Accounting Qualification

Indirect Tax (Level 3)
Reference material

The Association of Accounting Technicians
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Reference material for AAT assessment of Indirect Tax

Introduction

This document comprises data that you may need to consult during your Indirect Tax computer-based assessment.

The material can be consulted during the practice and live assessments through pop-up windows. It is made available here so you can familiarise yourself with the content before the test.

Do not take a print of this document into the exam room with you*.

This document may be changed to reflect periodical updates in the computer-based assessment, so please check you have the most recent version while studying.

*Unless you need a printed version as part of reasonable adjustments for particular needs, in which case you must discuss this with your tutor at least six weeks before the assessment date.

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Introduction to VAT

VAT is a tax that's charged on most goods and services that VAT-registered businesses provide in the UK. It's also charged on goods and some services that are imported from countries outside the European Union (EU), and brought into the UK from other EU countries.

VAT is charged when a VAT-registered business sells to either another business or to a non-business customer. This is called output tax.

When a VAT-registered business buys goods or services for business use it can generally reclaim the VAT it has paid. This is called input tax.

Her Majesty's Revenue and Customs (HMRC) is the government department responsible for operating the VAT system. Payments of VAT collected are made by VAT-registered businesses to HMRC.

Rates of VAT

There are three rates of VAT, depending on the goods or services the business provides. The rates are:

- standard – 20%. The standard-rate VAT fraction is 20/120 or 1/6
- reduced – 5%. The reduced rate VAT fraction is 5/105
- zero – 0%.

There are also some goods and services that are:

- exempt from VAT
- outside the UK VAT system altogether

Taxable supplies

If you sell zero-rated goods or services, they count as taxable supplies, but you don't add any VAT to your selling price because the VAT rate is 0%.

If you sell goods or services that are exempt, you don't charge any VAT and they're not taxable supplies. This means that you won't normally be able to reclaim any of the VAT on your expenses.

Generally, you can't register for VAT or reclaim the VAT on your purchases if you sell only exempt goods or services. If you sell some exempt goods or services you may not be able to reclaim the VAT on all of your purchases.

If you buy and sell only - or mainly - zero-rated goods or services you can apply to HM Revenue & Customs to be exempt from registering for VAT. This could make sense if you pay little or no VAT on your purchases.

Registration and deregistration limits

Registration threshold

If, at the end of any month, your turnover of VAT taxable goods and services (taxable turnover) supplied within the UK for the previous 12 months is more than the current registration threshold of £73,000, you must register for VAT without delay. You must also register if, at any time, you expect the value of your taxable turnover in the next 30 day period alone to go over the registration threshold.

If your trading is below the threshold for registration

If your taxable turnover hasn't crossed the registration threshold, you can still apply to register for VAT voluntarily.

Deregistration threshold

The deregistration threshold is £71,000. If your taxable turnover for the year is less than or equal to £71,000, or if you expect it to fall to £71,000 or less in the next 12 months, you can either:

- stay registered for VAT, or
- ask for your VAT registration to be cancelled.

Keeping business records and VAT records

If you are registered for VAT, you must keep certain business records and VAT records.

You do not have to keep these records in a set way, but you must ensure your records:
- are complete and up to date
- allow you to work out correctly the amount of VAT you owe to HMRC or can reclaim from HMRC
- are easily accessible when HMRC visits you, e.g. the figures you use to fill in your VAT Return must be easy to find.

Business records

Business records you need to keep include the following:
- annual accounts, including profit and loss accounts
- bank statements and paying-in slips
- cash books and other account books
- orders and delivery notes
- purchase and sales books
- records of daily takings such as till rolls
- relevant business correspondence

In addition to these business records, you need to keep VAT records and a VAT account.

VAT records

In general, you must keep the following VAT records:

- Records of all the standard-rated, reduced rate, zero-rated and exempt goods and services that you buy or sell.
- Copies of all sales invoices you issue. However, if you are a retailer you do not have to keep copies of any less detailed (simplified) VAT invoices for items under £250 including VAT.
- All purchase invoices for items you buy.
- All credit notes and debit notes you receive.
- Copies of all credit notes and debit notes you issue.
- Records of any goods or services bought for which you cannot reclaim the VAT, such as business entertainment.
- Records of any goods you export.
- Any adjustments, such as corrections to your accounts or amended VAT invoices.
- A VAT account

For how long must VAT records be kept?

Generally you must keep all your business records that are relevant for VAT for at least six years. If this causes you serious problems in terms of storage or costs, then HMRC may allow you to keep some records for a shorter period.

Keeping a VAT account

A VAT account is the separate record you must keep of the VAT you charged on your sales (output VAT or VAT payable) and the VAT you paid on your purchases (input VAT or VAT reclaimable). It provides the link between your business records and your VAT Return. You need to add up the VAT in your sales and purchases records and then transfer these totals to your VAT account, using separate headings for VAT payable and VAT reclaimable.

You can keep your VAT account in whatever way suits your business best, as long as it includes information about the VAT that you:

- owe on your sales
- owe on acquisitions from other European Union (EU) countries
- owe following a correction or error adjustment
- can reclaim on your business purchases
- can reclaim on acquisitions from other EU countries
- can reclaim following a correction or error adjustment
- are reclaiming via VAT bad debt relief.

You must also keep records of any adjustments that you make, such as balancing payments if you use annual accounting for VAT.

You can use the information from your VAT account to complete your return at the end of each accounting period. You subtract your VAT reclaimable from your VAT payable, to give the net amount of VAT you pay to or reclaim from HMRC.

Unless you are using the cash accounting scheme, you must pay the VAT you have charged customers during the accounting period that relates to the return, even if they have not paid you.

Exempt and partly-exempt businesses

Exempt goods and services

There are some goods and services on which VAT is not charged.

Exempt supplies are not taxable for VAT. So you do not include sales of exempt goods or services in your taxable turnover for VAT purposes. If you buy exempt items, there is no VAT to reclaim.

This is different to zero-rated supplies. In both cases VAT is not added to the selling price, but zero-rated goods or services are taxable for VAT at 0%.

If you only sell or supply exempt goods or services

If you only sell or otherwise supply goods or services that are exempt from VAT then your business is an exempt business. You cannot register for VAT - so you won't be able to reclaim any VAT on your purchases.

This is in contrast to the situation if you sell or otherwise supply zero-rated goods or services, where you can reclaim the VAT on any purchases that relate to those sales. In addition, if you sell mainly or only zero-rated items, you may apply for an exemption from VAT registration, but then you can't claim back your input tax.

Reclaiming VAT in a partly exempt business

If you are registered for VAT but make some exempt supplies your business is partly exempt.
Generally, you won't be able to reclaim the input VAT you've paid on purchases that relate to your exempt supplies.

If the amount of input VAT incurred relating to exempt supplies is below a minimum 'de minimus' amount, input VAT can be reclaimed in full.

If the amount of input VAT incurred relating to exempt supplies is above the 'de minimus' amount, only the part of the input VAT that related to non-exempt supplies can be reclaimed.

Tax points

The time of supply, known as the 'tax point', is the date when a transaction takes place for VAT purposes. This date is not necessarily the date the supply physically takes place.

Generally, you must pay or reclaim VAT in the VAT period in which the time of supply occurs (usually quarterly), and use the correct rate of VAT in force on that date. This means you'll need to know the time of supply/tax point for every transaction so you can put it on the right VAT Return.

Time of supply (tax point) for goods and services

The time of supply for VAT purposes is defined as follows.

- For transactions where no VAT invoice is issued (for example, sales to customers who aren't registered for VAT), the time of supply is normally the date the supply physically takes place (as defined below).
- For transactions where there is a VAT invoice, the time of supply is normally the date the invoice is issued, even if this is before or after the date the supply physically took place (as defined below). To issue a VAT invoice, you must send (by post, email etc) or give it to your customer for them to keep. A tax point cannot be created simply by preparing an invoice.

However there are exceptions to these rules on time of supply, detailed below.

Date the supply physically takes place

For goods, the time when the goods are considered to be supplied for VAT purposes is the date when one of the following happens.

- The supplier sends the goods to the customer.
- The customer collects the goods from the supplier.
- The goods (which are not either sent or collected) are made available for the customer to use, for example if the supplier is assembling something on the customer's premises.

For services, the date when the services are considered to be supplied for VAT purposes is the date when the service is carried out and all the work - except invoicing - is finished.

Exceptions regarding time of supply (tax point)

The above general principles for working out the time of supply do not apply in the following situations.

- For transactions where a VAT invoice is issued or payment is received in advance, the time of supply is the date the payment is received or the date the invoice is issued - whichever is the earlier.

- If the supplier receives full payment before the date when the supply takes place and no VAT invoice has yet been issued, the time of supply is the date the payment is received.

- If the supplier receives part-payment before the date when the supply takes place, the time of supply becomes the date the part-payment is received but only for the amount of the part-payment (assuming no VAT invoice has been issued before this date - in which case the time of supply is the date the invoice is issued). The time of supply for the remainder will follow the normal rules - and might fall in a different VAT period, and so have to go onto a different VAT Return.

- If the supplier issues a VAT invoice more than 14 days after the date when the supply took place, the time of supply will be the date the supply took place, and not the date the invoice is issued. However, if a supplier has genuine commercial difficulties in invoicing within 14 days of the supply taking place, they can contact HM Revenue & Customs (HMRC) to ask whether they can have permission to issue invoices later than 14 days and move the time of supply to this later date.

VAT invoices

What is a VAT invoice?

A VAT invoice shows certain VAT details of a sale or other supply of goods and services. It can be either in paper or electronic form.

A VAT-registered customer must have a valid VAT invoice from the supplier in order to claim back the VAT they have paid on the purchase for their business.

What is NOT a VAT invoice?

The following are not VAT invoices:

- pro-forma invoices
- invoices for only zero-rated or exempt supplies
- invoices that state 'this is not a tax invoice'
- statements
- delivery notes
- orders
- letters, emails or other correspondence.

You cannot reclaim the VAT you have paid on a purchase by using these documents as proof of payment.

What a VAT invoice must show

A VAT invoice must show:

- an invoice number which is unique and follows on from the number of the previous invoice - if you spoil or cancel a serially numbered invoice, you must keep it to show to a VAT officer at your next VAT inspection
- the seller's name or trading name, and address
- the seller's VAT registration number
- the invoice date
- the time of supply or tax point if this is different from the invoice date
- the customer's name or trading name, and address
- a description sufficient to identify the goods or services supplied to the customer.

For each different type of item listed on the invoice, you must show:

- the unit price or rate, excluding VAT
- the quantity of goods or the extent of the services
- the rate of VAT that applies to what's being sold
- the total amount payable, excluding VAT
- the rate of any cash or settlement discount
- the total amount of VAT charged.

If you issue a VAT invoice that includes zero-rated or exempt goods or services, you must:

- show clearly that there is no VAT payable on those goods or services
- show the total of those values separately.

You may round down the total VAT payable on all goods and services shown on a VAT invoice to a whole penny. You can ignore any fraction of a penny. (This concession is not available to retailers.)

Time limits for issuing VAT invoices

There is a strict time limit on issuing VAT invoices. You must normally issue a VAT invoice (to a VAT-registered customer) within 30 days of the date you supply the goods or services - or, if you were paid in advance, the date you received payment. This is so your customer can claim back the VAT on the supply, if they're entitled to.

You can't issue invoices any later without permission from HM Revenue & Customs (HMRC) except in a few limited circumstances.

You need a valid VAT invoice to reclaim VAT

Even if you are registered for VAT, you can normally only reclaim VAT on your purchases if:

- you buy an item and use it for business purposes and
- you have a valid VAT invoice for the purchase.

Only VAT-registered businesses can issue valid VAT invoices. You cannot reclaim VAT on any goods or services that you buy from a business that is not VAT-registered.

Where simplified (less detailed) VAT invoices can be issued

Simplified VAT invoices

If you make retail sales and you make a taxable supply of goods or services for £250 or less **including VAT**, then when a customer asks for a VAT invoice, you can issue a simplified (less detailed) VAT invoice that only needs to show:

- the seller's name and address
- the seller's VAT registration number
- the time of supply (tax point)
- a description of the goods or services.

Also, if the supply includes items at different VAT rates then for each different VAT rate, your simplified VAT invoice must also show:

- the total price including VAT
- the VAT rate applicable to the item.

Exempt supplies must not be included on a simplified VAT invoice.

If you accept credit cards, then you can create a simplified invoice by adapting the sales voucher you give the cardholder when you make the sale. It must show the information described in the six bullets above.

You do not need to keep copies of any less detailed invoices you issue.

Pro-forma invoices

If you need to issue a sales document for goods or services you haven't supplied yet, you can issue a 'pro-forma' invoice or a similar document to offer goods or services to customers.

A pro-forma invoice is not a VAT invoice, and you should clearly mark it with the words:
"This is not a VAT invoice".

If your potential customer accepts the goods or services you're offering them and if you actually supply them, then you'll need to issue a VAT invoice within the appropriate time limit.

If you have been issued with a pro-forma invoice by your supplier, you can't use that to claim back VAT on the purchase. You must obtain a VAT invoice from your supplier.

Advance payments and deposits

An advance payment, or deposit, is a proportion of the total selling price that a customer pays before you supply them with goods or services. If you ask for an advance payment, the tax point is whichever of the following happens first:

- the date you issue a VAT invoice for the advance payment
- the date you receive the advance payment.

You should then include the VAT on the advance payment on the VAT Return for the period when the tax point occurs.

If the customer pays you the remaining balance before the goods are delivered or the services are performed, another tax point is created when whichever of the following happens first:

- you issue a VAT invoice for the balance
- you receive payment of the balance.

You should then include the VAT on the balance on the VAT return for the period when the tax point occurs.

Discounts on goods and services

If any of your goods or services are discounted, you charge VAT on the discounted price rather than the full price.

If you make an offer to a customer such as 'we will pay your VAT', VAT is actually payable to HM Revenue & Customs (HMRC) on the amount the customer would have paid on the discounted price, not the amount they have paid at the full price.

Returned goods, credit notes, debit notes and VAT

For a buyer who has received a VAT invoice

If you have returned goods to the seller for a full or partial credit, you have three options:

- you can return the invoice to your supplier and obtain a replacement invoice showing the proper amount of VAT due, if any
- you can obtain a credit note or supplementary VAT invoice from your supplier
- you can issue a debit note to your supplier.

If you issue a debit note or receive a credit note, you must:

- record this in your accounting records
- on your next VAT Return, deduct the VAT on the credit or debit note from the amount of VAT you can reclaim.

For a seller who has issued a VAT invoice

If you receive returned goods from a customer, you have three options:

- you can cancel and recover the original invoice, and issue a replacement showing the correct amount of any VAT due, if any
- you can issue a credit note or supplementary VAT invoice to your customer
- you can obtain a debit note from your customer.

If you issue a credit note or receive a debit note, you must:

- record this in your accounting records
- on your next VAT Return, deduct the VAT on the credit or debit note from the amount of your VAT payable.

Business entertainment

Generally you cannot reclaim VAT on business entertainment expenses. Business entertainment is any form of free or subsidised entertainment or hospitality to non-employees.

You can reclaim VAT on employee expenses and entertainment expenses if those expenses relate to travel and subsistence or where you entertain only employees.

When you entertain both employees and non-employees, you can only reclaim VAT on the proportion of the expenses that is for employees.

Cars and motoring expenses

When you buy a car you generally can't reclaim the VAT. There are some exceptions - for example, when the car is used mainly as one of the following:

- a taxi
- for driving instruction
- for self-drive hire.

If you couldn't reclaim the VAT on the original purchase price of a car you bought new, you won't have to charge any VAT when you sell it. This is because the sale of the car is exempt for VAT purposes. If you did reclaim the VAT when you bought the car new, you charge VAT when you come to sell it.

VAT-registered businesses can generally reclaim the VAT when they buy a commercial vehicle such as a van, lorry or tractor.

Reclaiming VAT on road fuel

If your business pays for road fuel, you can deal with the VAT charged on the fuel in one of four ways:

- Reclaim all of the VAT. You must use the fuel only for business purposes.
- Reclaim all of the VAT and pay the appropriate fuel scale charge - this is a way of accounting for output tax on fuel that your business buys but that's then used for private motoring.
- Reclaim only the VAT that relates to fuel used for business mileage. You'll need to keep detailed records of your business and private mileage.
- Don't reclaim any VAT. This can be a useful option if your mileage is low and also if you use the fuel for both business and private motoring. If you choose this option you must apply it to all vehicles including commercial vehicles.

Transactions outside the UK

Exports, despatches, supplying goods abroad: charging VAT

If you sell, supply or transfer goods out of the UK to someone in another country you may need to charge VAT on them.

Generally speaking, you can zero-rate supplies exported outside the European Union (EU, previously known as the European Community or EC), or sent to someone who's registered for VAT in another EU country, provided you follow strict rules, obtain and keep the necessary evidence, and obey all laws.

If you supply goods to another EU country these sales are technically known as despatches (or ‘removals’) rather than exports. The term 'exports' is reserved to describe sales to a country outside the EU.

VAT on sales to someone who is not VAT registered in another EU country

When you supply goods to someone in another EU country, and they're not registered for VAT in that country, you should normally charge VAT.

VAT on sales to someone who is VAT registered in another EU country

If you're supplying goods to someone who is registered for VAT in the destination EU country, you can zero-rate the supply for VAT purposes, provided you meet certain conditions.

VAT on exports of goods to non-EU countries

VAT is a tax charged on goods used in the European Union (EU), so if goods are exported outside the EU VAT isn't charged. You can zero-rate the supply.

Imports and purchases of goods from abroad: paying and reclaiming VAT

Generally speaking, VAT is payable on all purchases of goods that you buy from abroad at the same rate that would apply to the goods if supplied in the UK. You must tell HMRC about goods that you import, and pay any VAT and duty that is due.

VAT on goods from EU countries

If you are registered for VAT in the UK and receive goods from inside the EU, these are known as acquisitions (or ‘arrivals’) rather than imports. You must enter the value of the acquisition in Box 9 and Box 7 of your VAT Return and account for VAT in Box 2 of your VAT return using the same rate of VAT that would apply if the goods were supplied in the UK. This VAT is known as acquisition tax. You can reclaim the VAT as if the goods were supplied in the UK by including the same figure in Box 4, subject to the normal VAT rules for reclaiming input tax.

VAT on imports of goods from non-EU countries

VAT may be charged on imports of goods that you buy from non- EU countries. You can reclaim any VAT paid on the goods you have imported as input tax.

Bad debts

When you can reclaim VAT on bad debts

You can reclaim VAT that you paid to HM Revenue & Customs and which you have not received from the customer. The conditions are that:

- the debt is more than six months old and less than three years and six months old
- you have written off the debt in your VAT account and transferred it to a separate bad debt account
- the debt has not been sold or handed to a factoring company
- you did not charge more than the normal selling price for the items.

How to claim bad debt relief

If you are entitled to claim bad debt relief, you add the amount of VAT you are reclaiming to the amount of VAT you are reclaiming on your purchases (input tax) and put the total figure in Box 4 of your VAT return.

To work out how much bad debt relief you can claim on a VAT-inclusive balance, you need to apply the VAT fraction to the unpaid amount.

Submitting returns and paying VAT

You must submit your VAT Return and pay any VAT you owe by the due date.

Paper returns

If you submit a paper return, the due date is usually one month after the end of the VAT period, which is usually quarterly. You can find the date that your return is due printed on the return.

If you submit a paper return and pay it electronically, you can get up to seven extra calendar days after the standard due date shown on your return for payment to reach HMRC. You don't get those seven extra days in the exceptional cases listed below.

Online returns

It is mandatory for all VAT-registered traders with a turnover of £100,000 or more, plus any newly registered traders (regardless of turnover), to submit their returns online and pay electronically.

Therefore most VAT-registered businesses have to submit online VAT Returns and pay electronically. You get seven extra calendar days after the standard due date to submit your online return and to pay any VAT due electronically unless one of the exceptional cases listed below applies to you.

Exceptions to the seven day extension

You do not qualify for the seven extra days after the standard due date to submit your return or make payment if:

- you use the VAT Annual Accounting Scheme
- you are required to make payments on account (unless you submit monthly returns).

VAT payment deadlines

You are responsible for calculating how much VAT you owe and for paying VAT on time. Paying on time will help you avoid having to pay a surcharge.

If you submit an online return you must pay your VAT electronically. If you submit a paper return, you can either pay electronically or enclose payment with your return.

For both online and paper returns, any VAT you owe must have cleared to HMRC's bank account on time whether paid electronically or by cheque.

In most cases, paying electronically provides you with up to seven extra calendar days after your standard due date for cleared funds to reach HM Revenue & Customs' (HMRC's) bank account. The exception to this is payment by Direct Debit, when HMRC will automatically collect payment from your bank account three bank working days after the extra seven calendar days following your standard due date.

If you miss the payment deadline you may be liable to a surcharge for late payment.

Special accounting schemes

Annual accounting scheme for VAT

Using standard VAT accounting, you must complete four VAT Returns each year. Any VAT due is payable quarterly, and any VAT refunds due to you are also repayable quarterly.

Using annual VAT accounting, you usually make nine interim payments at monthly intervals. You only need to complete one return at the end of the year when you either make a balancing payment or receive a balancing refund. Annual accounting can reduce your paperwork and make it easier to manage your cash flow.

You can use annual accounting if your estimated taxable turnover during the next tax year is not more than £1.35 million. If you are already using annual accounting you can continue to do so until your estimated taxable turnover exceeds £1.6 million.

Benefits of annual accounting

- You only need to complete one VAT Return per year, instead of four.
- You get two months rather than one month to complete and send in your annual VAT return and pay the balance of your VAT payable.
- You can better manage your cash flow by paying a fixed amount in monthly instalments.
- You can make additional payments as and when you wish.
- You can join from the day you register for VAT, or if you are already registered.

Disadvantages of annual accounting

- If you regularly reclaim VAT, you will only get one repayment per year.
- If your turnover decreases, your interim payments may be higher than your VAT payments would be under the standard VAT accounting - you would have to wait until the end of the year to receive your refund.

Cash accounting scheme for VAT

Using standard VAT accounting, you pay VAT on your sales whether or not your customer has paid you. Using cash accounting, you do not need to pay VAT until your customer has paid you. If your customer never pays you, you never have to pay the VAT.

You can use cash accounting if your estimated taxable turnover during the next tax year is not more than £1.35 million.

You can continue to use cash accounting until your taxable turnover exceeds £1.6 million.

The benefits of cash accounting

Using cash accounting may help your cash flow, especially if your customers are slow payers. You do not need to pay VAT until you have received payment from your customers, so if a customer never pays you, you don't have to pay VAT on that bad debt as long as you continue to use the cash accounting scheme.

Disadvantages of cash accounting

Using cash accounting may affect your cash flow:

- You cannot reclaim VAT on your purchases until you have paid your suppliers. This can be a disadvantage if you buy most of your goods and services on credit.
- If you regularly reclaim more VAT than you pay, you will usually receive your repayment later under cash accounting than under standard VAT accounting, unless you pay for everything at the time of purchase.
- If you start using cash accounting when you start trading, you will not be able to reclaim VAT on most start up expenditure, such as initial stock, tools or machinery, until you have actually paid for those items.
- If you leave the cash accounting scheme you will have to account for all outstanding VAT due, including any bad debts.

Flat rate schemes for VAT

If your taxable turnover is less than £150,000 per year, you could simplify your VAT accounting by calculating your VAT payments as a percentage of your total VAT-inclusive turnover. Although you cannot reclaim VAT on purchases - it is taken into account in calculating the flat rate percentage - the flat rate scheme can reduce the time that you need to spend on accounting for and working out your VAT. Even though you still need to show a VAT amount on each sales invoice, you don't need to record how much VAT you charge on every sale in your accounts, nor do you need to record the VAT you pay on every purchase.

Benefits of using a flat rate scheme

Using the flat rate scheme can save you time and smooth your cash flow. It offers these benefits:

- You don't have to record the VAT that you charge on every sale and purchase, as you would with standard VAT accounting. This can mean you spending less time on the books, and more time on your business. You do need to show VAT separately on your invoices, just as you do for standard VAT accounting.
- A first year discount. If you are in your first year of VAT registration you get a 1% reduction in your flat rate percentage until the day before the first anniversary you became VAT registered.
- Fewer rules to follow. You no longer have to work out what VAT on purchases you can and can't reclaim.
- Peace of mind. With less chance of mistakes, you have fewer worries about getting your VAT right.
- Certainty. You always know what percentage of your takings you will have to pay to HM Revenue & Customs.

Potential disadvantages of using a flat rate scheme

The flat rate percentages are calculated in a way that takes into account zero-rated and exempt sales. They also contain an allowance for the VAT you spend on your purchases. So the VAT Flat Rate Scheme might not be right for your business if:

- you buy mostly standard-rated items, as you cannot generally reclaim any VAT on your purchases
- you regularly receive a VAT repayment under standard VAT accounting
- you make a lot of zero-rated or exempt sales.

Errors

Action you must take at the end of your VAT accounting period

At the end of your VAT accounting period, calculate the net value of all the errors you have found during the period that relate to returns you have already submitted - that is, add together any additional tax due to HM Revenue & Customs (HMRC), and subtract any tax you should have claimed back. Don't include any deliberate errors - these must be separately disclosed to HMRC.

What you do next depends on whether the net value of all the errors is less than or greater than the ‘error correction reporting threshold’.

The error reporting threshold is the greater of:

- £10,000
- 1% of the box 6 figure on your VAT Return for the period when you discover the error - subject to an upper limit of £50,000.

If the net value of all the errors is less than the threshold then, if you prefer, you may correct the errors by making an adjustment on your current VAT Return.

However, if the value of the net VAT errors discovered is above this threshold, you must report them to HMRC separately, in writing.

How to adjust your VAT Return: Method 1

You can correct certain errors whose net value is below the error correction reporting threshold by adjusting your VAT Return.

At the end of the VAT period when you discover the errors, adjust your VAT account of output tax due or input tax claimed by the net amount of all errors. Make sure that your VAT account shows the amount of the adjustment you make to your VAT Return.

If you discovered more than one error, use the net value of all the errors to adjust your return. Adjust box 1 or box 4, as appropriate. For example, if you discover that you didn’t account for VAT payable to HMRC of £100 on a supply that you made in the past, and also didn’t account for £60 VAT reclaimable on a purchase, add £40 to your box 1 figure on your return.

How to separately report an error to HMRC: Method 2

For certain errors you must separately report to your relevant HMRC VAT Error Correction Team in writing about the mistake. The simplest way to tell them is to use Form VAT 652 "Notification of Errors in VAT Returns", which is for reporting errors on previous returns, but you don't have to use Form VAT 652 - you can simply write a letter instead.

You may, if you wish, use this method for errors of any size which are below the error reporting threshold instead of a Method 1 error correction. If you use this method you must not make adjustment for the same errors on a later VAT return.

You must always use Method 2 if the net errors exceed the error reporting threshold or if the errors made on previous returns were made deliberately.

Surcharges, penalties and assessments

Surcharges if you miss a VAT Return or VAT payment deadlines

You must submit your VAT Return and pay any VAT by the due date. If HM Revenue & Customs (HMRC) receive your return or VAT payment after the due date, you are 'in default' and may have to pay a surcharge in addition to the VAT that you owe.

The first time you default, you will be sent a warning known as a 'Surcharge Liability Notice'. This tells you that if you pay late ('default') again during the following 12 months - known as your surcharge period - you may be charged a surcharge.

If you submit or pay late again during your surcharge period you may have to pay a 'default surcharge'. This is a percentage of your unpaid VAT. If you don't submit a correct return, HMRC will estimate the amount of VAT you owe and base your surcharge on that amount (known as an assessment – see below).

HMRC assessments

You have a legal obligation to submit your VAT Returns and pay any VAT you owe to HMRC by the due date. If you don't submit a return HMRC can issue an assessment which shows the amount of VAT that HMRC believes you owe, based on their best estimate.

Penalties for careless and deliberate errors

Careless and deliberate errors will be liable to a penalty, whether they are adjusted on the VAT return or separately reported.

If a person discovers an error which is neither careless nor deliberate, HMRC expects that they will take steps to correct it. If the person does not take steps to correct it, the inaccuracy will be treated as careless and a penalty will be due.

Penalties for inaccurate returns

You may be liable to a penalty if your VAT Return is inaccurate, and correcting this means tax is unpaid, understated, over-claimed or under-assessed. Telling HMRC about inaccuracies as soon as you are aware of them may reduce any penalty that is due, in some cases to zero.

Penalties for submitting a VAT Return on paper instead of online

If you send your VAT Return on paper when you are required to submit your return online you will be charged a penalty.

Penalty for late registration

If you don't register for VAT with HM Revenue & Customs at the right time then you may be liable to a late registration penalty.

Finding out more information about VAT

Most questions can be answered by referring to the HMRC website.

VAT Helpline

If you can't find the answer to your question on the HMRC website, the quickest and easiest way is to ring the VAT Helpline where you can get most of your VAT questions answered. Before you ring, make sure you have your VAT registration number and postcode to hand. If you're not VAT registered you'll need your postcode.

What you can write to HMRC about

The VAT Helpline can answer most questions relating to VAT, but there may be times when you need to write to HMRC.

You can write to HMRC about VAT if:

- you've looked at the VAT information published by HMRC - either on the website or in printed notices and information sheets - and can't find the answer to your question
- you've already contacted the VAT Helpline and they've asked you to write
- you can show that you have real doubt about how VAT affects a particular transaction and your personal situation or business

If HMRC already publishes information that answers your question, they'll write to you and give the relevant details.

Visits by VAT officers

VAT officers are responsible for the collection of VAT for the government. They check businesses to make sure that their VAT records are up to date. They also check that amounts claimed from or paid to the government are correct. They examine VAT records, question the business owner or the person responsible for the VAT records and watch business activity.

Before a visit, HMRC will confirm the following details with you:

- the person the VAT officer wants to see
- a mutually convenient appointment date and time
- the name and contact number of the officer carrying out the visit
- which records the officer will need to see, and for which tax periods
- how long the visit is likely to take
- any matters you are unsure of, so that the officer can be better prepared to answer your queries.

HMRC will confirm all the above information in writing unless the time before the visit is too short to allow it. They will almost always give you seven days notice of any visit unless you want an earlier one, for example to get your claim paid more quickly.