



Understanding VAT FAQs



Introduction

With only Income Tax being a bigger source of revenue for the UK Government, VAT is important for businesses across the country.

Despite its importance, many businesses still struggle to fully understand and manage their VAT obligations. This can often lead to compliance issues, so we have put together this factsheet that answers your FAQs.

What is VAT?

Most, but not all, goods and services in the UK have VAT placed on them. Despite the wide application of the tax, the rules are complex, which can often result in well-intentioned businesses getting caught out. VAT is generally included in the advertised price for Business-to-Customer (B2C) transactions. In Business-to-Business (B2B) transactions, VAT is typically listed separately, as businesses handle VAT differently from individuals.

The most common application of VAT is the standard rate of 20 per cent of the cost of the goods or service to which it is applied. For some select goods and services, there is a reduced rate of five per cent VAT and this will typically be applied to things like home energy and children's car seats. It is important to accurately assess other goods and services in order to determine the correct rate of VAT.

In specific cases, the zero-rate of VAT applies. Many items of children's clothing are zero-rated, but this is not universally true. Even when there is no VAT attached to goods and services, it may be possible to reclaim input VAT on costs.

How is VAT calculated?

It is simple to add VAT to the cost of any product or service. To do so, take the price without VAT and multiply it by 1.2 for the standard rate and by 1.05 for the reduced rate. This will give you the figure with the 20 per cent VAT or five per cent VAT added on.

When is it necessary for a business to register for VAT?

Depending on your taxable turnover, your business's VAT obligations may vary. If your taxable turnover crosses £90,000 in any 12-month period, then it will be necessary to register for VAT.

Staying vigilant is important as you will need to register before your taxable turnover crosses the threshold. If you do slip past the threshold unexpectedly, then you will need to register within 30 days from the end of the month in which you went over the threshold to register for VAT. Neglecting these obligations will see you face penalties from HMRC.

There are times when a business may elect to voluntarily register for VAT and the most common reason for this is to begin reclaiming VAT on purchases or know they will eventually cross the threshold. Registering for VAT will mean you receive a unique VAT number and this should be kept safe at all times.

When should a business deregister for VAT?

If your business is no longer a going concern, you must deregister for VAT within 30 days. In other cases, a drop in taxable turnover may spark the ability to deregister for VAT.

The deregistration threshold is £88,000 of annual taxable turnover, meaning there is a buffer in which deregistration is not possible. Having this buffer means that you should not find yourself rapidly swapping between being registered and deregistered.

How should you manage VAT?

Making Tax Digital (MTD) for VAT is the main way that VAT is now managed. This gives you online access to your filings and your VAT registration certificate. The visibility afforded by this service means that you should be able to track when your VAT is due and how much it will be.

Every quarter, you will need to complete a VAT return and this should be submitted through either MTD-compliant software or bridging software that connects your spreadsheets to HMRC.

What are the penalties for VAT noncompliance?

Penalties are in place for those who fail to properly keep up with their VAT obligations. These may include failing to register for VAT on time, late submission of VAT returns or late payments of VAT liabilities.

The exact nature of the penalties is decided by your own behaviour in the situation. If an honest mistake has been made, then you will get a lesser penalty, but active fraud is treated severely.

Late registration penalties are impacted by the length of time it took you to register past the point when you should have done so. The penalty is a percentage of the VAT due from the date you should have registered to the date HMRC received your notification or when you became aware that you were required to register.

If the delay is of nine months or fewer, then the penalty will be five per cent, with this doubling to ten per cent if the delay is between nine and 18 months. Anything over an 18-month delay will incur a 15 per cent penalty. Penalty points are earned through late submissions and a £200 penalty is given once enough points are amassed.

The monthly penalty point threshold is five, the quarterly is four and the annual threshold is two. Once you reach the point threshold, every late filing will see you get a £200 penalty. If you keep below the limit, your penalty points will expire after two years. If you hit the limit, your points will only expire once you have submitted all your outstanding returns and stayed compliant for an extended period of time.

Missing payments causes interest to be charged on the tax bill and will need to be factored in alongside your late payment surcharges. HMRC is not unreasonable and does permit a 15-day grace period during which VAT payments can be submitted without getting a penalty.

If you are struggling to pay, you may be able to set up a Time to Pay agreement but this will not avoid the interest chargeable on these payments. If you are between 16 and 30 days late with payment, you will be charged at three per cent of the outstanding amount. After that, you will be charged an additional three per cent with a daily penalty added. The daily penalty is calculated at 10 per cent per year and will continue to be accrued until the balance is paid.

How does VAT reclamation work?

Where goods and services are for the exclusive use of a business, it is possible to reclaim VAT, the most notable exception to this is that business entertainment costs cannot be reclaimed.

Vehicle costs are also generally ineligible unless they are used for commercial reasons, at which point the extent of their commercial use will determine the amount that can be reclaimed.

If there are any goods or services that are entirely for personal use, these will not be able to be reclaimed. Even businesses below the registration threshold may choose to register for VAT if they are seeking to reclaim VAT. On the other hand, businesses that are not in a position to reclaim VAT are more likely to deregister should they be in a position to do so.

Seeking professional support is wise when handling VAT, as each business will have slightly different needs and considerations.

How can I get support with handling VAT?

Our expert team are more than happy to assist you with the complexities of VAT. We can help you understand the role VAT plays in the life of your business and what you must do to stay compliant and efficient.

There is a growing consensus that VAT is overdue for reform, but little progress seems to be being made in that area. If changes do happen, we will keep you updated and work with you to meet any new obligations.

If you would like VAT support tailored specifically to your business, Speak to our expert team today and take the stress out of VAT.

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