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VAT

The Active Business Series

VAT Update

Introduction

VAT legislation and policy are constantly changing at such a rate that it is essential for VAT registered businesses never to assume they are up-to-date. Even after 36 years of VAT in the UK, there is still sometimes an unawareness of its implications and application.

This update examines changes due to come into effect in 2010 as well as a number of the notoriously difficult areas of VAT, namely international business, partial exemption, and land and property transactions, where recent changes have been announced by H M Revenue & Customs. Misunderstanding these could lead to unnecessary and potentially expensive errors. The penalty regime from April 2009 is as follows:

The Penalty Regime

For all tax periods starting on or after 1 April 2008 and due to be filed on or after 1 April 2009, the penalty regime has changed. The main features are:

- **Penalties based on 'potential lost revenue' ('PLR')**
- **30% of PLR for careless errors**
- **70% of PLR for deliberate errors**
- **100% of PLR for deliberate and concealed errors**
- **Interpretation of 'taking reasonable care' will vary according to the type of business**
- **Reductions or suspensions are available for unprompted disclosures**

Self-accounting for VAT on imports of services from outside the UK

From 1 January 2010, the basic place of supply rule for supplies of international services, which determines where VAT is payable and by whom, will change from where the supplier is established to where the recipient of the services is established. This will represent a simplification as most types of services currently fall under one of the exceptions to the basic rule, notably 'intangible' services, which are already supplied where received.

The new rules make sense in that where UK-based businesses 'import' services into the UK, they account for the VAT under the reverse charge, avoiding the need for large numbers of foreign businesses having to register for UK VAT.

Specific changes will be phased in between 2010 and 2013, but most importantly, there will now be even more situations when the reverse charge applies. This will be of particular relevance to partly exempt businesses that are unable to recover all the output tax on the reverse charge as input tax.

Changes to European Community Sales Lists ('ECSLs')

From 1 January 2010, changes will be introduced affecting EC Sales Lists, the main new feature being the requirement to include intra-community services, which may be submitted quarterly, relating to calendar quarters. Other new features are as follows:

- Quarterly ECSLs for goods become permissible provided that the value (excluding VAT) of supplies of goods to other Member States has not exceeded £70,000 in any of the previous four quarters.
- Quarterly ECSLs for goods may continue unless the value of supplies of goods to other Member States exceeds £70,000 (excluding VAT) per quarter from 1 January 2010 to 31 December 2011 or £35,000 (excluding VAT) per quarter from 1 January 2012 onwards.
- If a business exceeds the quarterly goods threshold by the end of the first or second month in a quarter, an ECSL must be submitted at the end of that month, covering the month or months in that quarter. Lists must be submitted monthly from then on.
- If a business is completing monthly ECSLs because it has exceeded the threshold, they must continue for five clear quarters. Thereafter, quarterly filing is allowed provided turnover remains below the threshold.
- A business required to submit monthly ECSLs relating to goods may still submit ECSLs relating to services quarterly.
- Any business may submit ECSLs for goods and/or services monthly, if it wishes.
- UK businesses and H M Revenue & Customs must fulfill their ECSL obligations within one month (reduced from three).

Avoiding the confusion between business: non-business calculations and partial exemption

It is a fundamental principle of VAT that it should not be a 'cost component' to businesses that buy goods and services to be used to make taxable supplies. In other words, VAT on expenditure used to make taxable supplies can be fully reclaimed through the VAT return according to the normal rules. Conversely, VAT is a cost component to the extent purchases are used to make exempt supplies or to generate non-business income.

Identifying recoverable input tax can be particularly complicated for organisations such as charities that are proactively involved in generating non-business income. They should remember to carry out a preliminary 'business : non-business' apportionment to establish how much of the non-attributable VAT on their expenditure is actually input tax, and then apply the partial exemption rules to quantify recoverable input tax.

Some tips to avoid this potential trap:

- Directly attribute VAT on expenditure as far as possible to ensure the apportionable amount is kept to a minimum.
- Apply the de minimis limits for partial exemption after the business : non-business calculation as there are no such limits for the first calculation (some that are affected have a relatively small amount of exempt income and can therefore benefit from these limits).
- Remember to round up to the nearest whole number the recoverable percentage for partial exemption (provided that the apportionable amount is less than £400,000 per month on average). Note that rounding is not allowed for the business : non business calculation or for partial exemption special methods.

Changes of intent re residential property sales - letting

The VAT treatment of land and property transactions is notoriously difficult, in no small measure because any of the three rates or exemption could apply, and the values are usually high. For builders who construct new houses for sale, there is no problem when they do just that because the sales are taxable (albeit at the zero rate) and consequently all associated input tax is fully deductible. However, alarm bells should ring, especially in the current recession, once a decision is made to grant short-term lets if the depressed market prevents the planned sales, because the rental income would be exempt. This situation therefore creates dual intention and a partial repayment of input tax on the development cost claimed must be made because some is now attributable to the letting as well as the future sale. Where there is no partial exemption method in operation, H M Revenue & Customs will allow a 'clawback' of input tax based on the expected letting period expression as a proportion of 10 years (see Information Sheet 07/08). They will then accept that the business is still 'fully taxable' and no repayment is necessary if exempt input tax is below the de minimis limits. Where the builder will continue incurring exempt input tax, a proper partial exemption method must be adopted for the future.

Online VAT Returns

Many businesses are already completing their VAT returns online. However, for tax periods starting on or after 1 April 2010, it will become compulsory for all VAT-registered business, unless their turnover is £100,000 or less. Furthermore, all businesses that register for VAT on or after 1 April 2010 must file online.

The method should be seen as an advantage because it is easier and quicker than paper returns, and automatically eradicates postal problems. Also, on-screen guidance and automatic calculations reduce the risk of errors.

Paying under this method would normally be by direct debit, which allows a further seven days from the usual deadline and the payment would leave the taxpayer's account a further three working days later.

Antrobus Accountants Ltd | 01730 234 500
info@antrobus.biz | www.antrobus.biz
Antrobus House 18 College Street Petersfield GU31 4AD