Avoiding a trip up

Indirect Tax



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Neil Warren gives some practical tips about completing VAT returns, with those concerning overseas transactions in particular

Key Points

What is the issue?

An accurate VAT return means there is less chance of a query from HMRC on the figures declared each period. For example, a figure excluded from Box 6 in relation to a ‘reverse charge’ transaction might create an imbalance with the Box 1 output tax figure

What does it mean for me?

If a VAT return is properly completed and checked, there is less risk of a business making errors and potentially incurring a penalty

What can I take away?

Many errors and queries in relation to VAT returns relate to overseas transactions. It is important to recognise that the procedures are very different for goods and services

I always enjoy telling the tale about a client who was completing his VAT return online and didn't realise that HMRC's very helpful computer automatically completes Box 3 (total output tax, that is Box 1 plus Box 2) and Box 5 (output tax minus input tax, giving the VAT payable or repayable) without any pressing of buttons or entering of numbers. So the result for the poor client was that he entered his total output tax figure online into the input tax box, leaving a zero VAT payment in Box 5 that is, output tax equals input tax.

HMRC queried the return that he had submitted and he had in effect overclaimed input tax by £6,000, which was the difference between his output tax and input tax.

It sounds a basic error but, if people are not comfortable with computer screens and are just entering words or figures on a mechanical basis, you can see how it can trip someone up in the same way as a football defender past his sell by date trips up a speedy young winger.

The happy ending to this story is that HMRC did not apply a careless error penalty, recognising that the penalty regime requires them to takes into account the knowledge and experience of the individual taxpayer (this client was a builder). But if an accountant or tax adviser made the same mistake on his or her VAT return, and HMRC picked it up, then I feel a penalty would be justified.

Here, I am going to consider some practical situations in relation to completing VAT returns, particularly focusing on dealing with tricky international transactions.

Buying services from abroad

The 'reverse charge' calculation often causes confusion and applies when a UK business buys services from abroad. The basic principle is that the customer deals

with the VAT rather than the supplier, avoiding the need for lots of overseas businesses having to register for UK VAT.

As a starting point, always be clear that the reverse charge applies to services bought from EU and non-EU suppliers and not just from those based in the EU. See ***Example 1***.

Example 1 – Reverse Charge for Mike

Mike is an accountant in Manchester and registered for VAT. He uses the services of a bookkeeping firm based in India and received services of £10,000 in the VAT period ended 31 December 2014. What entries will he make on his VAT return for these services?

Under the 'reverse charge' procedures, Mike must treat the services received as both his income and expenditure. He will make the following entries on his VAT return:

Box 1 (output tax): £10,000 x 20% = £2,000 – the value of services multiplied by the rate of VAT that applies to that service in the UK, usually 20%.

Box 4 (input tax): same figure as Box 1 (£2,000). This assumes that the expense in question relates to 'taxable' activities and there are no partial exemption/non-business issues. This is the case for Mike.

Box 5 (VAT payable): nil effect if Box 1 is the same as Box 4.

Box 6 (outputs)/Box 7 (inputs): the net figure of £10,000 is included in both of these boxes so Mike is treating the services received as both his income and expenditure.

I am often asked about the logic of a business paying money to an overseas supplier but then recording this payment as income in Box 6 of its VAT return.

However, if you think about a domestic purchase of goods or services between two VAT-registered entities, the supplier will declare output tax in Box 1 and the net value of the sale in Box 6. The customer will claim input tax in Box 4 and record the inputs figure in Box 7. Here, we have the same boxes completed as with a 'reverse charge' calculation.

Selling services abroad

If Mike does some work for a German business customer (or Australian business customer as the rules for selling B2B (business to business) services here are the same for EU and non-EU customers), which boxes of the VAT return will be completed?

The answer is ‘only Box 6’ (outputs). This answer can sometimes cause confusion – there is a view that, if a service is outside the scope of VAT because the place of supply is outside the UK, no entry is made on the VAT return. This statement is correct in only one situation if the business uses the flat rate scheme. For examples of income sources that are included or excluded from Box 6, look at HMRC Notice 700/12, para 3.7. The point about including the overseas services is shown at bullet point 8, ‘Supplies which are outside the scope of UK VAT as described in Notice 741A place of supply
of services’.

Warning: ignore Box 8 and Box 9 for services

Here is my tip to save you unnecessary hassle: don’t forget that boxes 8 and 9 apply only if you either buy or sell ‘goods’ from a VAT-registered business in another EU country. The boxes do not relate to services. So if your client only buys or sells services abroad, then the figures in boxes 8 and 9 will be zero.

Buying goods from abroad

The rules on buying goods from abroad are very different according to whether we are buying from a supplier based in an EU or non-EU country. If the latter, VAT is paid at the point that the goods enter the UK, assuming they are standard-rated creating a source of input tax for the importer when he acquires the C79 VAT certificate issued by HMRC. But no VAT is charged by the supplier, or HMRC, in relation to an EU purchase from outside the UK, with the buyer accounting for ‘acquisition tax’ in Box 2 of his VAT return. See ***Example 2*** and ***Example 3***.

Example 2 – Mike buys a computer from Italy

Mike has bought a new computer for his practice from a supplier in Italy for £2,000. The sale has been correctly zero-rated by the Italian supplier because he is selling

goods to a VAT-registered business outside Italy.

Mike will make the following entries on his next VAT return:

Box 2 (acquisition tax): £2,000 x 20% = £400. This is the value of the goods multiplied by the UK rate of VAT applicable to them. Note: no tax would be due if the goods in question were zero-rated in the UK.

Box 4 (input tax): same figure as Box 2, assuming no input tax restrictions apply for exempt, non-business or private use.

Box 7 (inputs): net value of goods – £2,000.

Box 9 (acquisition of goods from other EU states): same figure as Box 7 – £2,000.

Example 3 – Mike buys a computer from Japan

Mike has bought a new computer from a supplier in Japan for £2,000. The computer is subject to customs duty of £200 when it arrives in the UK, so VAT payable at the point of entry is £440 (£2,200 x 20%).

Mike will make the following entries on his next VAT return:

Box 4 (input tax): he will reclaim VAT of £440, supported by a C79 certificate as evidence.

Box 7 (inputs): net value of goods £2,200. This includes the customs duty paid at the point of import.

What are the key issues in relation to Mike’s computer purchases?

The VAT payable on goods bought from an EU supplier is included in Box 2 of the return compared with Box 1 for services.

There is no Box 6 (outputs) entry for goods bought from an EU supplier. This is because the buyer in the UK does not need to treat the payment for goods as his own income as he does for services.

We have used Box 9 in the case of goods bought from an EU supplier but, as explained above, we never use Box 8 or 9 for services.

Selling goods abroad

To complete the loop, let us assume that Mike is now selling two computers abroad, one to a VAT-registered customer in France and one to a business in the US. Both sales are zero-rated but, in the case of the EU sale, the proceeds will be recorded in Box 6 (outputs) and Box 8 (sales of goods to VAT-registered businesses in EU countries outside UK) but only in Box 6 for the sale to the US. This is another important point: don't think that just because an entry has been made in Box 8 for a sale that it is not included in Box 6 as well – it is. In effect, Box 6 reflects worldwide sales made by a business.

Conclusion

As a final question, what basic checks should always made be made to ensure our VAT returns are accurate? It is always important to ensure that the VAT payable (or repayable) figure in Box 5 reconciles to the VAT creditor or debtor balance in the nominal ledger as at the same date.

Although you would expect this to be automatic, it is not necessarily the case. Think of the fun and games you have if someone forgets to 'reconcile' the VAT return system on Sage after it has been completed.

And how many computer systems exclude VAT journals from the VAT report? I even know one system that includes the previous quarter's VAT payment in the input tax figure for the following period; what an excellent idea that sounds!