

An Introduction to VAT (Value Added Tax)

Business Information Factsheet
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Introduction

VAT (Value Added Tax) is a tax levied on the sales of goods and services. It is charged by traders who are registered for VAT, and is one of the Treasury's major sources of tax revenue. HM Revenue & Customs (HMRC) is responsible for ensuring that VAT-registered traders comply with the legislation relating to VAT and meet their responsibilities with regard to accounting for and paying the tax due.

The legislation covering VAT is complex and it is important to seek professional advice or contact HMRC for guidance to ensure compliance with current law.

This factsheet introduces the basic principles of VAT. It explains what VAT is, the principles of VAT for traders, what the VAT registration thresholds are, and when registration is required. It also summarises the different rates of VAT and the situations in which sales are exempt from VAT.

What is VAT?

VAT is a tax on spending that applies to the value that is added to a product or service at each stage of its production and distribution.

VAT must be added at the appropriate rate to the net sale price of any goods or services that are liable to have VAT added to them, which are supplied by traders that are registered for VAT. VAT registered traders can then reclaim the VAT they have paid on the goods and services that they have purchased for use in their business. They must pay the VAT to HMRC, or in some circumstances can claim a VAT refund. Some types of supplies are exempt from VAT altogether.

Non-registered traders can neither charge nor reclaim VAT.

Although VAT is collected in stages by VAT-registered traders, it is the consumer who ultimately pays the full amount of the tax.

VAT-registered traders are required to keep accurate records of all VAT transactions and complete and submit a summary of these to HMRC in the form of a VAT return at the end of each VAT accounting period (usually every quarter). Any VAT owed must usually be paid when the VAT return is submitted, although the exact date it is due depends on the method of payment.

There are also specialist VAT schemes that traders can apply to join, which affect the way in which they collect and pay VAT and the dates on which it is due.

The principles of VAT

The principles of VAT that relate to traders are that:

- Goods or services are purchased from suppliers at a price that includes VAT (the input tax).
- All goods or services that are liable to have VAT added to them at the appropriate rate (that is any goods that are not exempt from VAT) are known as 'taxable supplies' and are sold to customers (whether consumers or other traders) at a price including VAT (the output tax).
- Traders are required to register for VAT when the value of their sales of taxable supplies (known as their 'taxable turnover') exceeds the VAT registration threshold, which is a figure that is fixed (and usually rises) in the Chancellor's Budget each spring. Exempt supplies are not included in taxable turnover.
- Traders account for the VAT due to HMRC by completing and filing a VAT return at the end of their VAT accounting period. To calculate the amount of VAT that is due, the input tax paid to suppliers is deducted from the output tax received from customers and the difference is paid over to HMRC, or a refund is claimed if the input tax exceeds the output tax.

Categories of supplies liable to or exempt from VAT, and the different VAT rates applicable

VAT must be charged by VAT-registered traders on goods and services that are liable to VAT in addition to the sale price of the items. VAT must be charged at specific rates that vary according to the type of goods or services supplied, and in some circumstances applicable rates of VAT also vary according to the user of the goods (for example children or people with disabilities), or to the type of trader or organisation providing the goods and services, such as builders or charities.

Under Directive 92/77/EEC, member states of the European Union are restricted in relation to the VAT rates they can charge, and all must apply a Standard VAT rate of at least 15%.

There are currently three rates of VAT in the UK covering the various categories of goods and services that are liable for VAT as well as categories of items (typically services) that are exempt from VAT altogether. The various rates and categories are as follows:

- The standard rate of 20%, which covers all taxable supplies that are not reduced or zero rated and applies to most goods and services that are supplied in the UK.
- The reduced rate of 5%, which is charged on certain specific products and services. The major ones are domestic fuel and power as well as domestic energy-saving products. The renovation and conversion of certain buildings is also subject to the reduced rate, as are children's car seats and some healthcare products.
- The zero rate (0%), which applies to specific categories of goods including children's clothes, exports outside the European Union, food (exclusions apply including restaurant meals and catering supplies), books and newspapers. The advantage of goods being zero-rated (as opposed to exempt) is that they are still included in the taxable turnover, so the input tax can be recovered.

If a product consists of both zero-rated and standard-rated goods (for example, food in a decorative container), there may be occasions when VAT will be charged at a proportional rate. HMRC has special schemes to help retailers selling a mixture of standard- and zero-rated products and it important to seek their advice to clarify what should be done in these situations.

- Exempt supplies, which are supplies that are excluded from taxable turnover, meaning that input tax cannot be recovered, typically relate to services rather than goods and are commonly found in the following sectors:
 - Financial services.
 - Education.
 - Insurance.
 - Health and welfare services.
 - Some property transactions.

It is important to clarify whether services supplied are exempt from VAT or not, and professional advice can be obtained from an accountant or from HMRC.

Further information about VAT rates applicable to different goods and services is available at www.gov.uk/rates-of-vat-on-different-goods-and-services.

VAT thresholds and registering for VAT

Traders are required to register for VAT and charge VAT on the goods and services they sell when their taxable turnover (which is the value of their sales of taxable supplies, not including exempt supplies) exceeds the mandatory VAT registration threshold, which for the tax year 2018/19 is £85,000.

VAT registration is required when the taxable turnover in any 12-month rolling period exceeds the current registration threshold or is likely to exceed it during the next 30 days, for example due to winning a large contract.

Once their taxable turnover exceeds the VAT registration threshold, the trader becomes a 'taxable person' and is legally required to register for VAT.

The term 'taxable person' applies not only to individual sole traders but also to partnerships and separate legal entities such as limited companies, limited liability partnerships, clubs, associations, charities and trusts. The term refers to any 'seller' of goods and services, (whatever the legal status of their business), who should be registered for VAT.

VAT registration is by taxable person not by business, so if a self-employed individual owns and runs more than one business and together these have a taxable turnover that exceeds the VAT registration threshold, they must register for VAT.

It is also possible to register voluntarily for VAT before taxable turnover reaches the mandatory registration threshold. This is common in cases where firms are set up that will primarily supply other VAT-registered firms, and if VAT registration is applied for when setting up, it also enables the input tax paid on the expenses incurred at start up to be reclaimed.

Fines may be imposed by HMRC if traders fail to register at the correct time, and traders will also be liable for any VAT that they should have charged in the interim.

A trader can apply to de-register for VAT if their taxable turnover falls below the de-registration threshold, (which for the tax year 2018/19 is £83,000), or if they cease to make sales of taxable supplies or cease trading altogether. Note that the VAT de-registration threshold is slightly lower

than the VAT registration threshold. There is more information about de-registering for VAT at www.gov.uk/vat-registration/cancel-registration.

There are various different specialist VAT accounting schemes that traders can join, such as VAT retail schemes and the VAT flat rate scheme. These schemes have their own turnover entry thresholds, which differ from the initial VAT registration threshold. For more information about the various VAT scheme registration thresholds, go to www.gov.uk/vat-registration-thresholds.

For more information about VAT retail schemes, go to BIF506, An Introduction to VAT Retail Schemes.

Hints and tips

- It is important to keep up to date with changes to the VAT rules. HMRC provides regular 'Business help and education emails'. Go to <https://public-online.hmrc.gov.uk/business-emails/subscription> to subscribe to the service.
- The mandatory VAT registration threshold is usually raised every year in the Chancellor's Budget and is applied for the forthcoming tax year.
- Accountants provide professional advice about VAT registration and suitable schemes, as well as providing guidance about record keeping.

Further information

BIF015 An Introduction to Tax, National Insurance and VAT
BIF045 An Introduction to Charging and Accounting for VAT
BIF386 A Guide to Invoices and Receipts
BIF483 Tax Deadlines in 2018
BIF522 An Introduction to Registering for VAT

Useful contacts

HM Revenue & Customs (HMRC) is the Government department responsible for the collection of taxes in the UK.

Tel: 0300 200 3700 (VAT helpline)

Website: www.gov.uk/business-tax/vat

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