are exempt:

- The issue of coins and banknotes.
- The supply of an automatic teller machine or services related to its routine operation.
- Charges made by an employer for deductions from an employee's pay.
- Charges by banks for dishonoured cheques.
- Commission for foreign exchange transactions.
- Interest on loans.
- Bank and building society charges.
- Charges by credit card companies except for late payment.
- Sales of shares.

If a retailer makes an additional charge to a customer for accepting payment by credit card, output tax must be accounted for on the full amount of the transaction, as the charge is seen as further consideration for the supply of goods or services under the principles outlined in chapter 6.

Charges levied by credit card companies for late payment are not a consideration for a supply and are outside the scope of VAT.

Investment, financial and taxation advice are all standard-rated, as are charges for equipment leasing.

Debt factors usually charge interest, also known as a discount charge, which is exempt. However, any administration or service charge is standard-rated. Likewise, charges made by a debt collection agency are standard-rated.

- Education

Education provided by eligible bodies, which are schools, universities, government bodies, local authorities, is exempt. Eligible bodies also include non-profit making organisations which apply profits from exempt supplies of education to the continuance of such supplies. The setting and marking of examinations supplied by or to any of the above, or to their pupils and students, are also exempt.

Even if not supplied by an eligible body, education is exempt if the consideration payable is ultimately a charge to the Learning and Skills Council for England or the National Assembly for Wales. *Creating Careers* successfully argued for exemption when it provided educational courses to colleges of further education, which in turn were reimbursed by the Learning and Skills Council. It was immaterial that the funds passed through the colleges en route to the company providing the courses.

Private tuition is exempt if supplied by an individual in a subject ordinarily taught in schools and universities, which includes sporting and recreational activities. The exemption does not apply if the tuition is given by an employee of the supplier – the person supplying and invoicing the tuition must actually carry out the tuition himself. This means that private tuition provided by limited companies is always standard-rated. Partnerships can exempt their supplies if the tuition is given by one of the partners.

- Health and welfare

Services of health professionals are exempt. Included are doctors, dentists, pharmacists, opticians and nurses. It makes no difference whether the services are provided to the patient or to a third party such as an employer or insurer.

Welfare services provided by charities or public bodies are exempt. This includes the provision of care for the elderly or sick, the care or protection of children and young persons, and the provision of spiritual welfare by a religious institution. Any goods provided alongside the welfare, such as meals or medication, are also exempt.

- Burial and cremation

Supplies of funeral packages including: the coffin; embalming; transport of the deceased; provision of bearers; and burial by undertakers and funeral directors are exempt, though the separate provision of flowers, catering and newspaper announcements are standard-rated. Orders of service are seen as zero-rated supplies of printed matter. If the package includes a mixture of exempt and standard-rated supplies, a fair and reasonable apportionment is needed.

Charges by cemeteries are likewise usually exempt, except that the erection of monuments is standard-rated.

- Subscriptions to trade unions, professional and other public interest bodies

Although subscriptions to clubs are usually standard-rated, subscriptions to trade unions are exempt, as are subscriptions to professional associations which exist for the benefit of individuals with a professional qualification. Subscriptions to political or religious bodies are also exempt.

- Sport, sports competitions and physical education

Entry fees for sports competitions are usually standard-rated but can be exempt if the event is run by a non-profit-making body, or otherwise if all the entry fees are put towards prizes.

There is a general exemption on sports facilities provided by a non-profit making body, and this covers the use of changing rooms and equipment, the provision of a playing area, training services and umpiring fees.

The letting of facilities otherwise than by a non-profit making body is standard-rated, with two exceptions: the provision of facilities for a continuous period of 24 hours or more, and a series of at least ten lets to a school or club, provided that the interval between each let is at least one day and no more than fourteen days. There must be at least 24 hours between events.

Cash prizes for competitions are outside the scope of VAT, but guaranteed payments and appearance money are standard-rated. Prizes in the form of goods are treated as business gifts. Loans of trophies are outside the scope of VAT. Sponsorship is likewise outside the scope of VAT unless something is given in return – for example, an event may be named after a sponsor, a logo may be displayed, hospitality facilities may be provided. In any of these cases the person receiving the sponsorship is deemed to be making taxable supplies.

- Works of art etc.

Sales of works of art under private treaty to bodies such as the National Gallery or the British Museum are exempt. Exemption also applies to works of art accepted in lieu of inheritance tax by HMRC.

- Fund raising events by charities and other qualifying bodies

Admission charges to fund raising events organised by charities or other non-profit making bodies are exempt. Goods sold at the event are also exempt, unless in their own right they would be zero-rated (children's clothes, for example).

The everyday running of a charity shop does not qualify, but one-off events such as balls, fetes, fireworks displays, dinners are all covered by the exemption.

- Cultural services etc

Local authorities and other government departments which charge for admission to a museum, gallery, art exhibition, zoo or a theatrical or musical performance must exempt those charges. Exemption also applies to similar charges levied by other non-profit-making bodies. Exemption does not apply to admission to cinemas, even by a charitable company.

- Supplies of goods where input tax cannot be reclaimed

If a business acquires goods and is precluded from reclaiming the input tax on purchase, the subsequent sale of those goods is exempt. This would occur on the resale of most cars, goods purchased exclusively for business entertainment, or goods purchased in the course of making exempt supplies. It does not apply where no VAT was charged on the original purchase; VAT must then be charged on the onward sale.

Under the same principle, a builder may acquire carpets for a property which is intended to be sold on a zero-rated basis and cannot reclaim the input tax on these items. If the property is a showhouse and the carpets are removed before the ultimate sale of the house and sold separately, that sale will be exempt.

- Investment gold

The supply of investment gold (as defined in VAT Notices 701/21 and 701/21A) is exempt.

Categories of reduced-rated supplies

EU countries may apply no more than two reduced rates, the minimum being 5%, to any of a list of goods and services specified in the VAT Directive. The UK has chosen to apply a rate of 5% to the following goods and services.

- Supplies of domestic fuel and power

Supplies of fuel and power for qualifying purposes – that is, for domestic use or for use by a charity otherwise than in the course of a business – are charged at the reduced rate. This applies to electricity, gas, oils such as kerosene, air conditioning and solid fuels such as coal, wood logs and barbecue fuels. If the fuel is used partly for qualifying and partly for non-qualifying purposes, an apportionment must be made, except that if at least 60% is provided for qualifying purposes, the whole can be reduced-rated.

If in doubt about the liability of the supply, the supplier should obtain a certificate from the customer declaring the precise percentage to be used for qualifying purposes. The certificate should include the supplier's name and address, the customer's name, address and VAT number, the address of the premises to which the supply relates and the percentage. A declaration should be made by a responsible officer that the facts are true and accurate.

Businesses can also benefit from the reduced rate if their usage is below certain *de minimis* levels specified in Notice 701/19. For example, a business receiving a supply of electricity at a rate not exceeding 1,000 kilowatt hours a month will be charged the reduced rate of VAT, as it will if it receives piped gas at a rate not exceeding 150 therms a month. The amounts are measured over the period covered by the invoice.

- Installation of energy-saving materials

Energy-saving materials such as insulation, draught stripping, central heating controls, solar panels and wind turbines, but not double glazing, are charged at the reduced rate if supplied by an installer for residential and charitable purposes. It is important to note that over-the-counter purchases are standard-rated – only an installer may reduced-rate the supply.

If the building is a new one, the supply is zero-rated.

- Grant-funded installation of heating equipment or security goods or connection of gas supply

Certain supplies to a person over the age of 60 or in receipt of benefits such as council tax or housing benefit, income support or an income-based jobseeker's allowance are reduced-rated. These supplies must be funded by a grant and include heating appliances, connection of a gas supply, installation, maintenance or repair of a central heating system, or installation of window and door locks or smoke alarms.

Again, the goods cannot be reduced-rated if they are purchased over the counter – only an installer may charge the reduced rate.

- Women's sanitary products

Sanitary towels and pads, tampons and panty liners are eligible for the reduced rate. This does not apply to wipes, sprays and incontinence products.

- Children's car seats

Safety and booster seats for children are charged at the reduced rate.

- Residential conversions

A conversion of a property which increases or reduces the number of self-contained dwellings within the building is reduced-rated.

- Residential renovations and alterations

The renovation or alteration of a residential building which has not been lived in for at least two years is reduced-rated.

- Contraceptive products

Any product designed for the purposes of contraception is reduced-rated, irrespective of whether the product is sold by a retailer, a vending machine or via the internet, or purchased by an individual or by an organisation.

This is overridden by the zero-rating of prescriptions and also for contraceptives fitted by a health professional as part of an exempt supply of medical care.

- Welfare advice or information

Any advice or information supplied by a charity or state-regulated welfare agency is reduced-rated if it relates to the physical or mental welfare of the elderly, sick, distressed or disabled, or to the care and protection of children and young persons.

Note that the exemption for education may override the reduced-rating provisions.

Separate supplies of goods are not covered by these provisions.

- Installation of mobility aids for the elderly

Certain mobility aids supplied personally to the elderly are subject to the reduced rate. The products affected are grab rails, ramps, stair lifts, bath lifts, built-in shower seats or showers containing built-in shower seats, and walk-in baths with sealable doors. The recipient must be over the age of 60 and the product must be installed in the person's private residence. Reduced-rating does not apply to such items installed in residential homes. Supplies of goods alone without installation cannot be reduced-rated, but supplies of installation alone can. The reduced rate will not apply to any repairs or replacements of those goods once installed.

This goes some way towards solving the problem experienced by many elderly people who are frail but not disabled and therefore do not qualify for zero-rating under the provisions for people with disabilities.

- Smoking cessation products

The reduced rate applies to smoking cessation products supplied by retailers or over the internet. This includes patches, inhalers and any other product whose primary function is to assist a smoker to give up smoking.

Products supplied on zero-rated prescription are unaffected and remain zero-rated.

- Caravans

From 6th April 2013, the reduced rate applies to caravans which do not meet BS3632 but exceed the limits of size of a trailer permitted to be towed on roads by a motor vehicle having a maximum gross weight of 3,500 kilogrammes. This is intended to apply to static holiday caravans.

Transfer of going concern

Transfers of a going concern are a special case, being outside the scope of VAT if certain conditions are met. The conditions for a transfer of going concern (TOGC) to be treated as outside the scope of VAT are as follows:

- The assets are to be used by the purchaser in carrying on the same type of business as that carried on by the seller. It is accepted that businesses are restructured after purchase, but provided that the same type of business is carried on for a very short period of time, it will be seen as a TOGC. But a shop previously used as a florist and sold to a hairdresser will not be a TOGC.
- Both buyer and seller must be VAT-registered. The buyer meets this condition if he or she registers immediately after the transfer.
- The business is capable of separate operation, irrespective of whether it is actually separately operated. The presence of goodwill is a reliable indicator of this: if the sale price is more than the market value of the assets transferred, then goodwill is probably present.
- There is no significant break in trading following the transfer. A short period of closure will be acceptable for repairs, and in *Abbas Aslanbeigi* a three-month closure of a catering business for hygiene improvements did not prevent the transaction from being seen as a TOGC.

If the shares in a limited company are sold from one person to another, it has been established by the ECJ in *AB SKF* that this may constitute a TOGC, provided that all of the shares are sold and the company carries on a discrete business. Otherwise, the sale of shares is exempt.

If all the conditions are met, no VAT must be charged. VAT may nevertheless need to be charged on the element of the sale price which relates to land and buildings – unless both the seller and the vendor have opted to tax the property before the sale takes place.

If the conditions for a TOGC are not met, VAT is charged on the sale of assets and goodwill in the normal way.

CHAPTER 4

TIME OF SUPPLY

This chapter explains the significance and identification of a tax point for both supplier and purchaser. The topics covered are:

- Importance of tax points
- Basic tax point
- Actual tax point
- Continuous supplies
- Advance invoicing
- Consequences of tax point for purchaser
- Authenticated receipts
- Bad debt relief

Importance of tax points

Every transaction within the scope of VAT has a time of supply, which is also known as its 'tax point'. The principal purpose of the time of supply is to establish the VAT period in which the supplier must account for VAT.

It is vital for the supplier to account for output tax in the correct period. However, the time of supply rules have other purposes. They enable a customer to establish the period in which input tax can be reclaimed. Should there be a change of VAT rate – either in the standard rate or in the rate applicable to a particular supply – the time of supply rules will dictate the rate of VAT to be charged on a particular supply. Businesses calculating their turnover in order to ascertain whether or not they should register for VAT will also need to be aware of the time of supply rules. Finally, the rules may affect the input tax reclaimable by a partially exempt business.

The first stage in establishing the time of supply is to identify the basic tax point. In the absence of an actual tax point, this basic tax point will be the time of supply. However, if an actual tax point is present, this becomes the time of supply.

Basic tax point

The basic tax point may differ depending on whether the supply is one of goods or of services. Usually there is no difficulty in differentiating between the two, as a supply of goods involves a transfer of title and not merely one of possession. Hence a business supplying goods under a hire purchase agreement would be making a supply of goods, whereas one simply leasing goods out for a fixed period, or carrying out work on another person's goods, would be making a supply of services. Power, heat, refrigeration and ventilation are seen as supplies of goods, as are the sale of freehold land or the grant of a lease in excess of 21 years.

The basic tax point for a supply of goods occurs when the goods are delivered or collected. If there is a series of deliveries relating to the same supply, the basic tax point occurs when the final delivery is made. In hire purchase and conditional sale transactions, although title to the goods often does not occur until the final payment has been made, the basic tax point is still the date when the goods are delivered or collected.

For goods supplied on sale or return, the basic tax point occurs on the earlier of the date when the customer indicates the intention to adopt the goods and twelve months after delivery.

The basic tax point for land is the date of the freehold conveyance.

The basic tax point for services is the date on which all work is complete except outstanding invoicing.

Actual tax point

Whether the supply is one of goods or of services, an actual tax point may override the basic tax point in one of three cases.

Firstly, if a payment is received before the basic tax point, this constitutes an actual tax point. Uncertainty may occur as to the exact date of payment if this is by cheque. Strictly, payment does not happen until the cheque has been presented and cleared, clearance usually being complete on the fifth working day after presentation. In practice, most businesses use the date a cheque has been paid in as the date of payment, and this date will then become the actual tax point.

Payment by standing order, direct debit, home banking facilities or other electronic transfer creates a tax point on the day the amount is transferred into the recipient's bank account.

It has been established by the ECJ in *Société Thermale d'Eugenie-les-Bains* that a deposit paid in respect of hotel accommodation which was forfeited when the customer cancelled the accommodation was not a payment for a supply and was therefore outside the scope of VAT. HMRC indicate that any VAT accounted for on the deposit can be reclaimed; the implication of this is that the customer must repay any input tax reclaimed when the deposit was paid.

Secondly, if a tax invoice is issued before the basic tax point, this creates an actual tax point.

Thirdly, if a tax invoice is issued no more than fourteen days after the basic tax point, this constitutes an actual tax point. This rule assists businesses which do not necessarily invoice their customers on the day that the supply is made. It is possible for a business to extend this fourteen-day rule, but only with the agreement of HMRC. In particular, many businesses invoice monthly for supplies made during the previous month and

may wish to use the invoice date as the time of supply – this is possible on written application to HMRC and subject to its agreement.

Continuous supplies

Special rules exist for continuous supplies of services, as there can be said to be no basic tax point until the agreement comes to an end. Therefore, an actual tax point occurs every time a tax invoice is issued, or when payment is made if earlier than the date of the invoice.

It is clearly to the supplier's advantage to treat supplies as continuous, as the time of supply will occur later. Supplies of rent, supplies by accountants and trustees, management services and long-term secondments of staff are normally regarded as a continuous service. Generally, there must exist a contract which commits the parties to doing some work during the period. An understanding that work will be undertaken should the need arise is not sufficient.

Suppliers of continuous services often issue pro forma invoices in order to delay the date of an actual tax point.

Although these are seen as goods, supplies of water, gas, heat, refrigeration and ventilation follow the same rules, and there is deemed to be an actual tax point every time an invoice is issued or a payment received if earlier.

Advance invoicing

Businesses often issue invoices specifying due dates for successive payments in respect of the same supply. Examples are tenancy agreements and the leasing of goods. Strictly, the time of supply for the whole amount invoiced is the date of the invoice, but provided that the invoice does not cover a period exceeding one year and it specifies the net amounts due on each date together with the rate of VAT and the VAT itself, the time of supply for each instalment is taken to be the due date. If payment is received earlier, the date of payment becomes the time of supply.

If there is a change of VAT rate between the date of the invoice and the final due date, the invoice becomes invalid for any payments outstanding, and a fresh invoice must be issued.

Consequences of tax point for purchaser

The rules for establishing the time of supply apply to purchasers in the same way as to suppliers. Thus a purchaser may reclaim input tax on the return for the period covering the supplier's tax point. The purchaser should have no difficulty establishing the supplier's tax point as this should be stated on the tax invoice.

> A business receives goods on 27th August. The goods are invoiced on 16th September. The business completes a return for the quarter ending 31st August.
>
> The business is able to reclaim the related input tax on its August return, as the time of supply – the basic tax point – falls within this period.
>
> If the goods had been invoiced on 6th September, the time of supply would have been 6th September under the fourteen-day rule. The input tax would have been reclaimable on the return for the quarter ending 30th November.

In the above example, input tax can be reclaimed on the August return only if the purchaser has received the supplier's invoice by the date that the return is submitted. Otherwise the purchaser must wait until the invoice has been received and claim the input tax on a later return. This does not constitute an error and no voluntary disclosure need be made; however, if the purchaser did not reclaim the input tax despite being in possession of an invoice and wishes to reclaim it on a later return, a voluntary disclosure may be required.

A purchaser in receipt of an advance invoice may not reclaim all of the input tax on receipt of the invoice. Instead the input tax must be reclaimed on each instalment as it falls due, though it may be reclaimed earlier if a payment is made before the due date.

Authenticated receipts

The authenticated receipt procedure may be used in the construction industry in connection with building, alteration, repair or demolition. It allows a supplier to issue an authenticated receipt for payment instead of a VAT invoice and must be mutually agreed by the customer and supplier.

First, the contractor issues a demand for a stage payment. The customer then pays, and within 30 days the contractor issues an authenticated receipt but must not also issue a

tax invoice. The authenticated receipt must show the date that payment was received and all the information normally required on a tax invoice.

The customer can reclaim input tax as soon as payment has been made, without waiting for an authenticated receipt. Customers who have difficulty in obtaining authenticated receipts should contact HMRC on the third occasion.

Tax invoices are more helpful than authenticated receipts for customers, as they can reclaim input tax before making payment.

Bad debt relief

As outlined above, the issue of a tax invoice will automatically give rise to a tax point if there has not been a tax point already. This means that the supplier must account for output tax even if the invoice has not been settled. This may pose problems if it becomes doubtful that the debtor will pay.

If the invoice remains unpaid six months after the later of the time of supply and the due date, bad debt relief may be claimed. There is no provision for earlier claims in the case of customers who have entered insolvency procedures. The supplier must write the debt off in the accounting records and then make an adjustment in box 4 of the next return for the VAT element of the unpaid invoice. If the invoice has been partly paid, the payment must be apportioned appropriately between the net amount and the VAT. It is not usually possible to allocate the whole of the customer's payment to the net amount and claim that none of the VAT has been paid, even if the customer has specifically refused to pay the VAT; although where a business (*Palmer t/a R&K Engineering*) retrospectively registered for VAT and issued invoices charging VAT on amounts which had already been invoiced, the tribunal ruled that full bad debt relief was allowable. In this case, the customer had paid the net amount and then gone into receivership. The tribunal commented that Customs had been dilatory in dealing with the registration, and the outcome might have been different had the business been responsible for delays in registration.

If the debt includes an element of interest for goods supplied in credit terms and the customer has defaulted after making some of the payments, the outstanding amount must be split between principal and interest when calculating the VAT outstanding.

The latest time at which a claim may be made for bad debt relief is four years and six months after the later of the time of supply and the due date of payment.

If a business buys another business and takes over debtors which subsequently become bad, there is normally no possibility of claiming bad debt relief. This is because only the original supplier may make a claim. The only exception to this rule occurs when one business takes over the VAT registration number of another business.

If, having claimed bad debt relief, the supplier subsequently receives payment from the debtor, the reclaimed VAT must be repaid by adjusting box 1.

At the same time as bad debt relief is reclaimed, the purchaser who has not yet settled the invoice must repay any input tax which was originally reclaimed. There is an obligation to do this by means of a negative adjustment to box 4 of the next return which falls after the later of the time of supply and six months after the due date of payment. If there is a dispute and the supplier has extended the due date for payment, the six-month period runs from the revised due date.

Once the debt has been settled in full or in part, an appropriate amount of input tax can be reclaimed.

CHAPTER 5

INVOICING

This chapter outlines the rules surrounding the issue of a tax invoice and gives examples of various types of invoice. The topics covered are:

- Time limits and means of transmission
- Standard invoice
- Retailer's invoice
- Rounding of VAT
- Credit notes
- Self-billing arrangements
- Pro forma invoices

Time limits and means of transmission

A business registered for VAT must provide a tax invoice if supplying goods or services to another taxable person in the UK. This does not extend to supplies to non-registered persons, although many businesses do not differentiate between customers and invariably provide tax invoices. No tax invoice is required if the supply is wholly zero-rated or exempt, nor if the purchaser will not be able to reclaim the input tax, for example on company cars or business entertainment, although it is nevertheless common practice to issue a tax invoice in such cases. Tax invoices must not be issued for supplies between companies belonging to the same VAT group, or where the customer operates a self-billing arrangement.

The time limit for issuing a tax invoice is 30 days from the tax point.

Invoices are usually prepared in paper form and delivered by hand or post. They can alternatively be transmitted by fax or e-mail, for which no permission is required from HMRC. The supplier has a responsibility to warn the recipient of a faxed invoice of the possibility that faxes received on thermal paper may not be permanent and that records should be maintained for at least six years.

Other electronic transmission which does not involve the preparation of a paper invoice is permissible with advance clearance from HMRC.

Standard invoice

Special rules apply for retailers' invoices and to invoices to VAT-registered persons in other EU countries but otherwise a tax invoice must include the following information:

- An identifying number. This must form part of a unique and sequential numbering system. It is possible to operate more than one sequence of invoices at the same time, for example for different customers or business units (VAT Information Sheet 10/07).
- The supplier's name, address and registration number.
- The tax point - also known as the time of supply.
- The date of issue if different from the tax point.
- The customer's name and address - the customer's registration number is not required.

- A description of the goods or services, the quantity and the unit price for accountable items.
- For each description, the net amount, VAT rate and VAT amount.
- The rate of any prompt payment discount.
- The total amount payable.

Sample invoice

ABC Ltd

ABC Limited
14 Farnborough Drive,
Cheadle, SK13 2NG

XYZ Ltd
31 Shepherds Avenue
South Cerney
GL6 1AZ

VAT reg **315 4664 63**
Sales invoice no **31456**

Tax point **31.1.XX** Invoice date **19.2.XX**

Quantity	Description and Price	Net Amount £	VAT Rate %	VAT Amount £
15	Tables @ £200	3,000.00		
50	Chairs @ £40	2,000.00		
	Cash discount of 5% if paid within 30 days	5,000.00	20	1,000.00
	VAT	1,000.00		
	TOTAL	**6,000.00**		

The only figure on the invoice which must be expressed in sterling is the VAT. Other figures may be expressed in other currencies.

Up to 1st April 2015 where a prompt payment discount is available, it is applied to the VAT whether or not the customer takes advantage of the discount.

From 1st April 2015 VAT is charged on the consideration received and VAT shown on invoices should be applied to the net amount before the discount.

The same does not apply to conditional discounts, which may be offered on the provision that the customer buys further goods at a later date. In this case, VAT is due on the full amount and can later be adjusted if the customer obtains the discount.

Retailer's invoice

A retailer is defined as a business which supplies goods to the public in relatively small quantities for use or consumption rather than for resale (OED). Retailers therefore include shops, restaurants and petrol stations. Services do not fall under the definition and therefore hotels and professional firms do not fall under these provisions.

Retailers are not required to produce a tax invoice unless requested to do so by the customer, and even then they may produce a less-detailed invoice. Retailers may of course provide full invoices if they so wish.

There are two options available. The first can be provided for any retailer's invoice and is similar to a standard invoice except for the following:

- Instead of the net amount of each supply, the VAT-inclusive amount is shown.
- At the foot of the invoice, the total payable must be analysed into the gross amount of standard-rated and reduced-rated supplies, the VAT, the net amount, the total zero-rated supplies and the total exempt supplies.
- Petrol stations may replace the customer's name and address with the vehicle registration number.

Sample retailer's invoice

Cobblers ltd

21 ST JOHN'S PRECINCT, CHESTER CH1 2JA
VAT REG 871 2075 34

MR L. LEATHER
11 LLYN LANE
LLANGOLLEN
LL11 1LL

SALES INVOICE NO **2345**

TAX POINT **5.3.XX**
INVOICE DATE **5.3.XX**

QUANTITY	DESCRIPTION AND PRICE	GROSS AMOUNT £
6	PAIR BROWN SHOES @ £60.00	360.00
12	PAIRS SHOELACES @ £2.40	28.00
2	PAIRS CHILDREN'S BLACK SHOES @ £25	50.00
		438.80
	VALUE OF STANDARD-RATED SUPPLIES INCLUSIVE OF VAT @20%	**388.80**
	VAT PAYABLE ON STANDARD-RATED SUPPLIES	**64.80**
	VALUE OF STANDARD-RATED SUPPLIES EXCLUSIVE OF VAT	**324.00**
	VALUE OF ZERO-RATED SUPPLIES	**50.00**

THANK YOU FOR SHOPPING AT COBBLERS LTD
PLEASE RETAIN YOUR RECEIPT

The second option is available only if the gross amount payable is no more than £250 and no exempt supplies are included on the invoice. In this case the invoice should include the following as a minimum:

- The supplier's name, address and registration number.
- The tax point.
- A description of the goods.
- The gross amount payable.
- For each rate of VAT: the gross amount payable and the VAT rate.

Many retailers omit the VAT rate. The result is that the invoice is not a complete tax invoice and should not be used by the purchaser to reclaim input tax.

Sample retailer's invoice – consideration no more than £250

W.H Boot Ltd

23 PARK STREET, ST COLUMB MAJOR TR8 7BV
VAT REG 564 9921 96

11:46:28	18AUG17
	AMOUNT PAYABLE £
DVD PLAYER	120.0
DVDs	24.00
BOOKS	
	174.00
VALUE OF STANDARD-RATED SUPPLIES INCLUDING VAT AT 20%	144.0
VALUE OF ZERO-RATED SUPPLIES	30.00

THANK YOU FOR SHOPPING AT W.H BOOT LTD

Please retain your receipt

There are two points to note. Firstly, the amount of VAT is not stated on this invoice. The VAT is calculated by multiplying the gross amount of the standard-rated supplies by 1/6 – here, the VAT is £24. Secondly, there is no requirement to state the customer's name and address.

Rounding of VAT

The general rule is that invoices can be rounded down to the nearest penny provided that the VAT charged to customers and the VAT recorded in box 1 of the return are the same.

If there is more than one supply on the invoice, each line must be rounded either down to the nearest 0.1p or to the nearest 1p or 0.5p. This means that VAT of 47.28p can be rounded down to 47.2p or rounded to 47.5p.

Credit notes

Where a credit note is provided in respect of an invoice, there is no obligation to adjust the VAT provided that both supplier and customer agree not to do so.

A credit note on which the VAT is adjusted must be issued within four years of the time of the original supply. It should be clearly identified as a credit note and include the following:

- Identification number and date.
- Names and addresses of supplier and customer.
- The goods or services involved, the quantity and amount credited, and the reason.
- The net amount credited, the VAT amount and the VAT rate.
- A reference to the date and number of the original invoice.

A debit note is issued by the customer instead of the supplier. Apart from this, the provisions applying to credit notes apply also to debit notes.

Self-billing arrangements

In some industries it is common for customers to draw up invoices themselves. Examples are those paying commission to their supplier based on the amount of sales they have made; publishers paying royalties to contributors based on copies sold; or customers receiving supplies such as oil which are weighed on their own premises. In each case, the customer ascertains how much is due to be paid to the supplier and draws up a self-billing invoice. A copy of this invoice is sent to the supplier together with payment.

Self-billing can be carried out without agreement from HMRC, but there must be a written agreement between the customer and the supplier which HMRC may ask to see. This agreement authorises the customer to produce self-billing invoices for a maximum period of twelve months; it must specify that the supplier is not to raise an invoice in respect of supplies covered by the self-billing agreement; and the supplier must agree to notify the customer of any changes in VAT status, for example if the business ceases to be registered, changes its registration number or becomes part of a VAT group.

When the customer produces an invoice, he or she must forward a copy to the supplier, having added the words 'The VAT shown is your output tax due to HMRC.' Otherwise, the same information is required to be included on the invoice as on a standard invoice. The supplier must then account for output tax and the customer may use the self-billed invoice as evidence for the reclaim of input tax.

Pro forma invoices

Pro forma invoices are often issued before it is known whether or not the customer will take up the goods. They are used where suppliers offer continuous services and wish to ask for payment from the customer without creating a tax point. A tax point would automatically occur if a tax invoice were sent.

Pro forma invoices are not tax invoices, and therefore do not create a tax point, if they are clearly marked 'This is not a VAT invoice', notwithstanding that they may include all the details normally required on a tax invoice. The supplier need not account for output tax but must do so when payment is received and must then send a tax invoice within 30 days. The customer may not use a pro forma invoice as evidence of input tax for the purposes of a reclaim but must wait until a tax invoice is provided.

CHAPTER 6

INCIDENTAL COSTS

This chapter considers the VAT treatment of a transaction appearing at first sight to include two supplies which in their own right would be charged at different rates of VAT. The topics covered are:

- Single and multiple supplies
- Disbursements

Single and multiple supplies

One transaction may apparently include more than one supply, even if the two are invoiced and paid together. The two elements of the transaction may carry different rates of VAT in their own right, or one may be a supply of goods and the other a supply of services.

The question often arises as to whether the two elements of the supply should be treated separately and different rates of VAT charged if appropriate, or treated as one single transaction with one rate of VAT. In the latter case, it would be necessary to identify the most significant element of the transaction and treat all other elements as ancillary.

Following *Card Protection Plan (2001)* which was ultimately referred to the ECJ, tribunals now have fixed criteria which they must consider in establishing whether a transaction consists of one single supply with one VAT rate or a multiple supply with independent elements and perhaps different rates of VAT. The effect of the judgment is that cases tend to be treated more often than not as single supplies. The case involved a company which provided insurance to holders of credit cards and maintained a register of the credit cards. Insurance would be exempt in its own right; maintenance of a register would be standard-rated. It was seen as a single exempt supply of insurance.

Tribunals must identify the essential features of the supply and consider what the customer is receiving. If it is to be treated as a multiple supply, the supplies must be distinct and independent and not merely components. Supplies which do not amount to aims in themselves but simply enhance the enjoyment of the principal supply are to be treated as ancillary, and one rate of VAT is to be applied to the entire transaction.

Obvious examples of single supplies include professional fees (which are usually standard-rated) and the professional's costs such as transport (often zero-rated) and postage (exempt). The transport and postage are not aims in themselves but are simply ancillary to the main supply of professional fees. They are known as 'incidental costs' and carry the same VAT liability as the fees.

Delivery charges are normally standard-rated but if supplied under a contract with food which is zero-rated then the entire transaction would be zero-rated. The same principle would apply to packaging which is normally standard-rated but when supplied with children's clothing it is zero-rated along with the children's clothing. Weight loss advice supplied together with food by *David Baxendale Services Ltd* was held by the High Court

to be a single supply of standard-rated weight loss advice. There was no zero-rating of the food element.

HMRC give the example of in-flight catering which would form part of a zero-rated supply of passenger transport as it is provided for the better enjoyment of the flight. Yet a substantial meal included on a river cruise is more than simply an adjunct and an end in itself, and there would be two separate supplies of zero-rated passenger transport and standard-rated catering (Revenue & Customs VAT Information Sheet 2/01). Distance learning is a standard-rated or exempt supply of education depending on the supplier, and any written materials are seen as ancillary and take the same liability (*College of Estate Management*). Company formation agents who supply standard-rated professional fees do not make a separate zero-rated supply of printed matter (the memorandum and articles of association) – the whole supply is standard-rated.

By contrast, a ski company (*Cairngorm Mountain)* provided standard-rated passes and zero-rated transport on a funicular railway, which was held to be valid.

In the case of a multiple supply, it is necessary to calculate the value of each separate supply on a fair and reasonable basis and apply output tax accordingly. The apportionment would normally be carried out on a cost basis, comparing the relative cost of the business of making the respective supplies. Alternatively, if the supplies are available separately, an apportionment can be carried out using normal selling prices.

Disbursements

Treating other costs as incidental and applying VAT to them is not necessarily the most beneficial course of action if the client is not registered for VAT and therefore cannot reclaim input tax. If the costs qualify as 'disbursements', they can be excluded when calculating the VAT. Certain criteria have to be met:

- The supplier must have acted as agent for the client when making the payment.
- The client actually received and used the goods and services. This means that the supplier's own travel would not qualify as a disbursement, but if the supplier paid for the client's travel, this could potentially be seen as a disbursement. Likewise, the supplier's own postage, bank transfer fees and telephone bills would not qualify as disbursements, although the costs of meeting the client's postage could be a disbursement.
- The client was responsible for paying the third party but authorised the supplier to make payment.

- The disbursements are separately itemised on the supplier's invoice, and only the exact amount paid by the supplier is recoverable from the client.
- The goods or services are clearly additional to the main supply to the client.

Even if all of these criteria are met, the costs may still be treated as incidental costs and VAT added in the usual way. Alternatively, they can be treated as disbursements: if they were standard-rated when the supplier met the costs, they must be added on as a VAT-inclusive amount and no further VAT must be added. In this case, the client will not be able to reclaim the related input tax unless the supplier passes on the third party's tax invoice addressed to the client, and the supplier will also have no right of reclaim. If the costs were zero-rated, exempt or outside the scope of VAT when the supplier met the costs, they are added on as a VAT-exclusive amount.

A solicitor invoices a client £4,900 for fees and the following costs:

Solicitor's own postage	£100
Estate agent's fees	£1,000 plus VAT £200
Stamp duty	£2,000

The postage cannot be treated as a disbursement. The estate agent's fees and the stamp duty potentially fall to be regarded as disbursements if they meet the criteria above.

If none of the costs are treated as disbursements, the invoice will appear as follows:

	£
Fees	4,900
Postage	100
Estate agent's fees	1,000
Stamp duty	2,000
	8,000
VAT at 20%	1,600
	9,600

A registered client will be able to reclaim input tax of £1,600 and the real cost will be £8,000. A non-registered client would have to bear the full cost of £9,600.

If the costs are treated as disbursements where possible, the invoice will appear as follows:

	£
Fees	4,900
Postage	100
	5,000
VAT at 20%	1,000
	6,000
Disbursements:	
Estate agent's fees	1,200
Stamp duty	2,000
	9,200

This is the cheaper option for a non-registered client. For a client who is registered, the real cost is £8,200 – the input tax on the estate agent's fees is not reclaimable unless the estate agent's invoice is made out in the client's name and is passed from the solicitor to the client.

Neither course of action makes any difference from the supplier's point of view: the VAT of £200 charged by the estate agent is reclaimable as input tax if it is treated as an incidental cost, or it is recoverable from the client if it is treated as a disbursement.

Instances in which businesses have treated costs as disbursements include the following:

A company paid its clients' taxi fares from the railway station to its premises. The taxi fares did not include VAT because the drivers were not required to register for VAT. The company treated the fares as disbursements.

A VAT consultancy obtained certificates of good standing on its clients from Companies House to send to overseas VAT authorities. These certificates were outside the scope of VAT. They were treated as disbursements.

A garage serviced cars and took them to a testing centre for MOT tests, which were outside the scope of VAT. The MOT testing fees were passed on as disbursements. In the case *Denton Auto Repairs*, the customer's bill set out the usual statutory fee for MOT tests and failed to mention that only a proportion of this was passed to the MOT testing centre by the garage, and in fact nothing on the invoice stated that the MOT test had been carried out elsewhere. HMRC took the view that this was a case of subcontracting and that VAT should therefore be added to the whole MOT fee; the tribunal disagreed

and stated that VAT did not apply to the part of the MOT fee which had been charged by the testing centre itself.

A printer compiled newsletters for its client and sent the newsletters to the addresses on its client's mailing list. The exempt postage was passed on as a disbursement.

The following is no longer available from 1st April 2009. An employment bureau supplying temporary staff to a business charged VAT only on its commission. If it paid the salary of the individual and invoiced this onwards, this element of the invoice could be treated as a 'disbursement' and VAT need not be charged. From April 2009, VAT must be charged by the employment bureau on the whole invoice, including the element relating to the salary.

The change outlined in the previous paragraph does not affect businesses hiring temporary staff which themselves make taxable supplies, as they can reclaim any additional VAT charged to them. There is a cash flow issue but nothing more. However, it does affect businesses which make exempt supplies. These include charities, care homes, medical practices and banks. Therefore if one of these organisations hires through an employment bureau an individual working as a temporary charity or care worker, a locum doctor or bank cashier, the additional VAT charged on the person's wages from 1st April 2009 is irrecoverable.

CHAPTER 7

RECLAIMING INPUT TAX: THE RULES

This chapter outlines the rules for recovery of input tax. The topics covered are:

- Criteria for reclaim
- Records
- Supplies to staff and subcontractors
- Pre-registration input tax

Criteria for reclaim

A business which is registered for VAT may reclaim input tax on its purchases subject to certain conditions. There are numerous special cases which are dealt with in chapter 8.

The purchaser must have received a supply in the course of business. An invoice received or payment made in relation to goods and services which have never been supplied, perhaps because the supplier has gone into liquidation, is not valid for VAT purposes and the input tax cannot be reclaimed.

Input tax on expenditure incurred for private purposes is not reclaimable. Whether or not expenditure is incurred for the purpose of a business is sometimes debatable: in *Wallman Foods* Ltd, expenditure on defending a sole trader or director against criminal charges was held not to be business-related (Wallman Foods Ltd).

The supply must have been made to the business and to no-one else. This is usually evidenced by an invoice addressed to the business – but see the notes on supplies to employees and subcontractors below.

> A Ltd is taken to court and is ordered to pay its opponent's legal costs which amount to £10,000 plus VAT of £2,000. Its opponent is not registered for VAT.
>
> The input tax of £2,000 is not reclaimable by A Ltd, as the legal fees were not supplied to it. The input tax is also not reclaimable by its non-registered opponent. The amount payable to its opponent will therefore be £12,000.

VAT which was incorrectly charged is not reclaimable as input tax. If a business receives a tax invoice which is incorrect because VAT has been charged on a supply which should have been zero-rated, exempt or outside the scope of VAT, no input tax is reclaimable. A retailer purchasing children's clothes which should have been zero-rated may not reclaim any input tax incorrectly charged. The purchaser of a business who was charged VAT when the conditions for a transfer of going concern were met may not reclaim any input tax, and the VAT charged may be recoverable by HMRC from the seller.

Likewise, VAT which is charged by a person who is not registered for VAT is, strictly speaking, not reclaimable, and the purchaser is liable to repay any input tax so reclaimed. Nevertheless, HMRC take a lenient view in most cases, particularly if the purchaser entered into the transaction in good faith and without good reason to suspect that the supplier was not registered. Businesses are not expected to check the identity of all suppliers but see chapter 3 for purchases of mobile telephones etc. In

case of doubt they may telephone HMRC to gain verification of a particular registration number and the identity of its owner. There exists a mathematical method of checking whether or not a given VAT registration number is in the correct format, but this should not be relied upon, as it does not allow for the possibility that the number has been 'borrowed' or even purchased - there have been reports of registration numbers being purchased for sums up to £50,000.

The input tax must have been incurred in the course of making taxable supplies. Any input tax directly related to exempt supplies made by the business is not reclaimable. Businesses which make both taxable and exempt supplies are subject to the partial exemption rules.

Finally, and most importantly, the purchaser must hold a valid tax invoice relating to the supply.

Records

A supplier's invoice, provided that it meets the criteria set out in chapter 5, if addressed to the purchaser and relating to supplies made to the purchaser for the purpose of the purchaser's business in making taxable supplies, is acceptable evidence for the reclaim of input tax. If the goods or services have been received but no invoice has yet arrived by the time that the return is submitted, the purchaser must reclaim the input tax on a subsequent return.

HMRC may accept tax invoices which are complete except for an identifying number, the customer's name and address and the tax point, provided that the invoice carries a date which can be assumed to be the tax point. It is, however, unwise to rely on this. Purchasers should make every effort to obtain complete tax invoices.

No tax invoice is needed if the total amount of the supply, including VAT, is no more than £25 and it relates to telephone calls, purchases through coin-operated machines, car park charges or toll charges. It is sensible to retain basic evidence that the expenditure was incurred – for example, a staff expense claim or cashbook entry – and input tax can be reclaimed only if the business is certain that VAT was actually charged. No VAT is chargeable for parking on public roads, as this can be administered only by the local authority; the subject of off-street parking provided by local authorities has been referred to the ECJ in the case *Isle of Wight Council.* The current position is that some authorities charge VAT and some do not. Note that certain toll charges are outside the scope of VAT, including the Dartford Crossing, the Erskine, Forth Road,

Humber, Itchen, Tamar and Tay Bridges, and the Mersey and Tyne Tunnels. Otherwise VAT is included in most toll charges including the Severn Bridge and M6 Toll Road.

Businesses which cannot obtain a valid tax invoice from their suppliers may be able to satisfy HMRC that they have a right of reclaim if they can provide alternative evidence such as a supplier's statement, prove that the goods were delivered or service provided and that payment was made, and show that the goods or services have been consumed.

Tax invoices from suppliers should, like other records including copies of sales invoices, delivery notes, bank statements and accounting records, be retained for at least six years. HMRC may give permission for records to be kept for shorter periods.

HMRC will expect to see original invoices during a VAT inspection, although it is accepted that some invoices may have been sent by fax or e-mail. Subject to permission from HMRC, it is possible to retain records in the form of microfilm and microfiche. Records can also be stored on computer if they can be readily converted into a legible form on request by HMRC. There is no requirement to notify HMRC of the decision to store records on computer.

Supplies to staff and subcontractors

HMRC accept that VAT on supplies made to employees in the course of their employment is reclaimable as input tax, provided that the expenditure is made for the purposes of the employer's business and the employer meets the full cost. This may cover fuel, car parking, subsistence, removal expenses and tools and materials purchased over the counter.

A valid tax invoice must be held. It does not matter that this may be made out in the name of the employee – although in the case of less detailed retailers' invoices, the invoice will not include a customer's name and address.

Note that no input tax is reclaimable on subsistence if a flat rate is payable to the employee. The amount reimbursed must be based on receipted expenditure; if the employer reimburses the employee a proportion of the expenditure, a similar proportion of the input tax may be reclaimed. Subsistence includes meals, accommodation and bar bills when the employee is away on business. It has been established by case law that, if a business pays for hotel accommodation for an employee who stays overnight following a late business meeting, or it accommodates employees who cannot travel home during a rail strike, the input tax is reclaimable.

Input tax on working lunches for employees is reclaimable provided that the lunch is not attended by any person who is not an employee. If any such third party attends, the lunch is covered by the business entertainment provisions.

If a self-employed person who is a subcontractor passes on expenses as part of an invoice, the position depends on whether or not the person is registered for VAT. If so, the VAT-exclusive amount of the expenses should be charged and treated as incidental costs – in other words, VAT should be added if the invoice is standard-rated.

If the person is not registered, the VAT-inclusive costs should be charged. The business may then be able to reclaim the input tax in the same way as it would if the subcontractor were a member of staff. This is, however, subject to the following conditions:

- The subcontractor is paid at a fixed rate which is not linked to the profits of the business.
- The expenditure is incurred solely in connection with the work for the business – if the sub-contractor stays in a hotel and then undertakes work for more than one firm in the locality, for example, the input tax is not reclaimable.
- The business must retain the tax invoice.

These provisions cover a subcontractor's subsistence, road fuel and other motoring costs. They also cover tools or materials, but only if the tools become the property of the business and the materials are incorporated into a supply by the business to the end-customer.

Pre-registration input tax

Businesses which register for VAT after incurring costs may nevertheless reclaim the input tax on those costs in certain circumstances. If goods such as stock and fixed assets have been purchased in the four years prior to registration (three years before 1st April 2009) and are still on hand on the date of registration, input tax may retrospectively be reclaimed. For services, the rule is more limiting: VAT may be reclaimed on services supplied in the six months before registration.

CHAPTER 8

RECLAIMING INPUT TAX: SOME PROBLEM AREAS

This chapter deals with expenditure on which the reclaim of input tax is subject to special rules. The topics covered are:

- Cars
- Fuel
- Business entertainment
- Mobile telephones
- Partial exemption

Cars

Input tax on the purchase of a car is in most cases 'blocked'. This means that VAT is charged by the supplier, but it is not reclaimable by the purchaser.

This principle does not apply to other vehicles such as vans and lorries. A car is defined as a vehicle with three or more wheels which is designed principally for the carrying of passengers, or alternatively has roofed accommodation with side windows behind the driver.

Excluded are caravans, ambulances and prison vans; vehicles designed to carry one person only, or twelve or more persons; vehicles which weigh more than three tonnes unladen or may carry a payload of one tonne or more; and vehicles constructed for a special purpose. Included in the last category are hearses, ice cream vans, and Land Rovers with certain modifications such as folding seats in the rear, no rear seats or no side windows behind the driver. In all these cases, input tax may be reclaimed.

The general rule of blocked input tax can be overridden in rare circumstances if a car is to be used exclusively for business purposes. It was established *in Upton t/a Fagomatic* that this condition is met in any of the following circumstances:

- The car is not physically available for private use.
- The car could not realistically be put to private use.
- The car is insulated from the possibility of private use.

The first condition would be met if the car were purchased and then leased out to a third party – even to a member of staff – provided that the lease rental is no less than at a market rate. The second would be met in the case of a police car or emergency vehicle.

The third poses most problems. The case in question involved a sole trader who purchased a Lamborghini for the delivery of cigarettes to public houses in London. The trader claimed that the car was not intended for private use, as all the social and personal needs were met by walking or taxi. The High Court ruled that a mere intention not to use the vehicle privately is insufficient: active steps must have been taken to make it unavailable for private use.

Strictly, pool cars which are kept on the employer's premises and used by employees for business trips are available for private use if there are no provisions in place to prevent employees taking the car home on the night before a business trip, or even stopping to

do their personal shopping on the return from their business destination. The case *Elm Milk Ltd* involved a Mercedes owned by a company which had only one employee, who was also the sole director. The minutes of a board meeting stated that any private use would be in breach of the employee's contract of employment. The Court of Appeal accepted that the vehicle was for business use only, and input tax of £5,790 was reclaimable. A counter-argument put forward by Customs was that the car was insured for private and business use; however, this was seen as insignificant given that the company had been told that it was not possible to insure a car for business use only.

Despite the above, HMRC are often lenient in allowing input tax reclaims for company pool cars which are never kept overnight at a private home nor allocated to a single employee. A tribunal in *Peter Jackson (Jewellers) Ltd* accepted that an oral requirement that employees must not use a pool car for private purposes allows the car to be treated as purchased solely for business purposes. The rules are interpreted more strictly in cases involving sole traders or companies with one employee, as in both cases above.

If input tax is reclaimed on the purchase of a car and there is a later genuine change of intention, output tax must be accounted for on the market value of the car at the time of change. If, however, input tax was incorrectly reclaimed on purchase, interest and penalties may be charged.

Input tax on cars purchased by dealers as stock-in-trade or by driving schools is reclaimable.

Input tax on accessories such as car phones can be reclaimed only if the accessory is fitted subsequent to the purchase and it has some business use. Input tax on personalised number plates is usually disallowed unless the number plate can be seen as a conspicuous advertisement for the business.

Input tax on repairs and maintenance is reclaimable except in the case of a car which is used solely for private motoring with no business use.

An alternative to purchasing a car is leasing. In such cases, only 50% of the input tax incurred on the leasing charges is reclaimable. This rule is relaxed for hire periods which do not exceed ten days, and input tax is then reclaimable in full – although this does not apply if the car is hired simply to replace a company car which is temporarily off the road, when the 50% block applies irrespective of the length of the period of hire. If the lessor's invoice is split into a leasing charge and a charge for maintenance, the 50% block does not apply to the maintenance charge if it is genuinely optional.

Fuel

Businesses can pay for petrol and diesel either by reimbursing an employee an amount related to mileage on business trips or by buying all the fuel used by a vehicle, whether private or business-related.

If a business pays for all private and business fuel on a particular vehicle, it has three options. The same method must be used for all the business's vehicles – it cannot apply different methods to different vehicles. The methods are as follows:

- It may reclaim all input tax on fuel expenditure, subject to the retention of tax invoices. Assuming that there has been some element of private use, it must then account for output tax based on the fuel scale charge. The rationale behind the scale charge is that the business is making a supply of fuel to its employee, albeit free of charge, and output tax must be accounted for on supplies.

  The scale charge is a fixed amount which depends solely on the CO_2 emissions and the length of the VAT period. It does not vary in line with the amount of private fuel used.

- It may ask employees to keep detailed mileage records and reclaim input tax only on the proportion of fuel used for business purposes, subject to retention of tax invoices. This avoids the need to account for the scale charge. If employees' private mileage is very low, the output tax on the scale charge may be higher than the input tax reclaim. This method would then become attractive.

- It may simply opt out of reclaiming input tax, which again avoids the need to account for the scale charge. This may be an attractive option if employees' private mileage is low but the business does not wish to go down the arduous administrative route of keeping detailed mileage records.

If the business does not pay for all the fuel for a vehicle but simply reimburses an employee's business mileage, it may do so in one of two ways.

Firstly, it may simply reimburse an employee's fuel costs, which would usually be the case if the employee had the use of a company car. In this case, subject to the retention of tax invoices, the business is able to reclaim all the input tax.

Secondly, it may reimburse an amount which takes account of all the running costs of a vehicle – typically 45p a mile for employees who use their own vehicles. The business may reclaim input tax only on the fuel element of the amount paid. A business may set

its own rates as an approximation of the cost of fuel, but it is sensible to use the advisory fuel-only mileage rates published by HMRC, which can be found at

http://www.hmrc.gov.uk/cars/advisory_fuel_current.htm

The relevant rate for a vehicle depends on its engine size and whether it uses petrol, diesel or LPG. HMRC's current policy is to change the rates quarterly on 1st December, 1st March, 1st June and 1st September. Each time the rates change, the previous rates may continue to be used for up to one month, although it is not in the interest of the business to do this if the rates have risen.

The total fuel-only mileage cost is multiplied by 1/6 to arrive at the reclaimable input tax.

Alternatively, a business may use the rates recommended by motoring organisations such as the AA or RAC.

Employees must attach a valid tax invoice to support the claim. Usually the invoice will not exactly match the mileage claim because the fuel purchased by the employee will cover his or her private mileage as well as business trips, but provided that the input tax on the invoice is at least equal to the input tax reclaimed by the business, the invoice will be acceptable.

An invoice will not be valid if it is dated subsequent to the business trip. Employers should therefore ask employees who may conceivably be asked to use their own vehicles for business trips to make a habit of asking for tax invoices at petrol stations. These can of course be less detailed tax invoices.

A business which has not in the past reclaimed input tax may submit a reclaim for the past four years. However, unless tax invoices have been retained, no reclaim will be possible.

Business entertainment

Entertainment provided for anyone who is not an employee, partner, trustee or director is seen as business entertainment and related input tax is not reclaimable. This includes food and drink, accommodation, theatre and concert tickets, sporting events, entry to clubs and the use of capital goods such as yachts and aircraft. The input tax on the expenses of staff acting as hosts in such situations is also not reclaimable.

Employees for these purposes include self-employed persons treated in the same way for subsistence purposes as an employee, helpers, stewards and anyone essential to the running of sporting or similar events.

It is not business entertainment if it is provided under a contract. This would be the case if a charge were levied for the event; also if the business pays for auditors' accommodation in return for a corresponding reduction in the fee.

Working lunches attended by any person who is not an employee are business entertainment. It is advisable for records to be kept as to who attends such events. This also applies when an employee goes to lunch with a third party and the business pays: none of the input tax is reclaimable. There is one exception: if the lunch forms part of a business trip and it would be unreasonable to expect the employee to return to the office for lunch owing to the distance, the input tax on the employee's meal only may be reclaimed.

From 1st November 2010 traders have been able to claim input VAT incurred on the entertainment of overseas customers providing it is a part of business life and of a reasonable scale and character.

Revenue & Customs Brief 44/10 announced an important change in the treatment of entertainment provided to overseas customers in the light of *Danfoss and Astrazeneca* which was heard by the ECJ. The blocking of input tax on such costs is inconsistent with EU law, and businesses which have failed to reclaim such input tax should consider making a reclaim within the time limits set out in chapter 11. HMRC expects that the reclaim should be supported by details of the overseas customers, the type of expenditure, the VAT claimed and evidence of the type of business entertainment the business usually excludes from recovery.

The case in question concerned in-house business meetings at which food and drink was provided. There is, however, a private use charge unless the entertainment is provided for a strict business purpose.

Entertainment which is primarily arranged for employees is not seen as business entertainment even if non-employees such as guests are present. In this case, the business must apportion the input tax on the expenditure – which would include the food and drink, hire of the venue, transport to and from the event – between the number of employees, including directors, trustees and partners and the number of non-employees. In the case of *Ernst & Young*, which concerned a party at which a charge of £15 per head was made for guests, all of the input tax on the event was reclaimable as the entertainment was thereby made contractual. This was despite the fact that the

£15 charge did not cover the actual cost to the business. However, the business would then need to account for output tax on the charge made to guests.

If entertainment is arranged purely for partners or directors, this is not business expenditure and the input tax is not reclaimable.

Mobile telephones

If mobile telephones are provided to employees, input tax on the purchase of the phone is reclaimable provided that there is some business use. A fixed monthly charge which does not give the caller the right to any free calls is treated in the same way.

Input tax on call charges is reclaimable in full if all calls are business-related. In practice, a business may ignore private calls if they are small in value.

If free private calls are allowed, an apportionment must be made between private and business calls and the input tax apportioned appropriately. Strictly, every bill must be analysed, but in practice HMRC will accept a fair and reasonable apportionment based on a sample of bills.

If a charge is made to the employee for private calls, all input tax is reclaimable without the need for apportionment. However, the business must then account for output tax on the charge made.

Input tax on standing charges which give the business the right to free calls is treated in the same way as the calls themselves: an apportionment must be carried out if there is a mixture of private and business calls.

Partial exemption

Businesses which make a mixture of taxable and exempt supplies are known as 'partially exempt' and must attribute their input tax as far as possible to taxable supplies, in which case it is reclaimable, or exempt supplies, in which case it is not reclaimable. In most cases there will also be non-attributable, or residual input tax, on expenditure such as general office overheads. A percentage of this residual input tax is reclaimed by multiplying it by the following formula, rounded up to the next percentage point:

$$\frac{\text{Taxable supplies in VAT period}}{\text{Total supplies in VAT period}}$$

A business incurs input tax in the quarter ended 30th April 20XX as follows:

	£
Attributable to taxable supplies	10,000
Attributable to exempt supplies	5,000
Residual	3,000

In the quarter, it made supplies as follows:

Taxable	200,000
Exempt	40,000

Its partial exemption fraction is 84% (200,000/240,000).

The amount of the residual input tax it can reclaim is £2,520 (84% x £3,000).

The total input tax reclaimable is £12,520 (£10,000 + £2,520).

The input tax reclaimable each quarter by a partially exempt business is provisional. Once a year it must make an annual adjustment based on its supplies and input tax for the year to 31st March, 30th April or 31st May, depending on its VAT quarter dates. This lessens the effect of distorting factors such as large property sales.

A partially exempt business completes quarterly returns based on the following information:

	Residual Input tax	Fraction	Reclaimable
	£	%	£
30th June 20XX	10,000	64	6,400
30th September 20XX	8,000	65	5,200
31st December 20XX	12,000	30	3,600
31st March 20YY	11,000	62	6,820
Total			22,020

Its annual recalculation shows the following figures:

Year to 31st March 20YY	41,000	55	22,550

The business may reclaim an additional £530 (£22,550 less £22,020).

The adjustment is made by increasing or reducing box 4 of the final return of the year or of the following return. Having made this annual adjustment, the business may choose to use the percentage as its provisional percentage for the next year, carrying out an annual adjustment at the end of that year.

There is a de minimis level below which a partially exempt business can be regarded as fully taxable. This is the case if its non-reclaimable input tax falls below £625 per month on average and is also less than half of the total input tax. Non-reclaimable input tax is defined as the input tax attributable to exempt supplies plus the non-reclaimable proportion of its residual input tax.

If the business falls below the de minimis criteria, it is able to reclaim all of its input tax as if it made fully taxable supplies. This does not apply to 'blocked' input tax on such items as cars and business entertainment which remains non-reclaimable.

The foregoing is known as the standard partial exemption method. If it does not produce a fair and reasonable result, HMRC may agree to or impose a special method in which residual input tax is apportioned on the basis of numbers of transactions, staff numbers, floor space or more complex factors.

CHAPTER 9

THE VAT RETURN

This chapter looks at the rules for submission and completion of VAT Returns including monthly returns. It also explains how payments on account for large businesses are calculated. The topics covered are:

- Return periods
- Time limits for submission and payment
- Payments on account
- Completion of return
- Estimated returns
- Electronic submission of returns

Return periods

Businesses registering for VAT are notified by HMRC of their return period. The year-ends are 31st March, 30th April or 31st May and a business is allocated to one of these groups with returns being completed quarterly.

A business may ask for the return period to be changed, but there is no guarantee that the request will be agreed. HMRC are likely to agree to a request to bring the VAT periods into line with the financial year of the business. They have been known to agree to a request to move the VAT periods so that they do not correspond to the financial year of the business; this may be desirable if the business wishes to spread its workload. Special arrangements may be granted for businesses which prepare their management accounts on cycles of four or five weeks.

Businesses may be allowed to prepare monthly returns. This will be advantageous if the business makes supplies which are predominantly zero-rated – for example, most of its sales are exports or to VAT-registered persons in other EU countries. HMRC are less likely to agree to a request for monthly returns by a person who registered voluntarily, as opposed to one which was required to register.

Time limits for submission and payment

The return must reach HMRC no later than the last day of the month following the end of the Return period. Any payment must reach HMRC by the same date. From 1st April 2010, cheques are treated as having been received on the date that cleared funds reach HMRC's bank account, and not the date that the cheque is received. Revenue & Customs Brief 14/10 recommends that businesses paying by cheque allow three working days for the cheque to reach HMRC and a further three working days for it to clear.

There is an extension available to businesses which make payment electronically, most commonly by bank transfer. Such businesses receive an additional seven days to submit the return and pay the VAT due. Thus, a business with a return period ending 30th April would normally be required to submit the return and make payment by 31st May, but if payment were made electronically, this would be extended to 7th June. The payment must be in the bank account of HMRC by 7th June. If this falls on a weekend or a Bank Holiday, it must be received by the last working day before 7th June. From 1st April 2010, this concession applies also to repayment and nil returns as long as they are submitted electronically.

Many businesses now submit returns online. A condition of this method of submission is that payments are also made electronically, and therefore the seven-day extension also applies. Businesses which are required to submit returns online receive a notice to submit a return, and the stated due date now takes account of the seven-day extension.

Payments on account

The seven-day extension does not apply to payments on account. Businesses which are required to make payments on account will be notified by HMRC that they are required to do so, and this will apply to a business with an annual VAT liability of more than £2 million in the twelve months to 30th September, 31st October or 30th November. The business will be notified of the amount of the payment, which will be one twenty-fourth of the annual total. This will take effect in its next VAT year; payments on account will need to be made two and three months after the return period-end. On the normal due date for the return, a payment on account will be due.

A company's annual VAT liability in the year to 30th September 2012 is £3.6 million. It has not previously needed to make payments on account.

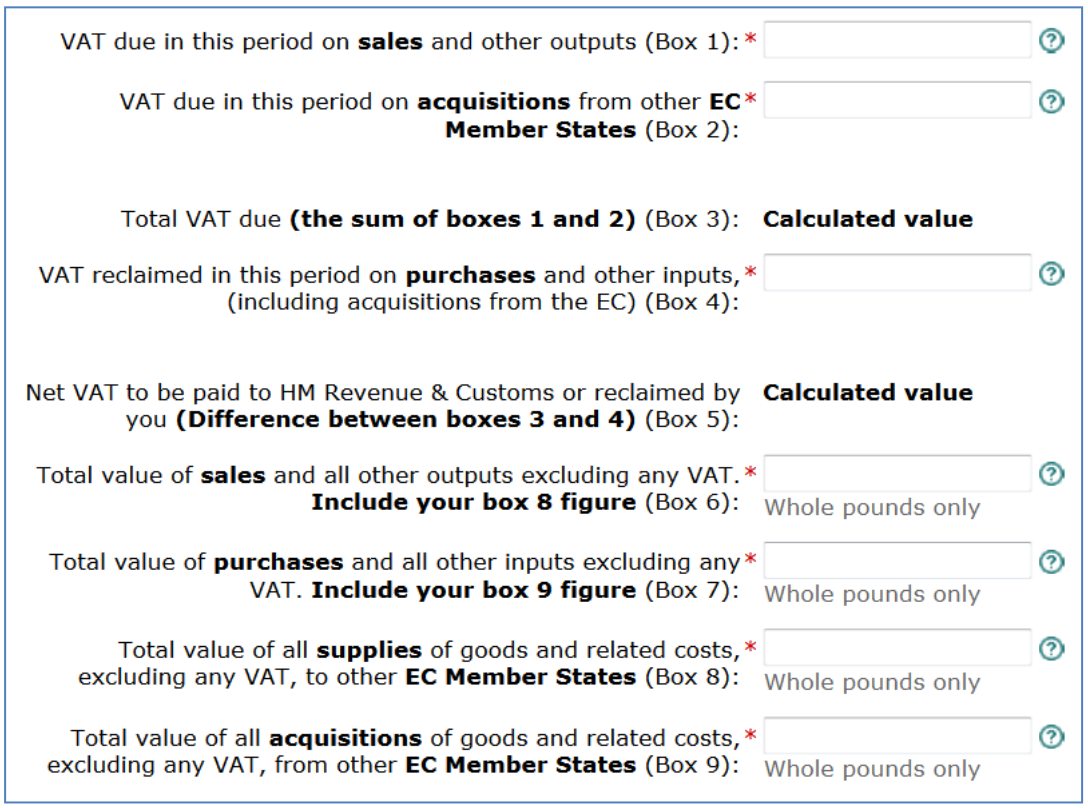
Its return to March 2013 shows a liability of £1 million; its returns to June and September 2013 show liabilities of £500,000 and £200,000 respectively.

The payments due are:

	£	
30th April	1,000,000	
31st May (£3.6 million / 24)	150,000	
30th June	150,000	
31st July (£500,000 - £300,000)	200,000	
31st August	150,000	
30th September	150,000	
31st October (£200,000 - £300,000)	(100,000)	(repayment)

A business which is normally required to make payments on account may change to monthly returns and thus benefit from the seven-day extension for electronic payments. Alternatively, it may continue to submit quarterly returns but make payments based on actual liabilities. However, in this latter case it will not receive an immediate repayment if it is in credit but will have to wait until the quarter-end. Nor will it benefit from the seven-day extension.

Completion of return



VAT due in this period on **sales** and other outputs (Box 1): *	
VAT due in this period on **acquisitions** from other **EC Member States** (Box 2): *	
Total VAT due **(the sum of boxes 1 and 2)** (Box 3):	**Calculated value**
VAT reclaimed in this period on **purchases** and other inputs, (including acquisitions from the EC) (Box 4): *	
Net VAT to be paid to HM Revenue & Customs or reclaimed by you **(Difference between boxes 3 and 4)** (Box 5):	**Calculated value**
Total value of **sales** and all other outputs excluding any VAT. **Include your box 8 figure** (Box 6): *	Whole pounds only
Total value of **purchases** and all other inputs excluding any VAT. **Include your box 9 figure** (Box 7): *	Whole pounds only
Total value of all **supplies** of goods and related costs, excluding any VAT, to other **EC Member States** (Box 8): *	Whole pounds only
Total value of all **acquisitions** of goods and related costs, excluding any VAT, from other **EC Member States** (Box 9): *	Whole pounds only

Box 1 includes all output tax in the period. The majority will be taken from the sales ledger, but it is important not to omit: supplies to staff such as vending machine sales, canteen proceeds, sales of old computers; sales of capital equipment; fuel for private motoring; business gifts; goods taken out of the business for private use; distance sales to non-registered persons in other EU countries; and self-billing invoices received. In addition, if there have been any part-exchange transactions, the full sales value must be recorded.

Box 2 includes VAT on acquisitions of goods from other EU countries. Boxes 1 and 2 are added together to form the total output tax in box 3.

Box 4 includes reclaimable input tax.

Box 5 contains the difference between boxes 3 and 4. This is the payment due. If it is a repayment, it should be shown in brackets. No payment or repayment is due for amounts under £1.

Box 6 includes all supplies made, whether taxable or exempt. Non-business income is not included. Supplies which are outside the scope of VAT under the place of supply rules are included in box 6. Insurance claims, loans and most grants are excluded.

During a VAT inspection, a business may be asked to reconcile box 6 to the revenue recorded in its financial accounts. The principal difference between the two will arise if the tax point is not the same as the point at which revenue is recognised in the accounts. This may occur in the case of a deposit or accrued revenue which has not yet been invoiced or paid which will not create a tax point but nevertheless may have to be recognised as revenue in the accounts. Non-business income such as grants may be included in the accounts but not in box 6.

Box 7 includes all purchases in the period. Excluded are wages, salaries and PAYE; drawings and dividends; loan repayments; MOT certificates; taxes and rates.

Boxes 8 and 9 include EU sales and acquisitions respectively.

Estimated returns

If a business is not able to produce an accurate return for a given period, it must obtain advance permission to submit an estimated return. Provided that permission is obtained and the estimate is adjusted and accounted for on the next return, no penalties will be charged.

Electronic submission of returns

Online submission of returns is mandatory for all businesses from 1st April 2012. However, businesses which are run entirely by individuals who have a religious conscience objection to the use of computers may still submit paper returns. HMRC have additionally indicated that they may allow exemptions from online filing for individuals with disabilities or those who live in areas with no internet access.

CHAPTER 10

VAT SCHEMES

This chapter deals with various special schemes for accounting for VAT. The topics covered are:

- Cash accounting scheme
- Annual accounting scheme
- Flat-rate scheme
- Second-hand goods scheme
- Tour operators' margin scheme
- Group registration

Cash accounting scheme

Businesses which have good reason to believe that their total taxable supplies in the next twelve months will not exceed £1.35 million may join the cash accounting scheme. A business whose taxable supplies in the last twelve months have exceeded £1.6 million must leave the scheme. Additionally, businesses are eligible only if they have a good compliance record over the last twelve months. If the business satisfies the conditions, it may join the scheme without notifying HMRC.

Standard VAT accounting may cause cash flow problems. A business must account for output tax in the period in which the tax point falls even if the customer has not yet paid the outstanding amount. The business must wait six months from the due date for payment before it can claim bad debt relief.

The cash accounting scheme may assist such businesses. In summary, output tax is accounted for only when the debt has been paid, and input tax can likewise be reclaimed only when the business has paid its creditors. The scheme is of no advantage to businesses which make predominantly zero-rated supplies.

There are certain transactions which must be accounted for in the normal way – in other words, the output tax and input tax must be accounted for in accordance with the normal tax point rules. They are:

- Hire purchase, lease and conditional sale transactions.
- Goods imported or acquired from a business in a different EU country.
- Supplies where payment is due more than six months after the date of the invoice.
- Supplies where an invoice has been issued before the delivery of the goods or the provision of services. However, cash accounting can be used if part of the goods/services has been supplied and the invoice relates only to that part.

When accounting for output tax, the business must treat the debt as having been settled on the day that the cash or cheque has been received, or, in the case of direct debits and bank transfers, the day the bank account has been credited. Input tax can be reclaimed on the basis of the date cash has been handed over or a cheque posted, or, in the case of direct debits and bank transfers, the day the bank account has been debited.

If a part payment is received, it must be apportioned between the net amount and the VAT.

A business using the cash accounting scheme issues an invoice as follows:

	£
Standard-rated goods	5,000
Reduced-rated goods	500
Zero-rated goods	1,000
VAT	1,025
	7,525

A payment of £1,850 is received.

The business must account for output tax of £252 (£1,850/£7,525 x £1,025) on the return for the period in which the payment falls.

Boxes 6 and 7 of the return must be based on net receipts and payments.

A business using standard VAT accounting should normally have no difficulty in reconciling its VAT account to its return. This is inevitably more complex for a business using the cash accounting scheme. A suitable reconciliation calculation might appear thus:

VAT account	X
VAT on outstanding debtors	(X)
VAT on outstanding creditors	X
Amount due on return	X

Annual accounting scheme

The turnover thresholds for joining and leaving the annual accounting scheme are exactly the same as those for the cash accounting scheme. There is no requirement to have been registered for more than twelve months. Unlike the cash accounting scheme, application is required for the annual accounting scheme.

One return is submitted each year. The business can choose its VAT year-end, and usually this will be the same as its financial year-end. The deadline for submission is the end of the second month following the VAT year-end.

It is usual for businesses to make nine interim payments during the year. These are paid on the last day of months four to twelve, and each one is 10% of the previous year's VAT liability, with a balancing payment made when the return is submitted.

Alternatively, HMRC may agree to three interim payments by the last day of months four, seven and ten, each being 25% of the previous year's VAT liability.

Flat-rate scheme

Businesses whose taxable supplies in the next twelve months are expected to fall below £150,000 may join the flat-rate scheme

Use of the scheme makes no difference to the output tax charged or to the format of invoices. However, when a business in the scheme completes its return, it calculates its total VAT-inclusive turnover for the period, including exempt supplies but not including interest received unless this arises from a primary purpose of the business, and applies the flat rate. This forms the figure in box 1. Because this will invariably be lower than the total output tax actually charged to its customers, there is no right of reclaim of input tax.

A business using the flat rate scheme has the following information for the quarter ended 30th September 2011:

	£
Standard-rated supplies	10,000
Zero-rated supplies	1,000
Exempt supplies	2,000
VAT charged	2,000
Input tax on purchases	250

Its flat rate is 6%.

Its total VAT-inclusive supplies are £15,000. It must therefore account for VAT of £900. This is much more advantageous than standard VAT accounting, under which it would need to account for £1,750 (£2,000 less £250).

The flat rate scheme cannot be used in conjunction with the cash accounting scheme. Nevertheless, a business using the scheme may choose whether to recognise turnover using the standard tax point rules or the cash based method, which recognises turnover when payment is received.

Input tax may be reclaimed only on the purchase of a single capital asset with a VAT-inclusive value of £2,000 or more. Capital goods are defined as any item which is not for resale, not expected to be consumed within one year and not for leasing out.

The rate applicable to a business depends on the category of business it carries on. The rates are shown at Appendix 2. Broadly, a business which does not normally incur large amounts of input tax is assigned a higher rate. Thus, labour-only construction services are assigned a flat rate of 14.5% whereas construction services with larger amounts of materials are assigned a rate of 9.5%. Accountants are assigned a rate of 14.5%, while manufacturers are subject to various rates between 9% and 10.5%. Businesses which make predominantly zero-rated or exempt supplies have very low rates – food retailers are assigned a rate of only 4% while post offices have a rate of 5%.

A newly-registered business joining the flat rate scheme is allowed to use a rate 1% lower than the published rate for its first twelve months of registration.

A business considering the flat rate scheme is well-advised to compare the likely reduction in output tax with the input tax foregone. It will not necessarily be advantageous for all businesses. The simplicity of the scheme is enhanced by the reduced need to keep detailed records of expenditure for input tax deduction. It is sufficient to keep a file of invoices in date order, although it is advisable to do more than this given that most expenditure – and the non-reclaimable input tax – is allowable for income or corporation tax purposes.

When completing the return, the business must include the VAT calculated at the flat rate in box 1. There will usually be no entry in box 4 and box 7 unless capital goods have been bought. Box 6 must include the total gross turnover to which the flat rate percentage was applied.

A business may leave the scheme voluntarily at any time, although HMRC usually expect this to be at the end of a VAT period. Alternatively, HMRC may specify that a business must leave the scheme because they consider it necessary to protect the revenue, although no examples of such circumstances are specified. If at any anniversary of the date it joined the scheme a business's total income in the last twelve months has exceeded £225,000, it must leave the scheme. A business which leaves the scheme is not eligible to rejoin for twelve months.

Second-hand goods scheme

By using the second-hand goods scheme, a business may opt to charge output tax only on its profit margin if the sales meet certain criteria. This significantly reduces the VAT and is an attractive scheme for motor traders, whose customers, being largely private individuals, cannot generally reclaim the VAT they pay at the point of sale.

A sale of goods qualifies only if no output tax was charged when the goods were purchased. Motor dealers will invariably have purchased second-hand vehicles from private individuals, in which case there will have been no VAT. No VAT invoice must be produced on sale. Instead, the dealer must make out a sales invoice showing the dealer's own name, address and registration number, the buyer's name and address, the stock book number, an invoice number, the date, description of goods and a total VAT-inclusive price. VAT must not be shown as a separate item. The invoice should be marked 'This is a second-hand margin scheme supply.'

However, when the dealer purchases the goods from a private individual or unregistered trader, a purchase invoice must be made out and retained showing the seller's name and address, the dealer's name and address, the stock book number, an invoice number, the date, a description of the goods and a total price. If the dealer has purchased the goods from another VAT-registered dealer, the invoice from that dealer should be marked 'This is a second-hand margin scheme supply.'

The scheme is not compulsory, and even goods which are eligible may be treated normally and VAT charged on the full sale price. It applies not only to second-hand vehicles but also to antiques, collectors' items and works of art, but not to precious stones or metals.

> A business sells a painting for £10,000 having purchased it for £7,000.
>
> It must account for output tax of £500 (£3,000 x 1/6).

Tour operators' margin scheme

Tour operators make supplies and incur expenditure in many countries. Under the normal rules, they would need to register for VAT in several EU countries, and the reclaim of their foreign input tax would necessitate extensive paperwork. The tour operators' margin scheme removes this necessity. It must be used by any business which buys in and resells the following to a traveller without material alteration: accommodation; passenger transport; hire of transport; use of special lounges at airports; trips or excursions; services of your guides. Catering, theatre tickets and sports facilities also fall within the scheme if they are supplied together with any of the above.

The place of supply rules for international services do not apply under the scheme. Therefore, a supplier who makes supplies only from an office in the UK, irrespective of

where the holidays actually take place, treats the place of supply of all its services as the UK, thus removing the need to register for VAT in other countries.

Suppliers falling within the scheme charge VAT only on the profit margin on a particular package when the supplies are enjoyed within the EU. Supplies are zero-rated when enjoyed outside the EU. No input tax reclaim is allowed on the cost of the package, obviating the need to reclaim input tax under several EU VAT regimes. Input tax reclaims on overheads are allowed in the usual way.

Group registration

EU legislation allows countries to treat independent legal persons as a single taxable person provided that they are closely bound by economic and organisational links and are established within the confines of one particular country.

EU Commission v Ireland (2013) C-85/11 – the CJEU confirmed that member states may allow non-taxable persons to be members of VAT groups. The UK position remains unchanged.

UK legislation interprets this as follows:

- Each of the companies has a fixed establishment in the UK – that is, its head office or a permanent place of business, with the necessary human and technical resources to carry on a business. A registered office or a UK-based branch alone are not sufficient.
- One of the companies controls the others, or one person controls all of them, or a partnership controls all of them.
- A company cannot belong to more than one group at the same time.

Applications can be made by a company to HMRC to form a group, join an existing group, leave a group, change the representative member, or disband a group. One company must be nominated as the representative member. In practice, the application is given immediate provisional effect from the day it is received, though HMRC then have 90 days to make enquiries and refuse it. The application may be refused if the companies have poor compliance records.

A business carried on by any group member is treated as though it were carried on by the representative member. Any supply of goods or services made by one group member to another is disregarded for VAT purposes. Output tax need not be accounted

for on these supplies, and no VAT invoices must be issued in respect of them. Goods imported by a group member or acquired from another EU country are treated as having been imported or acquired by the representative member. Input tax reclaim is determined in accordance with the use of the VAT group as a whole of goods and services received by each individual member.

> Group member A buys computer equipment and leases it to group member B, which uses the equipment to make exempt supplies outside the group.
>
> The input tax on purchase is attributed to exempt supplies and therefore non-deductible.
>
> If A and B were not in the same VAT group, A would charge VAT on the leasing to B and would consequently be able to reclaim the input VAT on purchase.
>
> In these circumstances, if the companies were not in the same VAT group and it were the opinion of HMRC that the leasing arrangement had been set up to engineer an input tax reclaim, an order could be given to treat the companies as grouped.

The representative member is responsible for accounting for VAT due on supplies made to outside parties, and for completing a single return. All members are, however, jointly and severally liable for any unpaid VAT – if the representative member is unable to meet a debt of the group, each member will be held liable for the amount of the debt until it is discharged.

Partial exemption rules apply to a VAT group as a whole in the way they would to a stand-alone business. Care should therefore be taken over a prospective member which makes any exempt supplies to ensure that the group as a whole does not suffer loss of input tax through the partial exemption rules.

The payment on account limits apply to the group as a whole and not to members individually.

CHAPTER 11

CONSEQUENCES OF UNDERPAID VAT

This chapter gives advice to businesses who have previously submitted incorrect returns; it explains the process for appealing against the assessments and gives details of the various penalties which may be levied. The topics covered are:

- Correction of errors
- Misdirection
- Assessments
- Default interest
- Default surcharge
- Misdeclaration penalties
- Civil evasion penalties
- Penalties for errors

Correction of errors

In order to avoid penalties, errors should be disclosed as soon as they are discovered and certainly before an inspection is announced. The time limit for correction of errors is four years after the end of the VAT period in which they arose. Prior to 1st April 2009 the error correction period was three years; a transitional period applied between 1st April 2009 and 31st March 2010.

The four year period runs from the end of the return period in which the error arose. However, where input tax has not been reclaimed, the four year period runs from the date on which the return was due to be submitted.

The method of correction depends on the size of the error. Prior to 1st July 2008, where the net value of errors discovered did not exceed £2,000, the next return could be adjusted and no default interest was charged. Errors above £2,000 had to be notified as a voluntary disclosure either by letter or on Form VAT 652.

For errors discovered in periods beginning on or after 1st July 2008, the threshold for accounting for errors by adjusting the return may depend on the figure in box 6 of the next return. If the net value of errors discovered since the last return is £50,000 or more, it must be disclosed by letter or on Form VAT 652. If the net value of errors is less than £50,000, it can be included on the return if it is no more than the greater of £10,000 and 1% of the amount in box 6.

If a business has underdeclared input tax, it should receive a repayment. The position with regard to overdeclared output tax is less straightforward: the business will not receive a repayment if, in the opinion of HMRC, it would be unjustly enriched. This would be the case if the business had incorrectly charged its customers VAT and were unable or unwilling to pass the refund on to them.

Marks & Spencer plc incorrectly charged output tax on chocolate-coated teacakes for 20 years before being alerted to the fact that, as cakes, they were zero-rated food. It made a claim for overdeclared output tax of £3.5 million covering the 20-year period, this being before the three-year cap was introduced in 1997. HMRC argued that the retailer would be unjustly enriched, as a retailer cannot pass a VAT refund to its customers. The retailer pointed out that its prices are set by the market and are not influenced by VAT rates, and so by including VAT in its prices it had suffered losses which it was now merely seeking to recoup. HMRC discovered that, when the standard rate of VAT increased from 8% to 15% in 1979, the retailer increased its prices. The House of Lords, however, ruled in favour of the taxpayer. This ruling was given on the grounds that the 'unjust enrichment' principle applied only to traders with a VAT liability at the time the

original claim arose, and not to traders who were due a repayment of VAT. This was held to be discriminatory.

Misdirection

If HMRC have misled a business with the result that VAT has been underdeclared, an assessment can still be raised. However, by concession HMRC have agreed that they will only raise an assessment from the date that the correct ruling is brought to the business's attention. For this reason it is important to obtain rulings in writing; although the concession applies also to advice given over the telephone, this is more difficult to prove.

HMRC's online guidance 'When you can rely on advice provided by HMRC' states that HMRC will be bound by their own incorrect information or advice provided that it is clear, unequivocal and explicit, the taxpayer made full disclosure of the facts and the application of statute law would result in the taxpayer's financial detriment. They go on to point out that their primary duty is to collect tax, and there will therefore be some circumstances in which they will not be bound by advice they have given.

Taxpayers should be very careful not to rely absolutely on advice given by HMRC's National Advice Service. The High Court heard a claim relating to *Corkteck* which was allegedly told that a supply of goods moving from the UK to Poland could be zero-rated, even though the customer was based in Belize and was not registered for VAT. The National Advice Service allegedly said that the supply could be zero-rated if the invoice stated the address and VAT number of the Belize business's end customer in Poland. The call record made by the officer who took the call differed from this. The High Court took the view that the National Advice Service is a source of general advice rather than binding rulings, and it upheld HMRC's assessment to recover VAT of £315,504 undercharged.

The principle of misdirection by omission was illustrated by a business which sold narrowboats. A narrowboat may be treated as a zero-rated houseboat if it is not capable of being readily adapted for self-propulsion. In this case, the boats did not qualify for zero-rating, but the business zero-rated them in error. HMRC did not notice the error during an inspection but discovered it on a subsequent visit and raised an assessment for past VAT. They subsequently acknowledged that this constituted misdirection by omission – the error was so fundamental to the business that no competent visitor would have failed to notice it. The business was therefore obliged to account for output tax only from the date of the second inspection.

Assessments

HMRC have the power to raise an assessment for errors discovered in the past four years. The period is extended to 20 years in cases of fraud.

Assessments may be made if no return has been submitted for a period. They remain enforceable until rebutted by evidence to the contrary, which would normally come in the form of a completed return. They may also be made if HMRC discover that insufficient records have been kept to justify the figures on returns. Otherwise, assessments are commonly issued if a business has reclaimed input tax not correctly reclaimable, or it has made supplies and not accounted for output tax.

Officers of HMRC must exercise their powers honestly, base their decisions on factual information and take into account all information presented to them. An officer who examines the takings of a business and finds them to be well in excess of what would be indicated by boxes 1 and 6 of a return would have good grounds for making an assessment. An officer who makes an assessment on the grounds that a business's declared gross profit margin is less than that of its competitors would have less justification, given that sales mixes may differ between businesses.

A business in receipt of an assessment may appeal to the VAT tribunal within 30 days of the date of the assessment or may request local reconsideration. If it requests local reconsideration and receives a decision, it still has the right of appeal, but in this case the time limit is 21 days from the date of the local reconsideration decision.

Following a tribunal decision, an appeal may be made to the High Court on points of law only, and not on points of fact. Further appeals may be made to the Court of Appeal, the Supreme Court or the European Court of Justice (ECJ), although the High Court or the Court of Appeal may be leap-frogged in certain circumstances. In Scotland, appeals following the tribunal stage go to the Court of Session and thence to the Supreme Court.

Default interest

Default interest may be charged on underpaid VAT. This applies most commonly when a business has made a voluntary disclosure.

Interest will not be charged if there was no overall loss of VAT – for example, where the VAT could immediately have been reclaimed as input tax by another business.

Until 1st September 2008, HMRC did not charge default interest on errors below £2,000. This relief has been withdrawn, but they have nevertheless indicated that they will not charge interest on errors legitimately corrected on a return in accordance with the new disclosure limits.

In cases where the business has overpaid VAT as a result of an error by HMRC, statutory interest may be paid to the business. Additionally, a business submitting a return with a claim for net repayment is entitled to the repayment within 30 days of submitting the return; if the repayment is delayed, the business will receive repayment supplement at the greater of £50 and 5% of the amount due.

The rates of interest change from time to time and are available on the website of HMRC.

Default surcharge

If a business fails to submit its return by the due date or submits a return without a payment, it will in the first instance receive a surcharge liability notice lasting twelve months. If there is a further late return or non-payment within this twelve-month period, a fresh surcharge liability notice will be issued and the business will be charged a penalty.

This penalty is initially charged at 2% of the VAT due. If there is a further omission within the revised twelve-month period, a penalty of 5% is charged, followed by a penalty at 10% and then at 15%. Subsequent penalties are all charged at 15%.

The penalty is subject to a minimum of £30 but is not charged at all at the 2% and 5% stages if the resultant figure would be less than £400. It is also not charged if HMRC agree that there is a reasonable excuse for late returns or payments – for example, a computer breakdown if reasonable steps have been taken to guard against this; the illness of the person responsible for preparing the return if no-one else is available; loss of key personnel; an unexpected cash crisis such as the sudden withdrawal of overdraft facilities; or the loss of records in a fire or flood. The dishonesty of a former employee, or incidents which would be considered as normal hazards of trade, would not be allowed as mitigating circumstances.

If a taxpayer is unable to submit a return owing to technical problems at HMRC's end, there will be no penalty. *Kwik Move Ltd* made three attempts to submit its return on 6th May but could not do so owing to problems with the HMRC server. It submitted the

return on 8th May, a day late. The tribunal allowed the appeal against the default surcharge.

Misdeclaration penalties

Misdeclaration and civil evasion penalties are being phased out. Penalties for errors apply for returns due on or after 1st April 2009. The old penalty regime still applies for returns due before that date.

A misdeclaration penalty may be charged where an error is discovered by HMRC without a voluntary disclosure. The penalty is charged at 15% of the error but applies only if the error exceeds or is equal to the lower of £1 million and 30% of the 'gross amount of tax'. The gross amount of tax is the sum of the correct amounts of output tax and input tax.

> A business submits a return showing output tax of £4,000 and input tax of £3,000. During an inspection it is discovered that input tax was reclaimed in error on a car and should have been only £900.
>
> The error of £2,100 is below £1 million but above 30% of the gross amount of tax. The gross amount of tax is £4,900 (£4,000 + £900) and 30% of this equates to £1,470.
>
> Therefore a penalty of £315 (15% x £2,100) applies.

Misdeclaration penalties are not normally charged if they fall below £300.

If the error exceeds or is equal to the lower of £500,000 and 10% of the gross amount of tax, a penalty liability notice will be served. If there are then two further such errors in the two years following the issue of the notice, a repeated misdeclaration penalty will be charged at 15% of the amount of the error.

In one case a charity providing braille books for the blind suffered a change of staff and incorrect returns were submitted. The tribunal agreed that a penalty should stand but reduced it by 60% owing to mitigating circumstances. It indicated that such mitigating factors might include compassionate grounds, unforeseen events, the degree of co-operation by the organisation, cases where published VAT guidance is unclear, and the compliance history of the organisation.

Civil evasion penalties

See the comments above under misdeclaration penalties concerning their replacement by penalties for errors.

In serious cases, VAT evasion will be dealt with through the criminal courts, potentially leading to an unlimited fine or imprisonment for up to seven years. Normally, evasion – which would be seen as knowing or reckless underdeclaration of VAT – is dealt with in the civil courts. This would include instances of signing and submitting a return with no honest belief in its veracity.

The civil evasion penalty is charged at 100% of the VAT evaded. In cases where the business promptly and truthfully explains how the error arose, the penalty may be reduced by up to 40%; if it co-operates by the prompt provision of information and attendance at meetings, a further reduction of 40% may be allowed, meaning that the penalty may be charged at only 20% of the VAT evaded.

Penalties for errors

The new 'penalties for errors' regime is being phased in, but no person is liable for a penalty under the new provisions in respect of a VAT period for which a return is required to be made before 1st April 2009. The provisions apply also to income tax, corporation tax, capital gains tax, PAYE, national insurance and deductions under the construction industry scheme.

A careless or deliberate error which leads to an underpayment or overclaim of VAT is punishable by a penalty of 30% of the potential lost revenue for a 'careless' error, 70% for a 'deliberate but not concealed' error, and 100% for a 'deliberate and concealed' error. 'Careless' means that there has been a failure to take reasonable care; 'deliberate but not concealed' means that the person has made a deliberate error but has not made arrangements to conceal it; and 'deliberate and concealed' means that the person has made arrangements to conceal a deliberate error.

There is also a penalty of 30% where HMRC issue an assessment which understates the taxpayer's liability to VAT and the taxpayer knew or should have known this but takes no steps to alert HMRC to the fact.

Penalties can nevertheless be mitigated. A person who has made an unprompted disclosure – that is, one which is made at a time when the person had no reason to believe that HMRC were about to discover it – may see a penalty mitigated from 30%

down to nil or above, from 70% down to 20% or above, and from 100% down to 30% or above.

Prompted disclosures may see a mitigation from 30% down to 15% or above, from 70% down to 35% or above, and from 100% down to 50% or above.

In all cases, the amount of the mitigation reflects the quality of the disclosure, including its timing, nature and extent. However, the correction of an error on a return is not seen as a disclosure for the purposes of mitigation. Taxpayers have a judgement to make, therefore, when they discover an error which can technically be included on the next return. If the error is in the form of an underpayment and could potentially be seen as 'careless' or worse, separate disclosure may result in mitigation of the error. Inclusion on the next return may still lead to a penalty if HMRC discover it on an inspection.

CHAPTER 12

INTERNATIONAL TRADE

This chapter provides a brief description of the international aspects of UK VAT. More detailed information is provided in another book, UK VAT and International Trade – the Complete Guide. The topics covered are:

- Transactions in goods – intra-EU
- Transactions in goods – exports and imports
- International services
- EC Sales Lists and Intrastat
- Reclaiming foreign VAT

Transactions in goods – intra-EU

Conditions for zero-rating

A sale of goods from a UK supplier to a customer in another EU country is zero-rated provided that two conditions are met:

1. The customer must be registered for VAT in an EU country other than the UK.
2. The goods must be dispatched out of the UK to another EU country.

In order to meet the first condition, the supplier should obtain the customer's VAT registration number and include it on the VAT invoice together with the two-letter code designating the country to which the VAT number belongs. These codes can be found in VAT Notice 725. The supplier's VAT registration number should as usual be included on the sales invoice but should be prefixed 'GB'. HMRC recommend that the supplier check the validity of the VAT number before issuing a zero-rated invoice – this can be done online using the website http://ec.europa.eu/taxation_customs/vies/ or alternatively by checking the standard format for the country concerned which can be found in VAT Notice 725, paragraph 16.19. If the customer cannot provide a valid VAT registration number, the supplier should charge VAT at the rate applicable to the goods.

The dispatch of the goods must take place within three months after the date of the invoice. The goods need not be dispatched to the invoicee's country but must arrive in an EU country other than the UK. The supplier must hold reasonable evidence of the dispatch of the goods, and documentation should be held which identifies the supplier, the consignor, where different from the supplier, the customer, the goods, an accurate value, the mode of transport and route of movement of the goods, and the EU destination. There is no exhaustive list of acceptable documents, but they might include a customer order, inter-company correspondence, a packing list, commercial transport documents and a receipted copy of the consignment note.

If the sale qualifies for zero-rating, it must be included in box 8 as well as box 6 of the UK return.

If a UK business transfers its own goods to another EU country without making a sale, it is deemed to have made a supply to itself. Provided that it is also registered in the country to which it has transferred the goods, this supply is zero-rated. If it subsequently makes a supply of these goods to a customer, VAT is chargeable under the regime of the country to which it transferred its own goods.

If a UK business supplies goods under a contract which requires it to install or assemble the goods on the customer's premises, the default position is that will be required to register for VAT in that country and charge local output tax on its supply of the goods and their assembly. Some EU countries operate a simplification procedure which enables the supplier to treat the supply as a zero-rated EU sale.

Distance sales

A supply of goods to a customer in another EU country who is not registered for VAT does not qualify for zero-rating. Such customers will usually be private individuals but may also be small businesses, government organisations or charities.

UK VAT must therefore normally be charged. However, if the supplier is responsible for the delivery of the goods, the supply is known as a distance sale. UK suppliers making distance sales initially charge VAT, but once the cumulative distance sales to a particular country in a given calendar year exceed the distance selling threshold in that country, the supplier must register in that country and account for local VAT on all subsequent sales in the calendar year and the following year. The distance selling threshold varies between EU countries but is always €35,000 or €100,000, or the local currency equivalent.

EU acquisitions

A UK purchaser of goods which qualify for zero-rating under the EU sales rules must account for acquisition tax at the rate applicable to the goods. For example, if a German supplier provides a zero-rated EU sales invoice for £10,000 to a UK customer and the goods would normally be standard-rated in the UK, the UK customer must account for acquisition tax of £2,000 (20% x £10,000). This is added to box 2 of the return. It is also added to box 4 if the customer can reclaim input tax – see the partial exemption rules outlined in chapter 8.

The invoiced amount should be added to box 9 of the return.

If a UK business transfers its own goods to the UK from another EU member state, it must account for acquisition tax based on the cost of the goods.

A UK business receiving supplies of installed goods from a business in another EU country may be charged UK VAT. Alternatively, the EU supplier may opt to use the simplification rules and zero-rate the supply. It must notify HMRC if it intends to do this.

Transactions in goods – exports and imports

Exports

Sales of goods which leave the EU are zero-rated. This includes goods moved to the Channel Islands, which are outside the VAT territory of the EU.

Direct exports occur where the movement of the goods to a place outside the EU is under the control of the supplier. Zero-rating applies if the goods leave the EU within three months of the time of supply, which is the date on which full payment is received. The supplier must retain acceptable evidence that the goods are exported within the time limit. VAT Notice 703 outlines the nature of evidence required.

Indirect exports occur where the movement of the goods to a place outside the EU is under the control of the customer. Zero-rating applies if the same time limit is observed, and evidence of export must again be retained. A crucial difference between direct and indirect exports is that the former may be supplied and invoiced to UK-registered customers provided that the supplier exports the goods; the latter cannot.

Imports

When goods are imported from outside the EU, import VAT is payable direct to HMRC. If import duty applies to the goods, VAT and duty are paid at the same time. The rate of import VAT is the rate applicable to the goods as if they had been supplied in the UK.

The default position is that VAT and duty are due before the goods can enter free circulation, although importers may apply for duty deferment, which allows them to pay monthly by direct debit.

If the importer has a Trader Unique Reference Number, form C79 is sent by HMRC to the importer monthly. This contains details of the import VAT, though not the duty, paid in the previous month. The importer may then reclaim the import VAT on the relevant return. It is not possible to reclaim import VAT without a C79.

International services

General rule

The first step when considering a supply of services is to establish the place of supply. The general rule is that if the customer is in business, that is making supplies, the place

of supply is the customer's country. If the customer is not in business, the place of supply is the supplier's country. These two types of supply are called B2B and B2C for convenience.

The second step is to establish the VAT treatment. For B2C supplies, a UK supplier charges UK VAT. For B2B supplies, if the customer belongs in the UK, a UK supplier again charges VAT. However, if the customer belongs in a different country, the supplier does not charge VAT and the customer accounts for VAT using the reverse charge procedure if appropriate.

This means that a UK supplier making a B2B supply of services to a customer who does not belong in the UK should not charge UK VAT. A UK customer receiving a B2B supply from an overseas supplier should account for VAT using the reverse charge procedure. This applies to a UK customer receiving supplies of services from any overseas supplier, whether within or outside the EU.

Reverse charge

A UK business customer receiving supplies of services from an overseas supplier must apply the appropriate rate of UK VAT to the invoice which will have been issued without VAT. For example, a UK customer receiving legal services of £1,000 from a US solicitor must account for VAT of £200 on its next return.

The relevant entries on the return in the above case are:

- £200 in box 1.
- £200 in box 4 provided that the customer makes taxable supplies – see the partial exemption rules in chapter 8.
- £1,000 in box 6.
- £1,000 in box 7.

Land-related supplies

Land-related supplies, which include construction, conveyancing and property valuation, are an exception to the general rule. They are taxed in the country in which the land is situated, irrespective of whether they are B2B or B2C. If a UK supplier makes supplies in relation to land outside the UK, no UK VAT is charged. It may be necessary to register for VAT in the country in which the land is situated.

Supplies of education, entertainment, exhibitions

Supplies of services relating to education, entertainment or exhibitions are also an exception to the general rule. In principle they fall under the general rule only for B2B supplies, but B2C supplies of these services are taxed where they are physically carried out.

However, it is important to distinguish between these services and supplies of admission to educational and entertainment events and to exhibitions. If a supply is one of admission, it is taxed where the event takes place irrespective of whether the supply is B2B or B2C. Discussions as to what constitutes admission are ongoing, but it appears that a UK company selling tickets for a UK exhibition to members of the public should charge UK VAT irrespective of whether the customer belongs in the UK or overseas.

Supplies of intangible services

Intangible services are very broad but include consultancy, legal and accountancy fees, advertising, royalties and electronically-supplied services. They follow the general rule if they are B2B. If they are B2C, they follow the general rule if the customer belongs in the EU, but they are outside the scope of UK and EU VAT if the customer belongs outside the EU.

Thus a UK solicitor with two B2C clients, one in Austria and the other in Switzerland, must charge VAT to the Austrian client but not to the Swiss client.

Other exceptions to the general rule

Other exceptions to the general rule are as follows:

- Passenger transport is taxed in proportion to where it is carried out.
- Freight transport follows the general rule for B2B supplies, except where the transport takes place wholly outside the EU, in which case it is outside the scope of UK VAT. For B2C supplies, it is taxed in proportion to where it is carried out, except for intra-EU freight transport, which is taxed in the country in which the transport begins.
- Supplies of intermediaries' services follow the general rule if they are B2B, but for B2C supplies they are taxed in the country in which the underlying supply, whether goods or services, is taxed.
- Work on goods, valuation of goods and ancillary freight transport services, such as loading and packing, follow the general rule if they are B2B, but for B2C supplies they are taxed in the country in which the work is carried out.

- The hire of transport follows the general rule for long-term hire - over 30 days, or 90 days for vessels. For short-term hire, it is taxed in the country in which the transport is placed at the customer's disposal.
- Catering services are taxed where they are carried out.

EC Sales Lists and Intrastat

EC Sales Lists – required information

EC Sales Lists must be submitted for two types of transaction:

1. EU sales of goods which qualify for zero-rating.

2. Supplies of services under the B2B general rule in which a VAT-registered customer in another EU member state accounts for VAT using the reverse charge procedure.

Supplies of services which are zero-rated or exempt in the customer's member state are not required to be included.

EC Sales Lists – completion and submission

The total supplies to each VAT-registered customer must be listed on the EC Sales List, with one line per customer - two if goods and services have been supplied to that customer. Customers should be identified by their VAT number and country code.

The reporting period is monthly for goods and quarterly for services, although services may be reported monthly. Goods can be reported quarterly if the trader has made EU sales of goods totalling below £35,000 in each of the last five quarters.

The deadline for submission is two weeks after the end of the reporting period. This is extended to three weeks in the case of traders submitting the form online.

Intrastat

Intrastat is a trade statistics collection procedure. There are two forms: one for dispatches and one for arrivals. The dispatches form includes all movements of goods from the UK to other member states, whether or not they qualify for zero-rating. The arrivals form includes movements of goods from other member states to the UK.

Traders with annual dispatches below £250,000 do not need to complete a dispatches form; traders with annual arrivals below £1.5 million are not required to complete an arrivals form.

In principle, each transaction must be listed separately, including a commodity code to identify the type of goods and a nature of transaction code to explain whether this is a standard sale and delivery or another type of transaction, for example return of goods, stage payment, distance sale, goods sent for processing. HMRC encourage traders to aggregate similar supplies.

Intrastat forms are completed monthly and should be submitted within a month of the end of the reporting period.

Reclaiming foreign VAT

UK businesses may incur VAT in other EU countries if they travel to those countries, for example for trade fairs. VAT will commonly be charged on subsistence, travel, entry to trade fairs or goods which are used before being taken out of the country.

VAT charged under the regime of another EU country may not be reclaimed on a UK return. However, it may be reclaimed under the intra-EU VAT reclaim scheme. An online application to use this scheme must be made to HMRC, and the application for refund is made via HMRC's website. The application is then transmitted to the VAT authorities in the other member state.

Each member state has its own rules relating to blocked input tax. There is usually a minimum claim of €50 per calendar year.

The deadline for submission of claims is nine months after the calendar year end. The claim will normally be processed within four months after submission and a repayment will be made within ten days after that.

UK businesses incurring VAT in countries outside the EU will need to ascertain whether that country has a VAT reclaim scheme for non-residents.

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