

There are also expenses you cannot reclaim the VAT on, such as the purchase of a car (with very limited exceptions) or business entertainment. Registered traders act as unpaid tax collectors for the Government, but they can suffer heavy penalties for getting the answers wrong – even if the rules are complicated and the mistakes are innocent.

The good news

There are a number of special schemes for small businesses that can make VAT registration easier or even more profitable.

The flat rate scheme allows you to keep some of the VAT you charge to customers instead of claiming the VAT back on your expenses – depending on the numbers, you can end up in pocket (it's simpler, too).

The cash accounting scheme allows you to delay paying VAT to HMRC until you have received it from your customers.

The annual accounting scheme means you only have to file one VAT return a year instead of 4 or 12.

How we can help

We can help guide you through the maze of VAT rules that apply to your business, from getting registration right to everything that follows, and steer you away from the mistakes that lead to penalties. We can help you pick the small business schemes that may be available to you, as well as explaining how to operate them and how to make sure you get the best advantage. Dealing with VAT is demanding and a constant requirement for a registered trader. We are here to help.

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Value Added Tax



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Value Added Tax



VAT's the deal?

VAT is a tax charged by the Government on consumption. We all pay it on many of the goods and services we buy from businesses. It's a fact of life and hard to avoid – often we don't even notice it, because shops usually price goods "including VAT".

It's different if you are running a business. Then you may be required by the Government to charge the tax to your customers, collect it and pass it on to HM Revenue & Customs. Now it's very noticeable – accounting for it is a major burden, it can reduce your profit margins, and getting it wrong leads to big penalties.

Must I charge VAT?

The law requires you to register for VAT and start to charge it if your sales exceed a certain level (currently £70,000 a year). Once you are registered you have to charge VAT on all sales, unless they qualify for one of the various VAT reliefs such as exemption or zero-rating.

Once you are registered, you can claim back the VAT which other traders charge to you on your business costs. That helps, but you hope your income will be bigger than your expenses – if so you will be paying VAT to HMRC. Also many costs – such as wages – don't carry VAT.

Example

George runs a café with a turnover of £65,000 a year. He does not have to charge VAT to his customers. He cannot reclaim VAT on his costs of £25,000 a year, but most of those costs are food and wages – there is no VAT to pay on either.

Jackie runs a café with a gross turnover of £75,000 a year. She has costs of £25,000, which includes £1,000 of VATable items such as professional fees and stationery. If the standard rate of VAT is 17.5%, she has to pay 7/47 of her sales to HMRC – £11,170 – and gets back just £175 in return. She is worse off than George, even though her sales are higher and her costs are the same.

Do I want to register?

If your customers are businesses who can recover their VAT, you might want to register even if you don't have to – that's allowed. It makes no difference to your customers if you charge VAT or not – so being able to get back the VAT on your expenses is a pure bonus for you.

If you are not VAT-registered, you give away the fact that your business is very small. Some people may think you are not declaring your income to the taxman if you don't charge VAT, even if you are entitled not to because you're too small. And some customers will not accept that a service provider is self-employed if not VAT-registered – they will want to deduct PAYE from their fees.

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Who's registered?

It's important to realise that the person running the business is registered, not the business itself. That means that a single person with several businesses has to deal with them all under the same VAT registration. They all get added together when you are considering the registration threshold. So if you are VAT registered as a plumber, and you start running a very small B&B operation, you immediately have to start charging VAT on the B&B.

On the other hand, if you can use two different people to run the separate businesses, you look at each on its own – for example, a husband could be the plumber and his wife could be the proprietor of the B&B. A partnership between husband and wife, and a limited company, are further examples of different "people" for VAT purposes.

Simply a minefield

The Chancellor who introduced VAT famously described it as a "simple tax". It was even set at 10% so you could work it out in your head. At present the sums are more difficult, as the standard rate is 17.5% – going up to 20% on 4 January 2011 – but you also have to tell the difference between standard rated, zero-rated, exempt, reduced rated and outside the scope activities.

In some areas, such as land, the rules can be very complicated and the numbers large – the consequences of a mistake are serious.