The ins and outs of VAT

KAREN BULLEN explains the impact of VAT on imports, exports, dispatches and acquisitions in seven easy diagrams.

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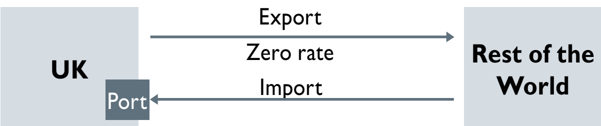
The aim of this student article is to explain in simple terms the way VAT operates on goods being sold to overseas customers and purchased from overseas suppliers. This should be useful for students preparing for ATT Papers 3 and 6 as well as those studying for the CTA Awareness VAT Module.

For VAT purposes, we can consider that the world is divided into three parts, as shown by ***The VAT World***.

The VAT World

The UK comprises England, Scotland, Wales, Northern Ireland and surrounding territorial waters and (for VAT purposes only) also includes the Isle of Man. But let's start with by considering transactions between the UK and the ***Rest of the World***.

Rest of the World



KEY POINTS

- An article for students of ATT Papers 3 and 6 and those studying for the CTA Awareness VAT Module.
- The important distinction between the UK, EU and 'rest of the world'.
- Evidence of the export of goods is essential when zero-rating for this purpose.
- The customs declaration form C88 must be completed at the port when importing goods from outside the EU.
- The tax point is important because it determines the VAT return on which the sale will be reported.
- The EC Sales List is usually submitted quarterly within 14 days of the quarter end.

Exports

All sales of goods to customers in the rest of the world are called 'exports' and are zero-rated. This is regardless of how they would be treated if supplied within the UK.

To illustrate this, let's say that we act for a chocolate manufacturer based in Birmingham, which sells chocolate to a customer in the UK. This would be a standard rated supply for VAT – it is 'naughty' food. However, if chocolate is sold to a customer based in Canada – in other words, in the rest of the world – this would be an export and consequently it would be a zero-rated supply.

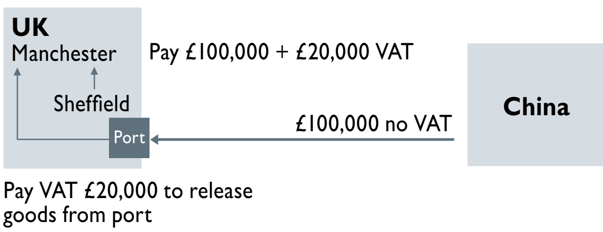
The business would need evidence that it had exported the goods and this might be indicated on a bill of lading, an air waybill or other commercial document. The manufacturer would also need to fill in details of the export on its next VAT return in Box 6 ('Total supplies excluding VAT').

Imports

If the chocolate manufacturer purchased goods from a supplier in the rest of the world this is an import. If goods arrive from the rest of the world they are held in the port of entry to the UK (the seaport or airport). To release the goods from the port they must be valued and the appropriate rate of VAT in the UK is then charged to free them.

This is illustrated by ***VAT on Imports***.

VAT on Imports



In ***VAT on Imports***, a business based in Manchester wishes to buy steel worth £100,000. If it buys the steel from a supplier

EXAM TIP 1

Brush up on geographical knowledge so you know which countries are in which box.

There is a list of all the EU countries within the VAT Regulations SI 1995/2518, reg 2 – which is in the *Tolley Orange Tax Handbook*, Part 1 (page 1179 in the 2016-17 edition and page 1255 in the 2017-18 version).

EXAM TIP 2

The tax point is important because it determines the VAT return on which the sale will be reported.

in Sheffield, it must pay VAT of £20,000 on top of the £100,000 price because the supplier will be making a standard-rated supply.

This £20,000 is input tax for the buyer, which it can recover on its next VAT return.

Let's say that the Manchester business decides to buy the steel from a supplier in China. In this case, it will pay the supplier only the £100,000 price, but the steel will be held up at the port of entry. To free the steel from the port and transport it to Manchester the steel must be valued (£100,000) and a declaration made of what it is – steel. The UK business will then look at the rate of VAT that applies to steel if it had been supplied by a UK supplier (the standard rate) and this must be paid to release the steel from the port. Further information on the details of this process can be found on HMRC's website at tinyurl.com/hvcwgo7. The £20,000 of VAT that has been paid is then treated as input tax and recovered on the business's next VAT return.

The administrative points for an import are that there is the customs declaration form C88 to be completed at the port and the next VAT return will record the purchase in Box 7 ('Total purchases'). On payment of the VAT, HMRC will issue a C79 certificate showing the amount paid, and this evidences the Box 7 entry.

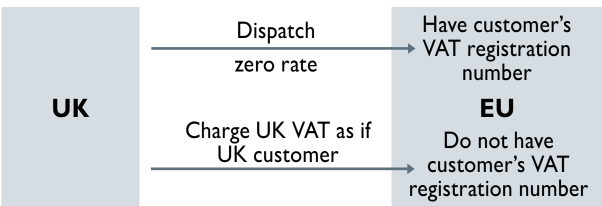
The whole point of these rules is to level the playing field for all purchases, whether from the UK or the rest of the world. In both cases – whether the purchase is from Sheffield or China – the transaction will be a purchase price of £100,000 plus £20,000 VAT.

To summarise, if the purchase is from a UK supplier, one payment of £120,000 is made to the supplier. Conversely, for a purchase from a rest-of-the-world supplier the payment is in two parts: £100,000 to the supplier and £20,000 to HMRC based at the port of entry.

The European Union

Let us consider the VAT implications of sales and purchases to and from the EU. Take a look at ***UK Sales to the EU***.

UK Sales to the EU



If a business makes a sale in an EU country it will ask the customer for its VAT registration number there. If the customer can provide a registration number, the supply will be zero-rated regardless of how that sale would be treated in the UK. This is called a 'dispatch' to differentiate this from an 'export' to a country in the rest of the world.

As an example, let's say that a Birmingham-based manufacturer of chocolate is selling confectionery to a customer in France. If the customer had provided a French VAT registration number the UK manufacturer would apply the zero rate because this is a business-to-business (B2B) supply.

If the French customer cannot provide a VAT registration number (presumably because it is not VAT-registered) the chocolate manufacturer must treat this in the same way as a supply to a domestic customer and charge the correct rate of VAT for a UK sale. Thus, if a Birmingham-based chocolatier sold its products to a customer in France that could not provide a French VAT number this would be treated as a sale to a UK customer; in other words, this would be a standard-rated supply for VAT purposes.

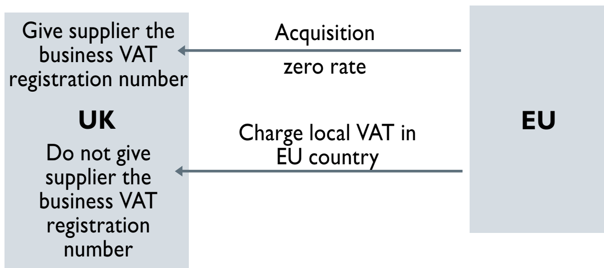
The tax point for a dispatch is the earlier of:

- the 15th day of the month after the one in which the goods are removed; and
- the day the invoice for the supplied is issued.

Acquisitions

Purchases of goods from EU suppliers are called 'acquisitions' (to differentiate these from imports from the rest of the world) and work in a mirror image way to dispatches. See ***UK Purchases from the EU***.

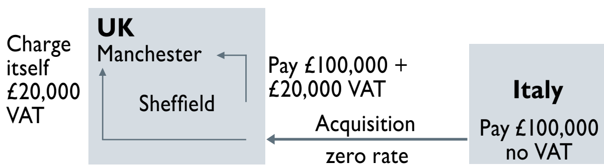
UK Purchases from the EU



Within the EU there is the free movement of goods. So the goods are *not* held at the port of entry (which is what happened with imports) and they therefore travel door to door – directly from the supplier to the customer.

So, let's consider the example in ***Steel Buyer.***

Steel Buyer



EXAM TIP 3

Use the tax point to determine on which VAT return this money must be paid.

EXAM TIP 4

HMRC's *VAT Notice 725: The Single Market* is useful when considering EU movements of goods. (See *Tolley Orange Tax Handbook*, Part 1, page 3405 in the 2016-17 edition and page 3498 in the 2017-18 version.)

A Manchester-based business wishes to buy £100,000 worth of steel. As before, if it buys the steel from a supplier in Sheffield it must pay £20,000 of VAT on top of the £100,000 price because the supplier is making a standard-rated supply.

This £20,000 VAT payment is now input tax that the business must recover on its next VAT return.

However, if the steel is bought from a supplier based in Italy (in other words, from a country within the EU) and the UK business provides its VAT registration number, the Italian firm will zero rate the sale and will be paid £100,000 with no VAT added. The goods will *not* be held up at the port of entry but arrive in Manchester with only £100,000 having been paid.

This does not provide a level playing field between purchases from UK and EU suppliers. If the goods are bought in the UK for £100,000, VAT of £20,000 must be paid. But goods bought from an EU country would cost only the net amount of £100,000. To even things up, a VAT liability of £20,000 must somehow be paid.

The Manchester business cannot pay at the port of entry because there is free movement of goods so a different way to pay must be found. This is done by paying the £20,000 VAT on the next VAT return after the good have arrived.

Tax and the tax point

So, for a purchase from a UK supplier one payment of £120,000 is made to the supplier, whereas for a purchase from an EU supplier the payment is in two parts: £100,000 to the supplier and £20,000 to HMRC on the next VAT return.

The £20,000 of VAT that the UK business has paid through its VAT return is now treated as input tax and is recovered on the next VAT return in the normal way.

Therefore, if a UK business makes a purchase from an EU supplier, its next VAT return should show the £20,000 of VAT owed to HMRC – shown as output tax – and the £20,000 is also input tax for the business. So, if the UK business is not partially exempt and can recover this input tax in full, the overall position is £20,000 output tax, £20,000 input tax – so a nil effect.

The tax point for an acquisition is the earlier of:

- the 15th of the month after the one in which the goods arrived; and
- the date on which the invoice is issued for the supply of the goods.

EXAM TIP 5

Highlight the Statistics of Trade (Customs and Excise) Regulations 1992 SI 1992/2790 which contain what is required on an Intrastat. (See *Tolley Orange Tax Handbook*, Part 1, page 1129 in the 2016-17 edition and page 1199 in the 2017-18 version.)

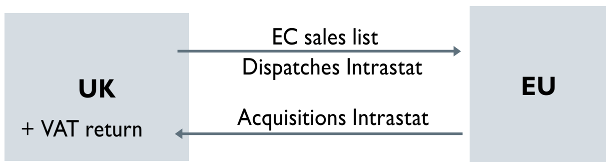
EXAM TIP 6

If you are not familiar with a VAT return it is worth asking a colleague who submits VAT returns whether you can watch them complete a few to familiarise yourself with which numbers go where. You would not be asked to complete a VAT return in the exam but you may be required to say into which box on the return a number would be entered.

The paperwork

Now let's think about documents that must be completed. As mentioned above, for exports we need proof of export and for imports we need the valuation form. For dispatches and acquisitions we need documents as shown in ***Paperwork***.

Paperwork



The EC Sales List (ESL) sets out the value of supplies made to each EU customer using their VAT registration number. It is usually submitted quarterly within 14 days of the quarter end. More information can be found on the HMRC website at tinyurl.com/pf6fwxk.

With free movement of goods, the only way the government can find out what is moving around the EU is through another form called the Intrastat (www.gov.uk/intrastat). This collects a lot of statistical information such as mode of transport, net mass of goods, and member state of dispatch and arrival. This form is also called the Supplementary Statistical Declaration (SSD).

Finally, the VAT return requires these entries.

- Box 6 – total supplies made.
- Box 8 – supplies of goods to the EU.
- Box 7 – total purchases made.
- Box 9 – acquisitions of goods from the EU.

For further information, HMRC has guidance at tinyurl.com/lyem3er This offers information on completing the VAT return and submitting this to the department.

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