

Simple as VAT

Sophie Hill highlights basic VAT issues to bear in mind on starting a UK business and when ceasing trade.

What VAT issues should be borne in mind on commencing a UK business? What circumstances make action necessary where a registered person ceases to trade? While I cannot hope to cover every detail or eventuality in the course of this article, I will stick to the points that regularly form part of the examiners' suggested solutions for ATT and CTA.

VAT is an ongoing issue for sole traders, partnerships and companies making significant levels of taxable supplies in the course of their business. Most businesses at some point during their existence will be exposed to the vast array of rules and requirements that HMRC has created to manage the tax. Having said that, HMRC is not usually waiting around the corner demanding a VAT return and payments from the moment a business commences and has put in place a couple of useful schemes which should not be ignored. There are also rules which apply at the time a business ceases or is transferred, which I will cover later.

Commencement: registration

As noted above, a new business, making taxable supplies may not have to worry about the burden of making VAT returns to HMRC from day one. As long as the business avoids becoming a taxable person for VAT, it will not have to charge 'output tax' on supplies to its customers. This may be an advantage from a commercial point of view, in that its prices on standard-rated supplies will not have to rise by 20%. The downside to this is that the business will not be able to recover VAT it suffers on its inputs (input tax) which it is likely to have been charged from the moment it started to trade.

The process of VAT registration will rectify this. A business, once VAT registered, charges output tax and recovers input tax in accordance with the detailed rules that exist. The new business does, however, have a degree of choice as to the timing of its VAT registration at the start of its operations. To register or not to register, that is the question.

Key points

- To register or not to register, that is the question.
- Liability vs entitlement to be VAT registered.
- The cash accounting scheme and annual accounting scheme.
- A person ceasing to do business must de-register and charge himself VAT.



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In deciding whether or not a business should join HMRC's 'VAT Club', two things should be borne in mind. First, the *liability* to be registered (no choice) and second, the *entitlement* to be registered (a degree of choice). These are perhaps more usefully remembered as compulsory and voluntary registration. The relevant legislation is contained in VATA 1994, Sch 1.

The liability to register arises (and thus the period of discretion ends) in two situations. First, at any month end where taxable supplies for the 12 months then ended (or since the start of trading if shorter) have exceeded the registration threshold (currently set at £85,000 until 31 March 2024). The trader then has 30 days from the end of that month to notify HMRC of this fact.

Second, liability to register arises when the business expects that its taxable supplies in the next 30 days (ignoring previous supplies) will exceed the £85,000 threshold. The trader then has 30 days from the date the expectation arises to give notice. In either case, Form VAT 1 is used for this purpose.

In order that smaller businesses need not suffer as a result of isolated instances of success, (eg an unexpected flood of sales), HMRC will waive the requirement to register if they are satisfied that taxable supplies in the following 12 months will not exceed the de-registration threshold (currently £83,000). In addition, HMRC can grant exemption from registration where taxable supplies are predominantly zero rated.

Businesses making taxable supplies below the registration threshold are entitled to register, ie they have a choice, by making application on form VAT 1. Intending traders, ie businesses who are going to make taxable supplies, also have this choice. Voluntary registration brings with it the considerable advantage of a business being able to recover input tax it has suffered. This will be of particular benefit to 'repayment traders', ie those who make predominantly zero-rated supplies and therefore charge output tax at the very generous rate of 0%. It also, of course, avoids the possibility of the trader incurring a penalty for late registration. I shall not deal with VAT penalties here but advisers should be aware of the penalty regime.

Recovery of input tax

HMRC has made it possible for businesses, which have not exercised their right to register, to nevertheless recover input tax suffered on certain expenses incurred during the period before any subsequent VAT registration is effective. Generally, VAT incurred on business goods acquired in the four years before registration and on services supplied within the six months prior to registration can be recovered.

Help from HMRC

Once a business has become VAT registered, it will charge output tax and recover input tax by way of its VAT returns, which are usually filed every quarter. It is the 'tax point' of a transaction that determines its inclusion in a particular VAT return. Often, the date of the VAT invoice is the tax point of the transaction. A consequence of this is that the output tax charged by the business to its customers must be paid over to HMRC before the customer has settled his bill. This can and does create serious cash flow problems for the business.

Businesses can overcome such cash flow difficulties by using the cash accounting scheme. The benefit of the scheme is that the tax point for VAT is the date that payment is physically received or made. Thus the business does not have to pay over the VAT it has charged on its invoices until it has received payment from the customer. Bad debt relief is therefore automatic when cash accounting is used.

A business is eligible to operate the scheme from the start of any VAT return period if it has reasonable grounds for believing that its taxable turnover in the following 12 months will not exceed £1,350,000. Businesses can stay in the scheme as long as their taxable turnover in the previous year had not exceeded £1,600,000. There is no need to apply to join the scheme, but certain further conditions must be satisfied. These are contained in Regulation 58, SI 1995/2518, and are essentially that the business has a squeaky clean VAT record. As such, only the worthy can join!

As mentioned earlier, a great inconvenience of registering for VAT is the subsequent requirement to complete and file VAT returns. This burden can be partially lifted by the use of the annual accounting scheme. Applications to join the scheme must be formally made to HMRC in accordance with VAT regulations 49–55, SI 1995/2518.

The business can apply for authorisation to operate the scheme if it expects taxable supplies for the following year not to exceed £1,350,000. It can stay in the scheme as long as its taxable supplies do not exceed £1,600,000. The scheme requires businesses to make payments on account, based on an estimate of the VAT liability for the year. Businesses can choose to pay in three equal instalments, each being 25% of the estimated VAT or in nine equal instalments, each being 10% of the estimated VAT. These payments are made without being accompanied by a VAT return.

Businesses in the scheme need only make one VAT return covering the whole year. This return, along with any balancing payment required, is due two months after the end of the year. As such the annual accounting scheme offers a lighter administrative burden for the small business without causing HMRC any cash flow headaches.

All very generous but there is one important caveat. HMRC will not permit a business to use this scheme unless it has a

clean VAT record. Also this scheme is not available to 'repayment' traders.

Cessation: the issues

Having discussed the issues that need to be borne in mind when a business starts up, let's now flip the coin and identify the issues when a business ceases.

A cessation of operations will mean that the business stops making taxable supplies. It must therefore de-register by notifying HMRC.

One point often overlooked is that on de-registration, the registered person is treated as making a supply to himself of any stocks and capital assets held at the date of de-registration. The logic is that the registered trader is supplying himself (now a new unregistered person) with the assets and stock and thus must charge himself VAT. This charge applies to all assets where input tax suffered on purchases has been recovered. It does not apply to items where recovery of input tax is blocked, eg motor cars. As a final point, no output tax needs to be charged where VAT due on de-registration is £1,000 or less.

It is important to identify the other scenarios where de-registration is necessary, for example when a business is transferred from one person, (say Max) to another, (say Chen). It will also be required when the nature of the entity carrying on the business changes, for example, where a sole trader becomes a partnership and vice versa, or where a sole trader (say Jordan) incorporates and starts to trade as a company (say Jordan Limited). In these situations there will again be a de-registration charge.

However, where a cessation occurs and the business of the transferor is thereafter carried on by the transferee, there is what is known as a transfer of a going concern (TOGC). TOGCs are outside the scope of VAT and as such the charge on de-registration does not apply. One of the conditions for a TOGC is that the recipient of the assets must be, or must immediately become, VAT registered. There are separate rules where the assets being transferred include land and buildings. This is a topic in itself and is outside the scope of this article.

So when we are talking to our client (either via the examiner or in the real world) we should not confine our discussions to the more obvious income and corporation tax consequences of starting and ceasing to trade. Knowing a few basic VAT points not only completes the picture for the client, it offers the opportunity to grab a few straightforward marks at both ATT and CTA level. ●

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