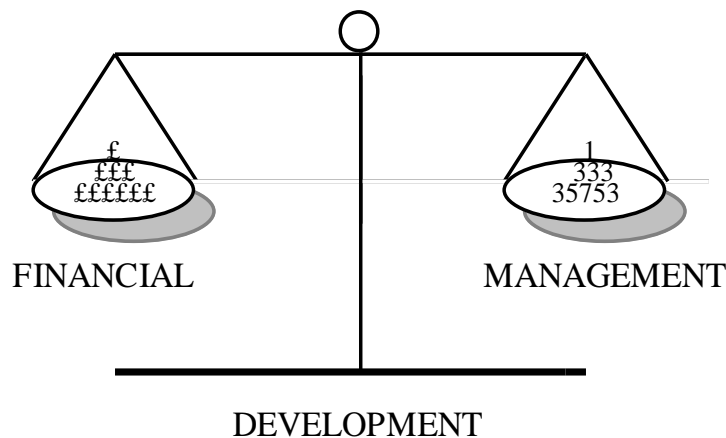


FINANCIAL MANAGEMENT DEVELOPMENT

Taxation

NO 413

VALUE ADDED TAX - AN OVERVIEW



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

VALUE ADDED TAX - OVERVIEW

1. Value Added Tax is a "Tax on the Value Added".
2. It is a self-assessed tax administered by Her Majesty's Revenue and Customs (HMRC) but since it was formerly administered separately it can have rules which differ from those for other major taxes.
3. Value Added Tax is charged on a "supplier of goods and services" in the UK by a "taxable person" in the "course of business" for "a consideration".
4. **SUPPLY OF GOODS OR SERVICES**

The following constitutes a supply of goods:-

- (a) Transfer of ownership - whether immediately or in the future.
- (b) Applying any treatment to another person's goods.
- (c) Supplying power, heat, refrigeration or ventilation.
- (d) Granting an interest in land or a short lease thereon.

Anything done for a consideration which is not a "supply of goods" is a "supply of services".

5. **TAXABLE PERSON**

A taxable person is someone, usually an individual or a company, who makes, or intends to make, taxable supplies while he is, or is required to be, registered for VAT.

Taxable persons act as unpaid tax collectors. The objective of VAT is to tax personal not businesses consumption. Therefore business requires a mechanism to enable business (with certain exceptions) to recover the VAT they have paid. This is known as input tax and represents:

"Tax chargeable on goods and services supplied to them by taxable persons; and tax paid to HMRC on imported goods".

Since taxable persons collect output tax on their sales to customers and recover input tax from HMRC (in theory) VAT has a neutral effect on business.

6. COURSE OF BUSINESS

This includes, not only, the income tax definition of activities pursued with a view to profit but also:

- any hobby organised in a businesslike fashion.
- any facilities e.g. by a club, provided for consideration.
- admission to premises for a consideration.
- the activities of certain statutory bodies e.g. nationalised industries.

Once the business has been defined any supply is likely to be taxable, including the termination of the business.

As a general rule employees do not carry on a business by virtue of their employment.

7. CONSIDERATION

The consideration is normally money, but can be other goods - barter is still subject to VAT.

Where business assets are given away, or used for private use a supply is deemed to have taken place unless the goods cost less than £50 (per recipient per year) or they constitute industrial samples given to customers.

8. IN THE UK

Goods provided in the UK or exported are subject to VAT. Services are provided "in the place the taxable person belongs". Where they are performed is irrelevant. If the taxable person has business establishments both in the UK and abroad, the supply attaches to the business establishment most directly concerned with the services supplied.

9. IN SUMMARY

Anything done by a UK taxable person which constitutes the transfer of ownership of an asset or a provision of a service is likely to be taxable.

Or to put it another way:

HMRC do not seek to tax activities by foreigners in foreign countries, anything else is fair game!

VALUE ADDED TAX - DETAILS

1. VAT is chargeable on taxable supplies at either zero rate or standard rate (2012 20%, although there are some items taxed at a reduced rate of 5% - primarily domestic fuel and power, installing energy-saving materials, sanitary hygiene products and children's car seats). In addition certain supplies are deemed to be "exempt". Unless a supply is classified as outside the scope of VAT e.g. salary payments, it will be standard rated if it does not fall within the statutorily defined categories of "zero rated" or "exempt" supplies.

2. **ZERO RATING**

The effect of zero-rating is to allow the trader to make supplies and add 0% VAT. However, the trader can reclaim any input tax paid on their inputs. Therefore, zero rating is extremely beneficial to the trader and most suppliers of zero rated goods will be reclaiming tax from HMRC.

3. **EXEMPT SUPPLIES**

The effect of exemption is that the trader does not add any VAT to the cost of the goods or services supplied. However, no input tax can be reclaimed from the HMRC for tax paid on their inputs. Exempt supplies are ignored for the purposes of determining whether a person is a taxable person. The position of a supplier who only makes exempt supplies is therefore similar to that of the final consumer. He cannot reclaim the tax included in the price of the goods he buys.

4. **PARTIAL EXEMPTION**

Most business make a number of different supplies which may include standard and zero-rated as well as exempt items. It is necessary for detailed records to be kept for each category since any claim to recover input tax will be restricted by the proportion which exempt supplies represent of the total supplies made. Such traders are known as partially exempt.

5. **REGISTRATION**

Any trader making taxable supplies i.e. standard or zero-rated supplies, of more than (2012: £73,000) in the preceding 12 months, or who believes they will make supplies in the next year which will do so, must register with HMRC.

It is normal for large groups of companies to have a group registration to avoid the need to account for VAT on intra-group supplies. All supplies and inputs are aggregated for one composite return. Where, within a group, a particular company makes exempt supplies it is normal to register that company separately from the rest of the group to avoid the partial-exemption rules being operated to restrict the reclaim of input tax throughout the group.

It is possible for particular departments within a company to be similarly excluded from the company registration e.g. where a trader operates a banking business in addition to their ordinary business.

The consequences of registration are that the trader should charge VAT and account for it. If supplies fall below an expected (2012:£71,000) in the next twelve months the trader may apply for de-registration.

6. INPUT TAX

Input tax is the tax paid by a taxable person on goods and services supplied to him. It is recoverable from HMRC provided certain conditions are met.

1. The claimant must be a taxable person when the VAT was incurred. (There are special rules which allow for the recovery of pre-incorporation input tax under certain circumstances).
2. Evidence must be provided in the form of a tax invoice unless the purchase is through coin operated machinery and is under £25.
3. The supply must have been to the claimant or their employees and must be for business purposes.

In addition specific expenditure disqualifies the reclaim of input tax.

Business Entertainment - unless for staff

Motor cars - unless acquired new, for resale or hire or acquired solely for business purposes. If there is any private use only half of the VAT is recoverable. Once VAT has been reclaimed any disposal of the vehicle will be VATable.) However, input tax on hiring of cars is allowable.

The reclaim of input tax is restricted if the claimant is partially exempt unless the exempt supplies are trivial in relation to the business as a whole or input tax thereon is below either:£ 625 per month on average or is less than half of the total input tax reclaimed.

7. ADMINISTRATION

VAT is a self-administered tax normally accounted for on a quarterly basis. If turnover is below £1,350,000 p.a. an annual return may be made. Some traders, particularly those who make zero-rated supplies and therefore reclaim tax, make monthly returns. In addition organisations with a total annual VAT liability of over £2 million may be required to make monthly payments on account.

Payment should be made not later than one month after the date of the return, plus seven days if payment is by credit transfer. There are penalties for annoying HMRC, especially for naughtiness over VAT.

These include:

Late payment 2% rising to 15% (for several tardinesses) of tax due.

Misdeclaration penalty of up to 15% of the error, rising up to 100% for

Dishonesty. For Fraud it is an unlimited fine and/or five years imprisonment.

8. RETAIL SCHEMES

There are a number of retail schemes designed to suit different types of business. Whichever scheme is used it is necessary to keep a record of daily gross takings. The schemes may be used by any taxable person who deals mainly with the public and who cannot, by the nature of their business be expected to issue a tax invoice for each sale.

The basis for the schemes is that tax is calculated on the takings received for supplies made. The various schemes allow for adjustment to account for expected (or known) values of exempt and zero-rated supplies. It is possible to agree modifications to the basic schemes, or indeed use different schemes for different parts of the business.

Whilst in principle HMRC have to agree the scheme used, it is normally appropriate to calculate the impact of the various schemes prior to application in order to identify the most cost effective scheme and then propose the adoption of that particular variant to HMRC.

9. CASH ACCOUNTING

Where the value of taxable supplies does not exceed a specific amount a trader may account for VAT in the period the associated cash changes hands. Thus output tax is accounted for when cash is received and input tax when cash for supplies is paid. The major benefit from this is that the VAT on bad debts is not lost to the business. Since introduction, however, specific relief has been introduced for debts which are more than one year old and have been written off in the accounts of the business.

10. FLAT RATE SCHEME

Where the value of taxable supplies does not exceed a £150,000 p.a. the supplier may opt for the VAT flat rate scheme, whereby they still charge VAT to their customers but they do not have to keep detailed records of VAT on purchases and merely have to pay over to HMRC a percentage of the amount (including VAT) they have charged to customers. The rates range from 4% to 14.5%, depending on the nature of the business. Notice this percentage is of the VAT inclusive figure. Thus an accountancy firm (rate 14.5%) making sales of £100,000 plus VAT of £20,000, would pay £17,400 (14.5% of £120,000) to HMRC. If their allowable input tax is likely to be more than £2,600 (i.e. their purchases were more than £15,600 including VAT of £2,600) then they might be better off with the ordinary system. There are rules on joining and leaving the scheme and to cover large capital purchases once in the scheme, but the rates are set to encourage smaller businesses to use it so it is worth investigating.

There are lots of other exciting schemes etc covering antiques, second hand goods. See www.hmrc.gov.uk for details.

VAT - ZERO RATED SUPPLIES (GROUPS DEFINED BY STATUTE)

These lists are provided as a guide. For specific supplies look at the HMRC website www.hmrc.gov.uk/vat/forms-rates/rates/goods-services

1. **FOOD** 1.For human consumption unless: (a)Supplied in the course of catering i.e. on the suppliers' premises or hot take-away food. or (b)"Naughty" food e.g. sweets, alcohol, soft drinks etc. 2. Animal foodstuffs (except pet food) 3. Plants and seeds (but not ornamental).
2. **SEWERAGE AND WATER SERVICES** Only for Non-industrial users. Supplies to industrial users are standard rated.
3. **BOOKS AND PRINTED MATTER**
but not if used for writing on (unless children's colouring books)
4. **TALKING BOOKS AND WIRELESS SETS FOR THE BLIND**
5. **CONSTRUCTION OF RESIDENTIAL OR CHARITABLE BUILDINGS**
6. **PROTECTED BUILDINGS**
7. **INTERNATIONAL SERVICES** This includes services connected with goods outside the EU; and specific services provided to a trader belonging outside the EU.
8. **TRANSPORT** This excludes transport by vehicles designed to carry fewer than 12 people. (Not rides at theme parks).
9. **CARAVANS AND HOUSEBOATS**
10. **GOLD**
11. **BANK NOTES**
12. **DRUGS, MEDICINES AND APPLIANCES**
13. **IMPORTS AND EXPORTS** For specific importing prior to entry not a general rule.
14. **TAX FREE SHOPS** If purchaser is travelling from UK to overseas, and the goods are for personal use and do not exceed certain volumes or values.
15. **CHARITIES**
16. **CLOTHING AND FOOTWEAR** For young persons and where used for protective purposes (except where protective clothing and boots are for own employees).

VAT - EXEMPT SUPPLIES (GROUPS DEFINED BY STATUTE)

These lists are provided as a guide. For specific supplies look at the HMRC website www.hmrc.gov.uk/vat/forms-rates/rates/goods-services

1. **LAND** (Exemption can be waived by the Landlord)
2. **INSURANCE**
3. **POSTAL SERVICES** By the Post Office
4. **BETTING**
5. **FINANCE**
6. **EDUCATION** By Schools and Universities
7. **HEALTH** Whether supplied by the NHS or privately and including goods provided in connection with health care (inc. spiritual welfare).
8. **BURIAL AND CREMATION**
9. **TRADE UNIONS AND PROFESSIONAL BODIES**
10. **SPORTS ACTIVITIES** Specifically entry fees
11. **WORKS OF ART**
12. **FUND RAISING EVENTS BY CHARITIES**
13. **CULTURAL SERVICES** Including admission charges
14. **SUPPLIES OF GOODS WHERE INPUT TAX IS IRRECOVERABLE**
15. **INVESTMENT GOLD**

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:

FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

(I wonder how God copes with disallowance of this cost in his Tax Computation?)