

Tax explainer: VAT



Introduction

Value Added Tax (VAT) is a tax on goods and services in the UK. Businesses that meet the VAT threshold must register with HMRC and charge VAT on their sales. Understanding VAT is essential for compliance and managing cash flow effectively.

Who Needs to Register for VAT?

A business must register for VAT if:

- Its taxable turnover exceeds £90,000 in a rolling 12-month period (from April 2024).
- It expects to exceed the threshold in the next 30 days.
- It buys goods worth more than £90,000 from the EU.
- Businesses can also register voluntarily if their turnover is below the threshold, which may be beneficial for reclaiming VAT on purchases.

VAT Rates

- Standard Rate (20%) – Applies to most goods and services.
- Reduced Rate (5%) – Applies to specific items such as home energy and some health products.
- Zero Rate (0%) – Applies to essential goods like food, books, and children's clothing.
- Some goods and services are exempt from VAT (e.g., financial services, education, healthcare). Businesses selling only VAT-exempt goods cannot register for VAT.

Rates will be different when charging customers who are based abroad. Advice should be taken on this area.

How VAT Works

VAT Registered Businesses Charge VAT

Businesses must add VAT to their sales invoices and issue VAT receipts, applying the correct rate for their product / service.

VAT on Purchases

Businesses must track and then can reclaim VAT on goods and services they buy for business use. Tracking of VAT on invoices and purchases is normally done through an accounting app, like QuickBooks

VAT Returns

Normally once a quarter VAT returns are submitted to HMRC through approved accounting software.

The amount due will be the net of the amount of VAT collected on sales (output VAT) and amount suffered on purchases (input VAT).

VAT returns and any tax due must be submitted one month and 7 days after the VAT period end.

Fines and interest can be levied for late payments or returns.

VAT Schemes Available for Businesses

Businesses can use different VAT schemes to simplify VAT accounting:

- Standard VAT Accounting – Report VAT on sales and purchases in each VAT return.
- Flat Rate Scheme – Pay a fixed percentage of turnover as VAT instead of tracking input and output VAT. Available for businesses with a turnover under £150,000.
- Cash Accounting Scheme – Pay VAT only when customers pay invoices rather than when the invoice is issued. Helps with cash flow.
- Annual Accounting Scheme – Make advance VAT payments and submit one VAT return per year instead of quarterly.

Conclusion

VAT is a key part of UK tax law that affects many businesses. Understanding VAT rules, using the right accounting scheme, and complying with Making Tax Digital requirements can help businesses manage VAT obligations efficiently.

Contact Parry and Parry for expert VAT advice and compliance support.