RELEVANT TO ACCA QUALIFICATION PAPER F6 (UK) AND PERFORMANCE OBJECTIVES 19 AND 20

Value added tax (VAT), part 1

This two-part article is relevant to candidates sitting the Paper F6 (UK) exam in 2012, and is based on tax legislation as it applies to the tax year 2011–12 (Finance Act 2011).

Paper F6 (UK) will always contain a minimum of 10 marks on value added tax (VAT). These marks will normally be included within Question one (focusing on income tax) or Question two (focusing on corporation tax), although there might be a separate question on VAT.

Standard rate of VAT
The standard rate of VAT is currently 20%.

EXAMPLE 1
Zoe is in the process of completing her VAT return for the quarter ended 31 March 2012. The following information is available:

- Sales invoices totalling £128,000 were issued in respect of standard rated sales.
- Standard-rated expenses amounted to £24,800.
- On 15 February 2012 Gwen purchased machinery at a cost of £24,150. This figure is inclusive of VAT.

Unless stated otherwise all of the above figures are exclusive of VAT.

VAT Return – Quarter ended 31 March 2012

	£	£
Output VAT		
Sales (128,000 x 20%)		25,600
Input VAT		
Expenses (24,800 x 20%)	4,960	
Machinery (24,150 x 20/120)	4,025	
		(8,985)
VAT payable		16,615

VAT registration
A business making taxable supplies must register for VAT if, during the previous 12 months, the value of taxable supplies exceeds £73,000. However,

VAT registration is not required if taxable supplies in the following 12 months will not exceed £71,000. These figures are exclusive of VAT. Remember that both standard-rated and zero-rated supplies are taxable supplies.

EXAMPLE 2
Albert commenced trading on 1 January 2011. His sales have been as follows:

		Standard-rated £	**Zero-rated £**			**Standard-rated £**	**Zero-rated £**
2011	January	3,200	0		August	5,500	100
	February	2,800	0		September	4,300	0
	March	3,300	0		October	10,100	0
	April	5,100	600		November	6,900	700
	May	2,700	0		December	8,200	300
	June	3,700	400	2012	January	8,800	900
	July	3,900	200		February	10,500	1,200

- Albert will become liable to compulsory VAT registration when his taxable supplies during any 12-month period exceed £73,000.
- This will happen on 28 February 2012 when taxable supplies will amount to £77,400 (3,300 + 5,700 + 2,700 + 4,100 + 4,100 + 5,600 + 4,300 + 10,100 + 7,600 + 8,500 + 9,700 + 11,700).
- Albert will have to notify HM Revenue & Customs by 30 March 2012, being 30 days after the end of the period.
- Registration is required from the end of the month following the month in which the limit is exceeded, so Albert will be registered from 1 April 2012 or from an agreed earlier date.

A business must also register for VAT if there are reasonable grounds to believe that taxable supplies will exceed £73,000 during the following 30 days. Again the figure is exclusive of VAT.

EXAMPLE 3
Bee commenced trading on 1 October 2011. Her sales have been as follows:

		£
2011	October	4,600
	November	5,400
	December	23,900
2012	January	92,700

Bee's sales are all standard-rated.

On 1 January 2012 Bee realised that her sales for January 2012 were going to exceed £90,000, and therefore immediately registered for VAT.

- Businesses must register for VAT if at any time they expect their taxable supplies for the following 30-day period to exceed £73,000.
- Bee realised that her taxable supplies for January 2012 were going to be at least £90,000. She was therefore liable to register from 1 January 2012, being the start of the 30-day period.
- Bee had to notify HM Revenue & Customs by 30 January 2012, being 30 days from the date that the expectation arose.

It is important that you appreciate the distinction between making standard-rated supplies, zero-rated supplies and exempt supplies. Only standard-rated supplies and zero-rated supplies are taxable supplies.

EXAMPLE 4
Cathy will commence trading in the near future. She operates a small airplane, and is considering three alternative types of business. These are (1) training, in which case all sales will be standard rated for VAT; (2) transport, in which case all sales will be zero-rated for VAT; and (3) an air ambulance service, in which case all sales will be exempt from VAT.

For each alternative Cathy's sales will be £80,000 per month (exclusive of VAT) and standard-rated expenses will be £15,000 per month (inclusive of VAT).

Standard-rated supplies

- Cathy will be required to register for VAT as she is making taxable supplies.
- Output VAT of £16,000 (80,000 x 20%) per month will be due, and input VAT of £2,500 (15,000 x 20/120) per month will be recoverable.

Zero-rated supplies
Cathy is not required to register for VAT as she is making zero-rated supplies, but will be permitted to do so as these are taxable supplies.

Output VAT will not be due, but input VAT of £2,500 per month will be recoverable.

Exempt supplies

- Cathy will not be required or permitted to register for VAT as she will not be making taxable supplies.
- Output VAT will not be due and no input VAT will be recoverable.

Voluntary VAT registration

A business may decide to voluntarily register for VAT where taxable supplies are below the £73,000 registration limit. This will be beneficial when:

- the business makes zero-rated supplies. As seen in Example 4, output VAT will not be due but input VAT will be recoverable
- the business makes supplies to VAT registered customers. Input VAT will be reclaimed, and it should be possible to charge output VAT on top of the pre-registration selling price. This is because the output VAT will be recoverable by the customers.

However, it will probably not be beneficial to voluntarily register for VAT where customers are members of the general public, since such customers cannot recover the output VAT charged. If selling prices cannot be increased, the output VAT will become an additional cost for the business.

EXAMPLE 5

Continuing with Example 3, assume that Bee's sales are all made to VAT-registered businesses, and that input VAT for the period 1 October to 31 December 2011 was £12,400. This input VAT would not be recoverable were Bee to register for VAT on 1 January 2012.

- Bee's sales are all to VAT registered businesses, so output VAT can be passed on to customers.
- Her revenue would therefore not have altered if she had voluntarily registered for VAT on 1 October 2011.
- It would therefore have been beneficial for Bee to have voluntarily registered for VAT on 1 October 2011, since additional input VAT of £12,400 would have been recovered.

Whether or not output VAT can be passed on to customers is also an important factor when deciding whether to remain below the VAT registration limit, or whether it is beneficial to accept additional work that results in the limit being exceeded.

EXAMPLE 6

Danny has been in business for several years. All of his sales are standard rated and are to members of the general public. He is not registered for VAT.

At present, Danny's annual sales are £71,500. He is planning to put up his prices, and this will increase annual sales to £77,000. There is no further scope for any price increases. Danny's standard-rated expenses are £8,700 per year (inclusive of VAT).

- Prior to putting up his prices, Danny's net profit is £62,800 (71,500 – 8,700).
- If Danny puts up his prices, he will exceed the VAT registration limit of £73,000, and will have to register for VAT.
- Output VAT will have to be absorbed by Danny, as sales are to the general public and there is no further scope for price increases.
- The revised annual net profit will be:

	£
Income (77,000 x 100/120)	64,167
Expenses (8,700 x 100/120)	(7,250)
Net profit	56,917

- This is a decrease in net profit of £5,883 (62,800 – 56,917), and so it is not beneficial for Danny to put up his prices.

Pre-registration input VAT
Input VAT incurred prior to registration can be recovered in certain circumstances.

EXAMPLE 7
Elisa commenced trading on 1 January 2012, and registered for VAT on 1 April 2012. She had the following inputs for the period 1 January to 31 March 2012:

	January	**February**	**March**
	£	**£**	**£**
Goods purchased	3,400	14,200	26,400
Services incurred	2,600	3,000	3,600
Non-current assets	64,000	–	–

On 1 April 2012 Elisa had an inventory of goods that had cost £13,800.

The above figures are all exclusive of VAT.

- Input VAT of £2,760 (13,800 x 20%) can be recovered on the inventory at 1 April 2012.
- The inventory was not acquired more than four years prior to registration, nor was it sold or consumed prior to registration. The goods must have been acquired for business purposes.

- The same principle applies to non-current assets, so input VAT of £12,800 (64,000 x 20%) can be recovered on the non-current assets purchased during January 2012.
- Input VAT of £1,840 (2,600 + 3,000 + 3,600 = 9,200 x 20%) can be recovered on the services incurred from 1 January to 31 March 2012.
- This is because the services were not supplied more than six months prior to registration. The services must have been supplied for business purposes.
- The total input VAT recovery is £17,400 (2,760 + 12,800 + 1,840).

VAT deregistration
A business stops being liable to VAT registration when it ceases to make taxable supplies. HM Revenue & Customs must be notified within 30 days, and the business will then be deregistered from the date of cessation or from an agreed later date.

A business can also request voluntarily VAT deregistration.

There is a deemed supply of business assets such as plant, equipment and inventory when a business ceases to be registered for VAT.

However, the transfer of a business as a going concern does not normally give rise to any VAT implications.

EXAMPLE 8
Fang is registered for VAT but intends to cease trading on 31 March 2012. On the cessation of trading Fang can either sell his non-current assets and inventory on a piecemeal basis to individual purchasers, or he can sell his entire business as a going concern to a single purchaser.

Sale of assets on a piecemeal basis

- Upon the cessation of trading Fang will cease to make taxable supplies, so his VAT registration will be cancelled on 31 March 2012 or an agreed later date.
- He will have to notify HM Revenue & Customs by 30 April 2012, being 30 days after the date of cessation.
- Output VAT will be due in respect of non-current assets and inventory on hand at 31 March 2012 on which input VAT has been claimed (although output VAT is not due if it totals less than £1,000).

Sale of business as a going concern

- If the purchaser is already registered for VAT then Fang’s VAT registration will be cancelled as above.

- If the purchaser is not registered for VAT then it can take over Fang's VAT registration, though from a commercial point of view this may be inadvisable.
- A sale of a business as a going concern is outside the scope of VAT, and therefore output VAT is not due.

Group VAT registration
Two or more companies can register as a group for VAT purposes if they are under common control (such as a parent company and its subsidiary companies) and each of them is resident in the UK.

A VAT group is treated for VAT purposes as if it was a single company registered for VAT on its own. Group VAT registration is made in the name of a representative member, and this company is then responsible for completing and submitting a single VAT return and paying VAT on behalf of the group. However, all the companies in the VAT group remain jointly and severally liable for any VAT liabilities.

EXAMPLE 9
Yung Ltd and its two 100% subsidiaries are considering registering as a group for VAT purposes.

- The advantage of group VAT registration is that there will be no need to account for VAT on goods and services supplied between group members. Such supplies are simply ignored for VAT purposes.
- It will also only be necessary to complete one VAT return for the whole group, so there should be a saving in administrative costs.
- However, the disadvantage is that various limits, such as those for the cash and annual accounting schemes (to be discussed in Part 2 of this article), will apply to the VAT group as a whole rather than on an individual company basis.

The tax point
It is very important to correctly identify the time of supply or tax point, as this determines when output VAT will be due.

EXAMPLE 10
Explain the VAT rules that determine the tax point in respect of (1) a supply of goods, and (2) a supply of services.

- The basic tax point for goods is the date that they are made available to the customer.
- The basic tax point for services is the date that they are completed.
- If an invoice is issued within 14 days of the basic tax point, the invoice date will usually replace that given above.
- If an invoice is issued or payment received before the basic tax point, then this becomes the actual tax point.

With the supply of services there may be more than one tax point.

EXAMPLE 11
Denzil is a self-employed printer who makes standard-rated supplies. For a typical printing contract he receives a 10% deposit at the time that the customer makes the order. The order normally takes 14 days to complete, and Denzil issues the sales invoice three to five days after completion. Some customers pay immediately upon receiving the sales invoice, but many do not pay for up to two months.

- The tax point for each 10% deposit is the date that it is received.
- Invoices are issued within 14 days of the basic tax point (the date of completion), so the invoice date is the tax point for the balance of the contract price.

Output VAT and input VAT
There are several important points regarding output VAT and input VAT that should be remembered:

- For VAT purposes there is no distinction between revenue and capital items as there is for income tax and corporation tax.
- VAT is only chargeable on the net amount where a discount is offered for prompt payment, regardless of whether payment is made within the specified time for the discount to be received.
- Relief for an impairment loss is only available if the claim is made more than six months from the time that payment was due, and the debt has been written off in the business's books.
- Input VAT cannot be recovered in respect of business entertainment (unless it relates to the cost of entertaining overseas customers) or the purchase of a motor car (unless the car is used 100% for business purposes).
- Input VAT cannot be claimed in respect of goods or services that are not used for business purposes.
- An apportionment is made where goods or services are used partly for business purposes and partly for private purposes.

EXAMPLE 12
Gwen registered for VAT, and is in the process of completing her VAT return for the quarter ended 31 March 2012. The following information is available:

- Cash sales amounted to £50,400, of which £46,200 was in respect of standard-rated sales and £4,200 was in respect of zero-rated sales. All of these sales were to non-VAT registered customers.
- Sales invoices totalling £128,000 were issued in respect of credit sales to VAT registered customers. These sales were all standard rated. Gwen gives her customers a 3% discount for payment within 30 days of the date of the sales invoice, and 80% of the customers pay within this period.
- Standard-rated materials amounted to £32,400, of which £600 were taken by Gwen for her personal use.
- Standard-rated expenses amounted to £24,800. This includes £1,200 for entertaining UK customers.
- On 15 March 2012 Gwen sold a motor car for £9,600, and purchased a new motor car at a cost of £16,800. Both motor cars were used for business and private mileage, but no fuel was provided for private mileage. The figures are inclusive of VAT where applicable.
- On 28 March 2012 Gwen sold machinery for £3,600, and purchased new machinery at a cost of £21,600. She paid for the new machinery on this date, but did not take delivery or receive an invoice until 6 April 2012. These figures are inclusive of VAT where applicable.
- On 31 March 2012 Gwen wrote off impairment losses in respect of three invoices that were due for payment on 15 August 2011, 15 September 2011 and 15 October 2011 respectively. The amount of output VAT originally paid in respect of each invoice was £340.
- During the quarter ended 31 March 2012 £600 was spent on mobile telephone calls, of which 40% relates to private calls.

Unless stated otherwise all of the above figures are exclusive of VAT.

VAT Return – Quarter ended 31 March 2012

	£	£
Output VAT		
Cash sales (46,200 x 20%)		9,240
Credit sales (128,000 x 97% (100 – 3) x 20%)		24,832
Motor car		0
Machinery (3,600 x 20/120)		600

Input VAT

Materials (32,400 – 600 = 31,800 x 20%)	6,360	
Expenses (24,800 – 1,200 = 23,600 x 20%)	4,720	
Motor car	0	
Machinery (21,600 x 20/120)	3,600	
Impairment losses (340 + 340)	680	
Telephone (600 x 60% (100 – 40) x 20%)	72	
		(15,432)
		19,240

- The calculation of output VAT on sales must take into account the discount for prompt payment, even for those 20% of customers that do not take it.
- Input VAT would not have been recovered in respect of the motor car sold as it was not used exclusively for business purposes. Therefore, output VAT is not due on the disposal. Similarly, input VAT cannot be recovered in respect of purchase of the new motor car.
- Input VAT cannot be claimed in respect of the materials taken by Gwen for her personal use since the goods are not used for business purposes.
- Input VAT on business entertainment is not recoverable unless it relates to the cost of entertaining overseas customers.
- Gwen can recover the input VAT in respect of the new machinery purchased in the quarter ended 31 March 2012 because the actual tax point was the date that the machinery was paid for.
- Relief for an impairment loss is not given until six months from the time that payment is due. Therefore relief can only be claimed in respect of the invoices due for payment on 15 August 2011 and 15 September 2011.
- An apportionment is made where a service such as the use of a telephone is partly for business purposes and partly for private purposes.

Refunds
The refund of VAT that has been overpaid is normally subject to a three-year time limit.

EXAMPLE 13
Hedge Ltd is completing its VAT return for the quarter ended 31 March 2012. The company has discovered that it has not been claiming for the input VAT of £35 that it has paid each quarter for the rental of coffee machines since 1 January 2002.

- Claims for the refund of VAT are subject to a three-year time limit.
- In addition to the input VAT incurred during the quarter ended 31 March 2012, Hedge Ltd can also claim for the input VAT incurred during the period 1 January 2009 to 31 December 2011.
- The total amount of input VAT refunded on the VAT return for the quarter ended 31 March 2012 will therefore be £455 (35 x 13).

Goods supplied free of charge
When goods are supplied free of charge then output VAT must normally be accounted for. However, there is generally no output VAT on services supplied free of charge, regardless of whether they are supplied to an employee or a customer.

Motor expenses
Input VAT can be recovered where fuel is used for private mileage (either by a sole trader or an employee), but output VAT must then be accounted for. Output VAT is normally calculated according to a scale charge based on the motor car's level of CO^2 emissions. The scale charge will be given to you in the exam, if required.

Provided there is some business use, input VAT can be fully recovered in respect of repairs to a motor car. No apportionment is necessary.

EXAMPLE 14
Ivy Ltd is to provide one of its directors with a company motor car, which will be used for both business and private mileage.

The company will pay for all the running costs of the motor car, including petrol and repairs. The relevant VAT inclusive quarterly scale charge is £472.

- Input VAT can be reclaimed in respect of the cost of petrol and repairs. No apportionment is necessary for motor expenses provided there is some business use.
- Because fuel is being provided for private use to the director, Ivy Ltd will have to account for output VAT based on the scale charge. The quarterly cost is £79 (472 x 20/120).

The second part of the article will cover VAT returns, VAT invoices, penalties, overseas aspects of VAT, and special VAT schemes.

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