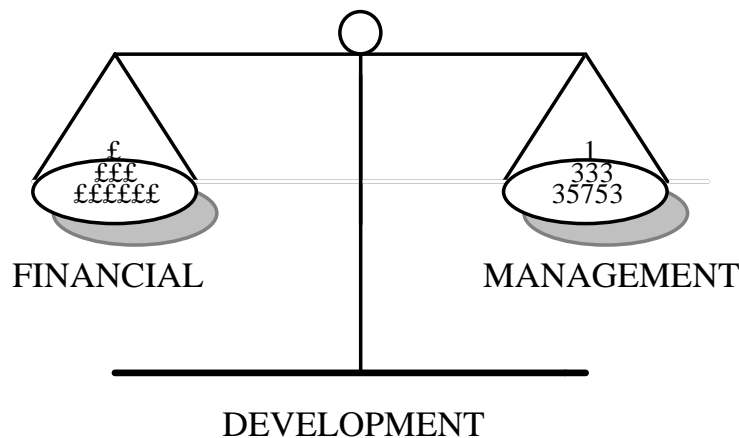


# FINANCIAL MANAGEMENT DEVELOPMENT

## Taxation

NO 413

### VALUE ADDED TAX - AN OVERVIEW



ONE OF A SERIES OF GUIDES FOR  
FINANCIAL MANAGEMENT DEVELOPMENT

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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 the Commissioners of the Customs and Excise. It is therefore completely separate from the Inland Revenue who are responsible for all 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 the Commissioners on imported goods".

Since taxable persons collect output tax on their sales to customers and recover input tax from the Commissioners (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 £10 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.

## VALUE ADDED TAX - DETAILS

1. VAT is chargeable on taxable supplies at either zero rate or standard rate (currently 17.5% apart from Home/Charity Fuel at 8%). 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 his inputs. Therefore, zero rating is extremely beneficial to the trader and most suppliers of zero rated goods will be reclaiming tax from the Commissioners.

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 Commissioners for tax paid on his 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 (1997: £48,000 ) in the preceding 12 months, or who believes they will make supplies in the next year which will do so, must register with the Commissioners.

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 his ordinary business.

The consequences of registration are that the trader should charge VAT and account for it. If supplies fall below an expected (1997:£46,000) 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 the Commissioners 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 £10.
3. The supply must have been to the claimant or his 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:

- £100 per month; or
- £250 per month and 50% of all input tax; or
- £500 per month and 25% of all input tax

**7. ADMINISTRATION**

VAT is a self-administered tax normally accounted for on a quarterly basis. If turnover is below £300,000 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. The penalties for late returns, late payments or incorrect returns are vicious. Payment should be made not later than one month after the date of the return, plus seven days if payment is by credit transfer.

Fraud - unlimited fine and/or seven years imprisonment

Late payment - has been as high as 0.5% interest per day on overdue amount. Now only 15% of tax due.

Plus serious mis-declaration penalty of up to 20% of the error.

**8. RETAIL SCHEMES**

There are a number of retail schemes designed to suit different types of business. Which ever 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 his 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 the C & E 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 the C & E.

**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.

## **VAT - ZERO RATED SUPPLIES (GROUPS DEFINED BY STATUTE)**

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.
- (b) "Naughty" food e.g. sweets, alcohol, soft drinks etc.

2. Animal foodstuffs (except pet food).

2. **SEWERAGE AND WATER SERVICES**

Only for Non industrial users from 1 July 1990. 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**

\*. **FUEL AND POWER** (not fuel for road vehicles)

From 1 July 1990 supplies to industry are standard rated.

From 1 April 1994 domestic fuel and fuel for charities is at 8% rate.

5. **CONSTRUCTION OF RESIDENTIAL OR CHARITABLE BUILDINGS**

6. **PROTECTED BUILDING**

7. **INTERNATIONAL SERVICES**

This includes services connected with goods located 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 (e.g. alcohol) 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)**

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 COMPETITORS**

Specifically entry fees

11. **WORKS OF ART**

12. **FUND RAISING EVENTS BY CHARITIES**

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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 thirty major organisations including Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco) and computer based training packages (The Post Office, Unilever and BP).

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 and the need for taxation awareness training for general managers.

He is married with one grown up daughter and his outside interests include being The Treasurer of the Hospice of St. Francis (Berkhamsted), and a member of the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

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).