CHAPTER 13

ACCOUNTING FOR VAT

13.1 Introduction

This chapter looks at four different but related topics which all come under the umbrella of "accounting for VAT". These are

1) the payment or repayment of VAT;
2) monthly payments on account of the VAT liability;
3) the annual accounting scheme; and
4) the cash accounting scheme.

13.2 Payment and Repayment of VAT

VAT returns must be **submitted** to HMRC not later than **one calendar month after the end of the VAT return period** in question. When a return is sent to HMRC, any VAT that is due for payment should be sent to HMRC at the same time. **Late returns and late payments of VAT due can result in penalties.** SI 1995/2518 Reg 25 & 40

If the VAT return shows input tax exceeding output tax for the return period, HMRC will issue a repayment. Where possible, HMRC like to make repayments of VAT though the Bankers Automated Clearing System (BACS).

13.3 Payment of VAT

Businesses which **pay VAT electronically** automatically receive a **7 day extension** to the deadline for the submission of the VAT return and the VAT due. However this 7-day extension is not available to traders making payments on account or using the annual accounting scheme.

HMRC have stated that businesses may pay their VAT in Euros if they wish, but the declarations of their liability must be made in sterling and VAT repayments will also be made in sterling.

13.4 Monthly Payments on Account

Very **large traders** are required to **pay their VAT monthly in advance** on account of their actual VAT liability for a return quarter. VAT Notice 700/60

Returns are still only submitted quarterly, but payments are made monthly. SI 1993/2001

For two months, a payment on account is made and for the third month of a VAT return the true payment is made. The true payment is made when the VAT return is submitted. This is the VAT due per the return, less the payments on account.

Monthly payments on account are not required if the trader makes monthly VAT returns.

Only businesses meeting the definition of a "very large trader" make monthly payments on account. There are two tests to determine what a very large trader is.

Test 1 states that the trader's total **VAT liability** for the previous year ended 30 September, 31 October, or 30 November **exceeded £2 million**. The September, October or November dates apply according to whether the trader has a group 1, group 2 or group 3 stagger.

Test 2 considers the businesses' total VAT liability in any subsequent period of one year tested at the end of each VAT return period. If total VAT liability exceeds £2 million, the business is a very large trader.

Whether a trader is defined as large under test 1 or test 2 is important because it effects the periods in respect of which the payments on account are required.

If test 1 is satisfied, payments on account will be required for the whole of the **following** VAT year. VAT years commence on 1 April, 1 May or 1 June, depending on whether the business has a group 1, 2 or 3 stagger.

If the business satisfies test 2, liability to make payments on account commences from the very next VAT return period.

Illustration 1

Giant Limited has a VAT year-end of 31 May. In the year to 30 November 2010 its net VAT liability totalled £2.1 million.

Giant Ltd has a VAT year-end of 31 May so it has a group 3 stagger. The VAT liability exceeds the £2 million threshold in the 30 November year-end period considered in test 1.

Hence, Giant Ltd is a very large trader and is now liable to make payments on account. Because it satisfies test 1, these payments on account will commence with the VAT year beginning 1 June 2011.

If the year to 30 November 2010 was the first time that Giant Ltd had exceeded the £2 million threshold, we would look at test 2 as well. At the end of a VAT return period, if the VAT liability for the year then ending exceeds the £2 million threshold, the trader is due to make payments on account from the next VAT return period. In this case, payments on account will be due from Giant Ltd for the quarter to 28 February 2011 as well.

Example 1

Enormous Limited has a 31 March VAT year-end. The company's VAT liability over recent return periods has been:

	Liability	Annual Total
	£	£
31.12.09	300,000	
31.3.10	400,000	
30.6.10	500,000	
30.9.10	600,000	1,800,000
31.12.10	400,000	1,900,000
31.3.11	450,000	1,950,000
30.6.11	750,000	2,200,000

Which is the first VAT return period affected by POA?

13.5 Due Date for Payments on Account

Payments on account are due at the **end of the second and the third month** in the VAT return period. The balance is due when the VAT return is submitted.

If the payments on account exceed the total amount due for the VAT return period, HMRC will repay the excess when the VAT return is submitted.

Each payment on account is **1/24th of total VAT liability for a year,** but which VAT liability for the year depends on whether test 1 or test 2 was satisfied.

If test 1 was satisfied, it is the total VAT liability to that 30 September, 31 October, 30 November year end as is appropriate to the trader's stagger group.

If test 2 was satisfied, it is 1/24th of the total VAT liability for that year in which the £2 million threshold was exceeded.

HMRC are required to notify the trader of the amount payable, how it has been calculated and when the payment is due. In certain circumstances, HMRC have the power to reduce or increase the amount of the payment on account.

The default surcharge regime **does** apply to payments on account. Thus a business will have to make all payments on account on time to avoid the surcharge.

13.6 *Annual Accounting*

Annual accounting allows small and medium sized taxable persons to pay VAT on an annual basis. It allows them to only submit one VAT return and make estimated payments on account during the year with a final VAT balance due at the year end. SI 1995/2518 Reg 49 -55 VAT Notice 732

Under the annual accounting scheme, **the VAT liability** for the current year is **estimated** by HMRC. **90% of this estimate is then paid by direct debit in nine equal instalments** on the last day of months 4, 5, 6, 7, 8, 9, 10, 11 and 12 of the VAT year. The VAT year is the year ended 31 March, 30 April, or 31 May depending on the stagger group of the trader.

The **balance** of VAT due is sent with the **single annual VAT return on the last day of the second month following the year-end**. There is only one VAT return every year which is filled in with the whole year's details. Traders have two months after the year end to complete the VAT return and calculate the VAT due.

The payments on account already made are deducted, and the balance is sent to HMRC with the return. If a repayment is due to the trader, this will be repaid by HMRC when the VAT return is submitted.

A business may apply to make only 3 interim payments instead of 9. If this request is approved, the business will pay 25% of the estimated tax on the last day of the 4th, 7th and 10th month with the balancing payment due on the last day of the 14th month.

Illustration 2

Jane pays VAT for the year to 30 April 2011 under the annual accounting scheme. HMRC estimate that she would be due to pay £25,000 for the year, and she based her payments on this estimate.

On completing her VAT return for the year, £29,000 of VAT is due.

HMRC had estimated that Jane would be due to pay £25,000 for the year, so her payments on account were based on this estimate. Thus 90% will be paid in nine equal instalments – ie 9 instalments of £2,500 each.

These will be paid on the last day of months 4, 5, 6, 7, 8, 9, 10, 11, and 12. Month 4 is August, so the first POA is due on 31st August 2010.

Jane will then pay £2,500 every month until the 30th April 2011. Over 9 months she will pay £22,500.

Jane's payments were thus:

	£
31 August 2010 (£25,000 x 90% ÷ 9)	2,500
30 September 2010	2,500
31 October 2010	2,500
30 November 2010	2,500
31 December 2010	2,500
31 January 2011	2,500
28 February 2011	2,500
31 March 2011	2,500
30 April 2011	2,500
	22,500
VAT balance due with VAT return on 30 June 2011	6,500
	29,000

When the VAT return is sent in, June will pay any balance due. The return is due two months after the year-end so it will be due on the 30 June. The balance of £6,500 to make up to the £29,000 of VAT will also be due at this time.

13.7 Annual Accounting Conditions

There are various conditions which have to be met by the trader before he can use the annual accounting scheme.

Firstly if the annual value of taxable supplies is expected to be less than £1,350,000 (VAT exclusive), the trader may join the scheme at any time once registered for VAT.

Secondly, the trader must not have ceased to operate the annual accounting scheme in the past 12 months.

Finally, the trader was **not a member of a VAT group** registration.

In certain circumstances the trader must leave the scheme.

Firstly he must **leave the scheme if his turnover exceeds £1,600,000**. So, if at the end of the year, the value of taxable supplies has exceeded £1.6 million in that year, he must cease to use the scheme immediately.

Also if at any time he has reason to believe that the value of his taxable supplies in the current year will exceed £1.6 million he must also inform HMRC and leave the scheme.

A trader must **leave the scheme if he becomes insolvent**, on his death or if he ceases to trade.

HMRC have the power to withdraw authorisation from a trader to use the annual accounting scheme in certain circumstances. This will occur where the trader makes false statements, fails to furnish his annual VAT return on time, or fails to make any payments under the scheme.

There may be cash flow advantages for a trader when he uses the annual accounting scheme. The main advantage for the trader is that he knows exactly what he is paying and when he is paying, and this can help many traders to budget.

Another advantage of the annual accounting scheme is that penalties for late VAT returns are unlikely be applied because there is only one VAT return every year. Also only having to file one annual VAT return reduces the compliance burden on the trader.

13.8 Cash Accounting

Under the normal rules of VAT, the "tax point" for the supply will determine which VAT return period an output or input relates to. VAT Notice 731

Smaller businesses are allowed to dispense with the "tax point" rules and instead are allowed to use the cash accounting scheme as an alternative.

SI 1995/2518 Reg 56-65

The idea of the cash accounting scheme is that a trader accounts for VAT in respect of when money is received and money is paid.

One major advantage of the cash accounting scheme is **automatic bad debt relief**. For most traders that sell on credit, output tax is often paid to HMRC before it has been collected from the customer. If the customer does not pay, the VAT still has to be accounted for to HMRC. The trader has suffered a bad debt and he will have to wait 6 months before he can reclaim the output tax. VAT Notice 731 para 1.3

Under the cash accounting scheme, if the cash was never received from the customer, the output tax is not paid to HMRC hence automatic bad debt relief.

There are some conditions to satisfy before operating the cash accounting scheme.

1) There must be reasonable grounds for believing that the value of **taxable supplies will not exceed £1,350,000** in the next 12 months;

2) all VAT **returns must have been made up to date** and any **outstanding VAT has been paid**.

If the conditions are satisfied, it is not necessary to apply to HMRC or even to notify them that a trader is to use the cash accounting scheme.

13.9 Leaving the Cash Accounting Scheme

There will be situations when a trader will leave the cash accounting scheme.

A trader is required to **leave the cash accounting scheme if the turnover** in the 12 months to the end of a return period **exceeds £1,600,000**. VAT Notice 731 paras 2.6, 5.1, 5.3

A trader can also leave the scheme voluntarily at the end of a return period if the trader feels it is not beneficial.

HMRC can expel a trader from the scheme if it appears necessary to do so for the protection of the revenue.

Businesses that leave the cash accounting scheme either voluntarily or because they have exceeded the turnover limit, can bring outstanding VAT into account on a cash basis for six months after they leave the scheme. This new rule only applies to supplies made and received whilst using the cash accounting scheme.

A summary of the annual and cash accounting schemes can be found at the end of this chapter.

Example 2

Large Ltd has a VAT liability for the previous 12 months of £3million and pays VAT by monthly payments on account. Its VAT due for quarter ended 31 August 2010 is £500,000 and for quarter ended 30 November 2010 £400,000.

State the following:

1) **The amounts due for payment in advance under the monthly payments on account regime.**

2) **The due dates for the payments for the quarters ended 31 August 2010 and 30 November 2010.**

3) **When the VAT returns are due for quarters ended 31 August 2010 and 30 November 2010.**

Answer 1

The year-end for this group 1 trader is the 30th September. The results to the 30th September 2010 are given and the annual VAT liability for the year then ending is £1.8 million. This does not exceed £2 million and so test 1 is not satisfied.

Test 2 says that at the end of every quarter, look at the year's VAT liability for the quarter then ended. By 30 June 2011, the annual VAT liability for that period then ending is £2.2 million (ie it exceeds £2 million). The VAT return to 30 June 2011 is the one which satisfies test 2, so payments on account start from the next VAT return period which will be the quarter to 30 September 2011.

Thus the quarter to 30th September 2011 is the correct answer.

Answer 2

1) Amount due for each instalment in advance is 1/24 x 3,000,000 = £125,000.

2)

Quarter	**Payment date**	**Amount £**	**Total for quarter £**
31 August 2010	31 July 2010	125,000	
	31 August 2010	125,000	
	30 September 2010	250,000	
			500,000
30 November 2010	31 October 2010	125,000	
	30 November 2010	125,000	
	31 December 2010	150,000	
			400,000

3) 31 August 2010 return due 30 September 2010
30 November 2010 return due 31 December 2010