UNDERSTANDING VAT

YOUR ULTIMATE GUIDE TO **ACHIEVING VAT CONFIDENCE** AS YOU RUN YOUR LIMITED COMPANY.

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DNA Accountants

https://dna-accountants.co.uk/start/

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GETTING STARTED

VAT doesn't have to be overwhelming!

As the owner of a limited company, you're juggling what feels like a million things at once. Sorting out VAT is another thing on your to-do list and, at the rate you're growing, you know you'll have to deal with it soon.

Worry not! The thing is, getting your head around VAT is easier than you might think.

This guide is here to break it all down and demystify the world of VAT. You'll get concise, jargon-free answers that tell you:

- Your VAT responsibilities
- When and how you're meant to do things
- How much you're expected to pay
- How it will affect your business

We'll walk you through the what, the how and the why of the process so you feel confident to take ownership of your VAT situation.

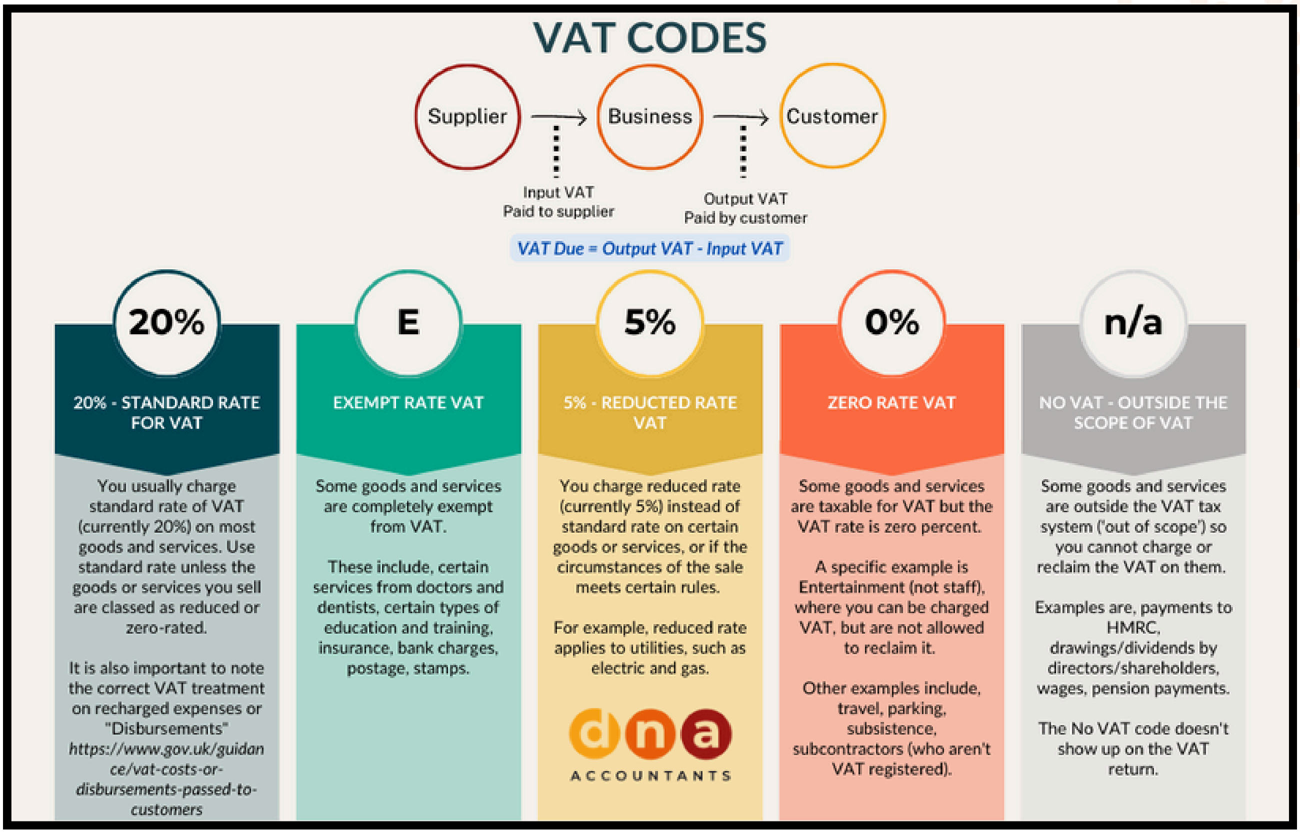
Sound good? Let's dive in!

WHAT IS VAT?

Let’s start with the basics. VAT (value-added tax) is a tax added onto most goods and services sold by businesses in the UK.

The standard rate of VAT is currently set at 20% (as of 2024), which is charged on most goods and services.

Some products have different VAT rates:



For a full run-down of the different rates, click here.

TIPS FOR VAT CONFIDENCE!

- Gain peace of mind you’re HMRC compliant by familiarising yourself with the VAT rates that apply to the goods or services you sell.
- Keep an eye out for VAT-exempt or zero-rated products. These will still need to be included and coded correctly on your VAT return (they can’t just be allocated as 0% or no VAT).

VAT IN THE CONSTRUCTION INDUSTRY

Domestic Reverse Charge

Now let's look at an important VAT measure that applies to certain businesses.

For transactions in the construction industry, the Domestic Reverse Charge (DRC) reverses the normal way of VAT accounting where the supplier charges VAT to the buyer.

In other words, if you receive or supply building and construction services which are both:

1. Reported within the Construction Industry Scheme (CIS) and
2. Subject to VAT at the standard or reduced rate

...the buyer (or contractor) will account for the VAT instead of the supplier (or subcontractor). It means they will include VAT on their return as both VAT on sales and on purchases.

In short, the measure combats VAT fraud in the industry while ensuring fair and transparent tax practices.

When you need to use DRC

DRC must be used for most supplies of building and construction services, with HMRC laying out very specific rules for when you can and can't use it.

As a rule of thumb, it must be applied to most transactions involving constructing, altering, repairing or demolishing buildings and other infrastructure. For a full rundown of all DRC use conditions, **click here**.

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VAT REGISTRATION

When To Register

The UK VAT threshold (as of 2024) is £90,000.

This means you need to register for VAT if **either**:

- Your business's VAT-taxable turnover for the last 12 months was over £90,000.
- You think it could exceed £90,000 in the next 30 days.

Remember: the £90,000 threshold applies to your turnover during the last 12-month period. In other words, it's not restricted to your financial year!

Example:

Between April 2023 and March 2024, your business generated total sales of £85,000.

The next month, in April 2024, you experience increased demand and expect sales to exceed £90,000 in the next 30 days.

To stay HMRC compliant in this scenario, you'd need to register for VAT.

You don't have to register for VAT if your business only sells VAT-exempt items.

VAT on recharged expenses

MAKING PAYMENTS TO SUPPLIERS ON BEHALF OF YOUR CUSTOMERS?

A "disbursement" (or recharged expense) is when you pass on the cost to your customers when you invoice them. If these payments meet specific criteria, you might be able to exclude them from your VAT threshold (win!). Check if you can **here.**

TIPS FOR VAT CONFIDENCE!

Keep an eye on your total sales revenue so you know when you're approaching the VAT threshold. HMRC considers both your past 12-month turnover and your anticipated turnover in the coming month when determining VAT registration requirements

Not sure how close you are to hitting the VAT threshold?
Book a chat with us *and our team will advise you.*

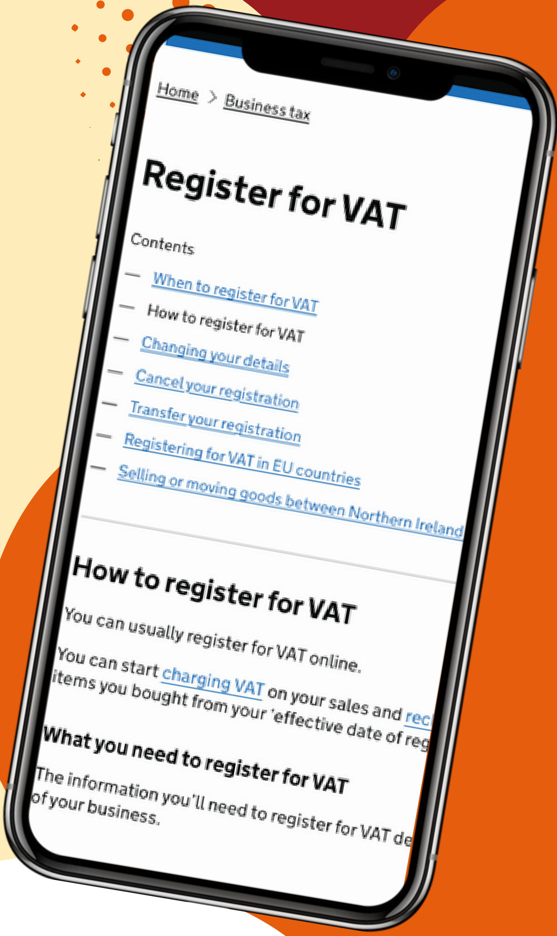
HOW TO REGISTER

When the time comes to register for VAT, here's how it usually works:

1. Visit the UK government's **[VAT registration page](#)**.
2. Submit your registration to HMRC.
3. Receive a confirmation letter and your unique 9-digit VAT number in the post.

Once you've completed these steps, you'll be able to download your VAT certificate from your Government Gateway portal.

This has your effective date of VAT registration and the dates for the period of your first VAT submission (which HMRC will be expecting).



TIPS FOR VAT CONFIDENCE!

- Factor in a good amount of time for the registration process. Once you've completed the online application, it can take 30+ days to receive your VAT number in the post.
- After sending off your application, wait until you've received your VAT number before adding VAT to your invoices.
- Issue pro-forma invoices to customers to ease cash flow fluctuations through VAT registration. These are estimated invoices used to request payments from buyers for goods or services before you supply them and should be issued as a VAT inclusive total. Once your VAT number arrives, you should then send out a VAT invoice with the net amount, VAT and Gross shown on that invoice (together with your VAT number).
- Think about adjusting your prices to factor in VAT costs while you're waiting for your registration number. If you'd like advice on the best strategy to ensure a stable cash flow, get in touch with our team.

VOLUNTARY REGISTRATION

We've looked at when you need to register for VAT...but now we're going to talk about voluntary registration.

You can choose to become VAT-registered even if your turnover is below £90,000.

The benefits:

- You can reclaim VAT on your business expenses (both now and retroactively!).
- It gives your business a professional edge.
- You're more likely to attract other VAT-registered partners.

*Voluntary VAT registration can be more advantageous for certain types of companies. To understand how it would impact your business, **book a chat** with our team.*

CHARGING VAT TO CUSTOMERS

Calculating VAT

Once you've received your unique VAT number in the post, you'll need to start charging VAT to customers when they buy your products or services.

HOW IT WORKS?

1. Calculate the total price of the product including VAT. To work out the standard 20% VAT rate:
   Price of product before VAT x 1.2 = Total price including VAT

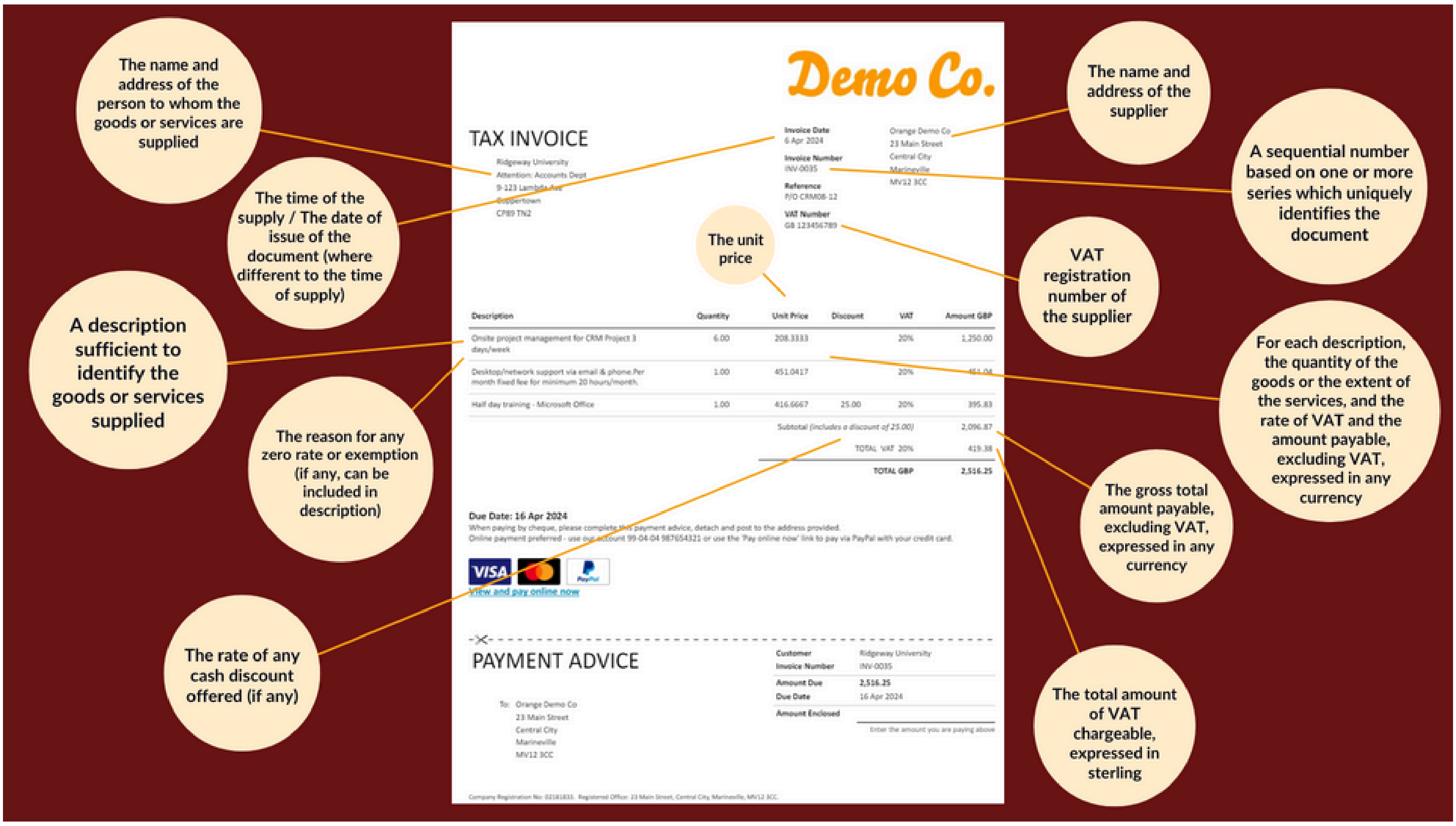
2. Make sure the invoice includes your VAT number and clearly shows the VAT amount separately.

3. Log the transaction in the VAT account in your digital accounting software.

4. When it's time to do your VAT return, record the total VAT amount on the return to comply with HMRC.

VAT INVOICES

When you start charging VAT in your business, you'll need to show the following details on the VAT invoices you issue:



Tips for VAT confidence!

- Use Xero as your digital accounting software to really streamline the VAT billing process. Say goodbye to tedious manual calculations!
- Remember certain goods and services are exempt from VAT. Even if you buy or sell one of these products, you'll need to record the transaction but using a different VAT rate.
- TOP TIP: If you would like to check if a company is VAT-registered and using the correct VAT number you can use this link from Gov.uk

RECLAIMING VAT

Once you're VAT-registered, you'll also be able to reclaim VAT on goods and services bought for business purposes.

To reclaim this VAT, you need to:

- Have a valid VAT invoice that's addressed to the company.
- Keep records to support your claim.
- Only claim VAT on products for business use. If something has dual personal-business use (like a phone), you can only claim the business proportion of the VAT.

Claiming VAT pre-registration

When you receive your VAT number, you can claim back the VAT you paid on business purchases made before registering (within specific timeframes).

- **4 years for goods** (stock, vehicles, machinery, products used to make other goods you still have) as long as they are still on hand at the date of VAT registration.

- **6 months for services** (marketing, accounting fees, IT services, consultancy).

Remember: you'll only be able to reclaim these VAT costs:

- On your first VAT return.
- On purchases that directly contribute to your VAT-registered business activities.
- On goods and services bought for the specific business you've registered for VAT.

Claiming VAT post-registration

Daily purchases made after registration don't have any restrictions, with the exceptions of client entertainment and purchases of cars for personal use.

Tips for VAT confidence!

Always double-check the amount to pay on invoices. If you pay less than the amount due on a valid invoice, you can only claim the VAT on the amount paid (not what's on the invoice).

VAT SCHEMES

A VAT scheme refers to the way you calculate VAT in your business. Let's look at the two main types which most UK businesses fall under, before exploring additional schemes which can provide greater flexibility to certain companies.

ACCRUAL SCHEME

In an accrual VAT scheme, you'll include in your VAT return:

- Any bills you receive during the VAT return period (usually quarterly).
- Any sales raised, regardless of whether the payments have been fulfilled.

This is the standard VAT scheme (and the one most businesses are automatically enrolled into).

CASH SCHEME

In a cash VAT scheme, you'll include in your VAT return:

- Only the sales and purchases that have been physically received or paid out by your business, regardless of the invoice date.

You can only use cash accounting if your estimated VAT taxable turnover is £1.35 million or less in the next 12 months. If you often experience fluctuations in cash flow, a cash VAT scheme could be a better option for your business.

ALTERNATIVE VAT SCHEMES

Although less common than cash and accrual, there are additional VAT schemes that can provide benefits depending on your type of business.

- **VAT FLAT RATE SCHEME**
  - You can only use this scheme if you're a small business with an annual taxable turnover of £150,000 or less (excluding VAT).
  - This lets you work out what you owe HMRC as a percentage of your gross turnover, and the amount of VAT you pay will depend on your industry and type of business.
  - For more details on this scheme, **click here**
- **VAT ANNUAL ACCOUNTING SCHEME**
  - This lets you complete one VAT return each year instead of four.
  - You can also make advanced VAT payments towards your bill based on your last return (or your estimated amount of VAT if you're newly registered).
  - For more details on this scheme, **click here.**
- **VAT Margin scheme**
  - This scheme is available to retail businesses and those selling second-hand goods.
  - You'll pay VAT on the value you add to the goods, rather than on the full sale price of each item.
  - For more details on this scheme, **click here.**
- **RETAIL VAT SCHEMES (THREE DIFFERENT TYPES)**
  - There are three other main VAT schemes available to retail businesses to make calculating your VAT simpler.
  - You can work out your VAT once with each VAT return, rather than calculating it for each sale you make.
  - For more details on these schemes, **click here.**

Tips for VAT confidence!

- Thoroughly research each option to find the VAT scheme that's best suited to your business.
- Our team of experts at DNA will advise you to help you feel confident you're choosing the right scheme. If you'd like our guidance, drop us a message.

COMPLETING YOUR VAT RETURN

What to include

In your VAT return, you'll need to include:

- Total sales and purchases
- Amount of VAT you owe
- Amount of VAT you can reclaim on business expenses

You'll also need to keep a record of the following:

- Everything you buy and sell
    - Including VAT-exempt, reduced and 0% items
- All invoices you've issued
- All invoices you received
- Self-billing agreements (where the customer prepares the invoice)
    - Including the name, address and VAT number of self-billing suppliers
- Debit or credit notes
- Goods you've given away or taken from stock for private use
- General business records
    - Including bank statements, cash books, paying-in slips

If HMRC wants to inspect your records to check you're paying the right amount of tax, don't worry. Your VAT inspection will go smoothly if you have all the records listed above.

Tips for VAT confidence!

Make record-keeping simpler and less time-consuming with Xero. The user-friendly digital accounting software streamlines the process, ensures compliance and saves time.

WHEN YOUR RETURN IS DUE

The deadline for submitting your VAT return online and paying your VAT bill to HMRC is:

1 calendar month and 7 days after the end of your accounting period.

If you miss your deadline or you know you won't be able to pay a VAT bill on time, contact HMRC as soon as possible.

Depending on your accounting period, you may be charged a penalty or interest if you don't submit your return or pay on time. You can monitor your penalty points in your HMRC account.

Tips for VAT confidence!

- Make sure to factor in time before the deadline for your payment to reach HMRC.
- If you're unsure when you need to make your VAT payment, use HMRC's **VAT deadline calculator.**

VAT repayments from HMRC

If you've paid out more VAT than you've charged to your customers, HMRC will typically reimburse you the difference.

Repayments are usually processed within 30 days of HMRC receiving your VAT return. If you haven't received any communication from HMRC after that, it's a good idea to chase them up.

The repayment will be deposited directly into your bank account if HMRC already has these details on file. If not, they'll issue a cheque.

COMMON MISTAKES IN VAT RETURNS

Let's look at some frequent errors business owners make when completing VAT returns.

WRONG APPLICATION OF TAX RATES

DOUBLE-CHECK THE VAT RATE OF INDIVIDUAL PRODUCTS

- Many business owners assume the tax rate is either 20% VAT or no VAT (which can misplace transactions in the wrong part of your VAT return).

WRONG COA CODE USE

CHECK YOU'RE USING THE RIGHT CHART OF ACCOUNTS (COA) CODE WHEN CATEGORISING TRANSACTIONS.

- Clarify if you're posting the item to the balance sheet or the profit and loss.

Using the wrong COA code can miscategorise transactions, leading to mistakes when it comes to reporting.

MIS CATEGORISATION OF EXPENSES

TAKE CARE NOT TO CATEGORISE SMALL EXPENSES AS FIXED ASSETS.

- This can distort financial statements and give you unreliable performance data.
- We recommend only capitalising expenses over £250 (with some exceptions).

FORGETTING TO CHECK WHAT YOU OWE

REGULARLY REVIEW HOW MUCH YOU OWE TO REPORT YOUR DEBT ACCURATELY.

- Double-check bills and loans on your balance sheet to make sure your financial records are correct and don't cause inaccuracies down the line.

DUPLICATING TRANSACTIONS

AVOID POSTING THE SAME TRANSACTION MULTIPLE TIMES.

- Duplicate entries can arise if you double-code through both cash (spend/receive money) and invoice.
- Review your outstanding bills and invoices to check for copies of the same transaction.

WRONG APPLICATION OF TAX RATES

TRY NOT TO RELY ON XERO TO COMPLETE YOUR VAT RETURN.

- When reconciling a transaction in Xero, fill in the "Who/What/Why" boxes manually. Xero makes auto-fill suggestions which can be inaccurate and miscategorise transactions.

FORGETTING TO REVIEW YOUR RETURN

TRIPLE-CHECK THAT EVERYTHING IS CORRECT IN YOUR VAT RETURN BEFORE SUBMITTING IT.

- Review the document to ensure you've got the right transaction codes and that all the data is accurate.

CORRECTING ERRORS IN YOUR RETURN

If you've made a mistake in one of your VAT returns, it's not the end of the world. If you let HMRC know about it, it's usually solvable!

HMRC will let you correct mistakes in VAT returns from the preceding 4 years, if the net value of the errors is:

£10,000 or less
Between £10,000 and £50,000, but less than 1% of your total sales value

For these errors, you can simply correct them in your next VAT return.

However, if the errors are:

Over £50,000
Over £10,000 and more than 1% of your total sales value
Deliberate mistakes

...you will need to tell HMRC about them separately.

Here's how to work out the net value of errors:

Add up the additional tax you're due to pay HMRC
Subtract the amount of tax you're due

TAKE VAT OFF YOUR PLATE

Whew! There we go. You're now ready to navigate your business's VAT situation with confidence.

It's not as complex as it first seems – but it does require a bit of time set aside for filing returns and working out what you can claim.

THE THING IS YOU DON'T HAVE TO DO IT BY YOURSELF.

GET STARTED

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