

COMMON PROBLEMS WITH VAT

28th May 2013

VAT rules are notoriously complex and often appear to follow no logical pattern. The majority of transactions for many businesses, however, are straightforward and this article is aimed at providing help with the more common transactions that you will encounter when preparing your VAT returns. Knowing whether an item should be included in a VAT return and if so what rate of VAT is applied is the first hurdle to overcome.

There are three main types of transaction:

1. Outside the Scope
2. Exempt from VAT
3. Taxable

1) Outside the Scope of VAT

These are transactions which are not business supplies and therefore have nothing to do with VAT. For example:

- Local Authority Rates
- Wages and salaries
- Payments of VAT to or from HM Revenue & Customs
- Road Fund Licence
- Tax and National Insurance payments
- Capital introduced to and drawings from a business
- Loan receipts and repayments

None of these items should be included in any of the boxes on the VAT return. If you are using a computerised accounts package select the VAT code which treats these as outside the scope or non-vatable (e.g. T9 on Sage). Note that 'outside the scope' is not the same thing as zero-rated (see below).

2. Exempt Supplies

The law on what is or is not exempt is complicated and the categories shown below only indicate broad areas which include exempt supplies. The important point to remember with exempt supplies is that you cannot charge VAT if making the supply and you cannot reclaim any input VAT that has been incurred and which relates to those exempt supplies. (If using Sage the VAT code is T2). If you make a mixture of exempt and standard rated supplies you may be partially exempt and able to recover input VAT incurred in making the exempt supplies below a certain amount. You should seek advice from HM Revenue & Customs or your accountant if you think this applies to you. Exempt supplies are included in your VAT return figures in boxes 6 and 7.

There are 13 major categories of exempt supplies:

a) Land

This is a very complex area and you should seek advice from your accountant or the VAT advice helpline if in any doubt. If you are paying rent for business premises look carefully at the invoice to see whether VAT is being added to the rent. If it is then it is standard rated but if not it will be exempt.

- b) Insurance
Insurance premiums include something called 'Insurance Premium Tax'. This is not VAT and cannot be reclaimed through your VAT return.
- c) Postal Service
The exempt status only applies to the Royal Mail. Private delivery services such as couriers are standard rated.
- d) Betting, Gaming and Lotteries
- e) Finance
Banking services, credit costs and interest charges. This also includes stockbroking services.
- f) Education
This includes Local Authority and Public Schools (as long as the education is not being provided for profit). Private tuition by teachers is also exempt unless it is in respect of a leisure activity.
- g) Health and Welfare
This includes doctors, dentists, optician services (but not providing glasses), physiotherapists, chiropractics etc.
- h) Burial and Cremation Services
- i) Trade Unions and Professional Bodies
Only applies to services in return for subscriptions
- j) Sport, Sports Competitions and Physical Education
The exempt status only applies in limited circumstances such as when all application fees are returned in prizes or where the competition is run by a non-profit making organisation established for the purposes of sport.
- k) Works of Art
- l) Fund Raising Events by Charities
- m) Cultural Services etc.

3. Taxable Supplies

Unless a supply is outside the scope of VAT or specifically exempted then it is deemed to be Taxable. In this case VAT is applied at 0% (i.e. zero-rated,) 5% (reduced rate) or 17.5% (standard rated). If in doubt about which rate you should use seek advice – the answer is not always obvious!

Zero Rated Supplies:

- a) Food – but not non-essentials such as alcohol, chocolate and soft drinks which are standard rated. Hot take-away food or drink and food eaten in a cafe or restaurant is also standard rated.
- b) Animal feeds (but not pet food).
- c) Books and newspapers.
- d) Construction of new domestic dwellings. Note that construction services are a complex area of VAT and professional advice should always be sought.
- e) Transport – in vehicles designed to carry 12 or more people e.g. train, coach and air fares.
- f) Drugs and medicines on prescription, surgical appliances and aids for the handicapped.
- g) Children’s clothing and footwear (12 years old or under).

Reduced Rate Supplies:

- a) Fuel and power for domestic and charitable use.
- b) Women’s sanitary products.
- c) Contraceptive products.
- d) Children’s car seats.

Standard Rated Supplies:

This covers the majority of other supplies.

COMMON ERRORS IN VAT RETURNS

The above paragraphs give basic guidance as to what type of transaction you might be dealing with. Many VAT returns are incorrect due to errors made in deciding what to include where. The following are common problems encountered:

- a) You can only reclaim input VAT if you have a valid VAT invoice showing the supplier's VAT number, rate of VAT and amount of VAT that has been charged. If this information is absent then your supplier is probably not VAT registered, has not charged VAT and therefore you cannot reclaim any VAT. (For details of the full information required to be shown on a VAT invoice seek advice)

You should still include the cost of the purchase in the statistics in box 7 unless it is a supply that would have been outside the scope even if the supplier was VAT registered.

- b) If calculating VAT on your own sales invoices the rate of VAT is applied to the net of VAT amount. If working backwards e.g. you want to charge a VAT inclusive amount of, say, £100 then the VAT element is 7/47ths of the gross – in this case £14.89 and the net of VAT amount becomes £85.11. Note that this does not give the same result as if you had incorrectly calculated the VAT as being 17.5% of the gross amount of £100.
- c) Do not net off sales and purchases even if you have part exchange or contra items. You should show the sale and the purchase element separately.
- d) If some of your purchases are for a mixed private/business use you can only reclaim the input VAT on the business proportion. Road fuel and car repairs are treated differently from this general rule as described below.
- e) If you are reclaiming VAT on car fuel and there is an element of private use you must add a Fuel Scale Charge to your output VAT. Since 1 May 2007 the amount of the scale charge depends on the CO2 emissions for your vehicle. Prior to this date the scale charge was dependent on the size of engine and fuel type. Note that the scale charge changes each tax year on 1 May so remember to update it when preparing your next return after 1 May. If you are typically covering less than about 10,000 miles per annum in your car the scale charge may exceed the VAT being reclaimed and you may be better off by not claiming the VAT on fuel instead.
- f) You can recover 100% of the VAT on car repairs & servicing regardless of the private/business usage split.
- g) If you hire/lease a car and have mixed private and business use you can only recover 50% of the input VAT.
- h) Don't include any 'outside the scope' items in your return.

- i) If you make an error in a return you can correct it by amending the next return as long as the VAT involved is below £10,000. If the error is for more than this you must make a voluntary declaration using the appropriate forms. Remember to change boxes 6 and 7 as well as 1 and 4 if you make an adjustment.
Keep a copy of the VAT return and notes to explain any changes you have made.
- j) All purchases within the scope of VAT should be included in box 7 even if the supplier is not VAT registered.
- k) VAT is charged on operating and finance lease payments but not hire purchase instalments. If you acquire an asset under HP you should receive a VAT invoice for the full amount of VAT included in the purchase price at the start of the agreement and you can recover the whole amount at that point. For lease arrangements you should receive a schedule setting out the dates and the VAT element of each instalment. Remember to include the relevant instalments in each subsequent VAT return.
- l) If you sell the occasional second-hand piece of equipment or perhaps a van that you have been using in the business remember to charge VAT on the full selling price. You are still making a taxable supply even though it is not your usual type of sale. The above article is a brief summary of the more common areas that give problems and is not intended to cover all areas of VAT.

If you are in any doubt about how to deal with a particular transaction you should seek advice from the VAT helpline or your accountant.