Should I register voluntarily?

Indirect Tax



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Neil Warren answers some common questions posed by business owners when they start trading

Key Points

What is the issue?

Choosing the correct or most effective VAT registration date ensures compliance with the law and maximises potential input tax claims for a new business

What does it mean to me?

Once a business owner has been granted a registration date by HMRC, there is no scope to amend it unless the business exceeded the compulsory threshold at an earlier date

What can I take away?

There is scope to claim input tax in the pre-registration period, but advisers need to be aware of HMRC's view that a 'use' adjustment is needed in the case of goods

It is usually clear whether a business should register for VAT as soon as it starts trading. This might be because it has a large amount of input tax to claim in relation to buying capital assets or stock, or because all customers are also VAT-registered and can reclaim input tax anyway (see ***Example 1***). In some situations, a business owner might want to register because of the 'prestige' factor. Having a VAT number indicates to potential customers that the business is a legitimate, serious player.

> **Example 1 – VAT Registration**
>
> John has bought the freehold of a commercial property for £200,000 plus VAT to rent out to a firm of solicitors on a 10-year lease for an annual charge of £15,000. It would be sensible for John to opt to tax the property as soon as he has acquired it (VAT1614A is sent to HMRC's option to tax unit in Glasgow) and become VAT-registered to claim input tax of £40,000 on the property purchase. The VAT charged to the solicitors will not be a problem because they will be registered for this and fully taxable.

Can a business register for VAT before it makes a sale?

Yes. This is known in VAT speak as an 'intending trader' application. Contrary to popular thinking, there is no time limit between when a business becomes registered and when it makes its first taxable sale. HMRC will almost certainly require evidence of trading intentions in the form of business plans, potential customer orders and possible deals with suppliers, or details about trading premises if relevant. They have the power to refuse an application should they not be satisfied of a genuine intention to make taxable supplies (see ***Table***).

Table – Voluntary Registration

In the case of *TL Step by Step Ltd* (TC4338) the company was compulsorily deregistered by HMRC on 1 October 2013, the same day that it had initially registered on a voluntary basis. The reason for the cancellation was that the director could provide no evidence that the company intended to make taxable supplies. The declared activity was the sale of beers, wines and spirits plus business consultancy. The director provided evidence of two wine sales for small amounts to friends (eight months apart), but could not give details of purchase orders, correspondence, business plans or other documents about her intention to sell wine to retailers and restaurants, or carry on a proper business activity. Her appeal against the cancellation of the registration was dismissed.

Can a business retrospectively register for VAT?

A business must register for VAT on a compulsory basis if it has made more than £82,000 of taxable sales in any rolling 12-month period or if it expects them to exceed this figure in the next 30 days. In the latter case, the registration date is the beginning of the 30-day period. In the case of the rolling 12-month historical test, the registration date is the first day of the second month after the limit has been exceeded.

However, the legislation also allows a business to register retrospectively on a voluntary basis by going back up to four years from the application date (VATA 1994 Sch 1(9) – see also HMRC guidance note VATREG21300). This might give scope for a windfall of input tax – and the four-year window for input tax gains could be extended by pre-registration claims as well (see below).

A common question relates to VAT returns for a retrospective registration. HMRC will issue a single long period return for the retrospective period rather than divide the period into quarters and ask for many different returns to be submitted. As a final tip, ensure the requested date of registration is correct on the initial VAT1 application form. Once HMRC have issued a VAT registration number based on the requested date, there is no scope to go back and ask them to adjust it.

How does a business deal with output tax on sales invoices already issued before it registered but which are now captured

by the retrospective period?

This is a tricky aspect of VAT accounting and is best explained in ***Example 2***.

> **Example 2 – Retrospective Output Tax**
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> Mary is a self-employed tax consultant who provides services to one customer, a firm of accountants called Hyde and Co. She started trading on 1 October 2014 and achieved sales of £60,000 in the year to 30 September 2015. She has retrospectively registered for VAT on a voluntary basis from her first day of trading and must submit a 12-month return to HMRC for the period to 30 September 2015. It is now November 2015.
>
> In this situation, Mary will issue a VAT-only invoice to Hyde and Co for £12,000 for the retrospective period. The invoice will show a current date – let's say 15 November 2015. Hyde and Co will claim input tax on the VAT return that includes this date. However, Mary will declare output tax of £10,000 on her September 2015 VAT return (£60,000 x 1/6) and then £2,000 on her December VAT return – £12,000 less £10,000. This is because the sales in the retrospective period are treated as being for '£60,000 including VAT'.
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> ***Note*** The above process is important in the case of compulsory registrations backdated retrospectively, where a business might be faced with a late registration penalty based on the tax due in the late period. So a correct adjustment as above will reduce output tax in the late period and reduce the potential penalty.

How much input tax can be claimed on pre-registration expenses?

A welcome opportunity for a newly-registered business is to claim input tax on particular pre-registration expenses:

- **Goods** – which were purchased within the four-year period before the date of registration (and VAT was charged by the supplier) and which have been used in the business during that time. They must still be owned by the business on its first day of VAT registration. The definition of 'goods' includes both stock and fixed assets.

- **Services** – the time window is capped at six months before registration and the service cannot relate to a sale that has been invoiced before registration.

There are circumstances when a claim cannot be made. Three examples are:

1. A friend started his business on 1 January this year and immediately registered for VAT– but he could not claim input tax on the laptop and other computer equipment bought in the previous four years because they did not relate to his business at the time of purchase since there was no business. In other words, private expenditure cannot be turned into business expenditure at a future date.
2. A computer consultant claimed input tax on the cost of subcontractor fees incurred in the six-month period before registration, which would normally be fine. However, the services in question related to completed jobs for which he had invoiced before he became registered.
3. A hairdresser who fitted out her salon must recognise that a lot of the pre-registration expenditure will relate to capital building services, for which the six-month window applies, rather than goods, for which the four-year window applies. There is no problem with input tax recovery using the four-year window on physical items such as hairdryers and chairs, but it is definitely an issue with spending on, say, decorating, electrical and plumbing works.

A recent challenge on this subject has highlighted how HMRC expect a depreciation adjustment to be made to reflect the use of goods in the pre-registration period (see ***Example 3***).

> **Example 3 – Depreciation Adjustment**
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> Bob the builder became VAT-registered on 1 October 2015 because he exceeded the registration threshold on 31 August 2015. He bought a van on 1 October 2012 for £10,000 + VAT that he has used in his business since. How much input tax can he claim on his first VAT return?
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> The van has been used for three years before registration, so HMRC would expect the claim to be less than £2,000. Based on a 20% reducing balance method of depreciation, the VAT not claimed would be £976 (£400 in year 1; £320 in year 2; £256 in year 3). The net claim on the first return would be £1,024.

What about the flat rate scheme?

If a newly registered business is eligible for, and adopts, the flat rate scheme (expected taxable sales in the next 12 months are less than £150,000 excluding VAT), particular planning points must be recognised:

- A business can claim a 1% discount on its relevant flat rate percentage in the first year of VAT registration.
- A business using the scheme for its first VAT period can claim pre-registration input tax on this return in the same way as a non-scheme user as considered above. This is the only time that a scheme user can claim input tax unless it buys capital goods costing more than £2,000 including VAT.

Some advisers incorrectly think that the 1% discount can be claimed by a business in its first year of using the scheme. This is incorrect. It is only in the first year of VAT registration. And if a business joins the scheme part way through its first year of registration, the 1% discount applies to the remaining balance of the first-year period (see ***Example 4***).

> **Example 4 – Flat Rate Scheme**
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> John became VAT-registered as an accountant on 1 January 2015 and he joined the flat rate scheme on 1 July 2015. He can apply a flat rate percentage of 13.5% for his next two returns – until 31 December 2015 – and a rate of 14.5% will take effect from 1 January 2016.