

Cash flow savings for VAT

(Lecture B1195 – 15.48 minutes)

Deregistration opportunity?

There has been some confusion among accountants about whether a business that has been forced to temporarily shut its doors because of the coronavirus crisis can deregister from VAT if expected sales in the next 12 months will be less than £83,000. The answer to this question requires a precise review of the legislation and the issue of suspended trading. To cut to the chase, VATA1994, Sch 1, para 4(1), confirms that a business can deregister if taxable sales in the following 12 months are expected to be less than £83,000 and HMRC (the Commissioners) accepts this will be the case.

But section 2 of the same paragraph then confirms that the taxable supplies figure is not reduced because the business “will suspend making them for a period of 30 days or more.”

HMRC’s interpretation of the legislation is recorded in VAT Notice 700/11, para 3.2:

“HMRC will not allow you to cancel your registration if the reduction in your turnover is the result of your intention to stop trading or suspend making taxable supplies for 30 days or more in the next 12 months.”

In reality, it makes sense to remain VAT registered in any suspended trading period because input tax can be claimed on expenses but with no output tax on sales. The £83,000 threshold can then be reviewed when trading starts again.

Deregistration pitfalls

Even if your clients are still able to deregister after passing the suspended trading hurdle, there are other major issues to consider before submitting form VAT7 to HMRC:

- Output tax will be due on all stock and assets owned on the date of deregistration if the items are standard rated and input tax was claimed when they were purchased;
- There is a de minimis figure if the total output tax payable on all stock and assets is less than £1,000;
- The basis of paying output tax is the market value of the asset on the date of deregistration ie the calculations take account of wear and tear, depreciation, out-of-date or obsolete stock.

A property with an option to tax election and where input tax was claimed when it was purchased will come within the output tax rules for stock and assets – this would be a very expensive outcome.

Delaying tax points

Unless a business uses the cash accounting scheme, it will usually account for output tax when a sales invoice is raised. The invoice must be raised within 14 days of either goods being supplied or services being completed – the latter creates what is known as an ‘actual tax point’. But if this 14-day deadline is missed, the ‘basic tax point’ takes effect, which is the earlier completion or supply date.

However, many invoices are raised for continuous supplies of services and in such cases, the tax point is the earlier of the invoice or payment date.

Example

John is registered for VAT and submits returns on a calendar quarter basis; he does not use the cash accounting scheme. He sold a machine to Jane on 30-day payment terms for £100,000 plus VAT. The machine was delivered on 27 March 2020. As long as John raises his invoice before 11 April 2020, the invoice date will be the tax point for the supply. So, if he delays invoicing until 1 April or later but before 11 April, he will not pay output tax until the June rather than March quarter.

It is important that John’s contract specifies payment is due 30 days after the invoice date and not the end of the month following 30 days ie the April invoice date is not delaying payment for the machine until the end of May rather than April.

Cash accounting scheme

An unfortunate outcome of the coronavirus will inevitably be that many businesses will permanently lose sales and have to operate on reduced trading levels. However, this might open the door for a business to join the cash accounting scheme because the joining threshold is based on future rather than historical sales. The scheme means that output tax is not included on a return until customers pay their dues, although input tax cannot be claimed until suppliers are paid.

To quote from notice 731, para 2.1, a business can join the scheme if “you expect the value of your taxable sales in the next year will be £1.35m or less”.

Example

ABC Management Consultants – joining the cash accounting scheme

The partners expect the following sales in the next 12 months:

- Consultancy fees charged to UK customers £1m excluding VAT;
- Consultancy fees charged to overseas business customers £400,000;

The income from overseas customers is outside the scope of VAT under the general B2B rule, ie the place of supply is the customer’s country. The relevant figure for the cash accounting scheme is therefore £1m ie less than the joining threshold of £1.35m.

Will there be a problem with HMRC if the joining threshold is exceeded in the first year of scheme membership because sales are better than expected? The forward-looking test is also relevant with the flat rate scheme and annual accounting scheme. The answer is 'no.' As long as the business had a logical basis for arriving at its expected sales figure, then HMRC will not back pedal and seek to retrospectively cancel the scheme benefits.

Leasing vehicles

A common decision made by a business with cash flow difficulties is to lease vehicles rather than buy them as an outright purchase. The implication of leasing an asset is that VAT is usually charged on monthly hire payments made to the leasing company rather than when the asset is initially purchased by the business. The leasing company will often issue an annual tax invoice in advance, which serves as evidence for the lessee to reclaim input tax on each monthly payment.

A potential winner with leasing cars is that 50% of the input tax can be claimed on the monthly payments ie recognising that most vehicles are available for private use. This is a much better VAT result than buying a vehicle, where a 100% input tax block applies if it is intended to make it available for private use.

Default surcharge – potential VAT saver with part payment

A small business with annual taxable sales of less than £150,000 gets two lifelines with late VAT returns or payments in a 12-month period. It firstly gets a polite letter from HMRC offering help and support; it then receives the usual surcharge liability notice (SLN) for a second offence, confirming that any late payments in the next 12 months thereafter will lead to a penalty of 2% of the tax unpaid by the due date, rising to 5%, 10% and then 15%. A business that is not classed as small for this part of the legislation gets the SLN for its first offence.

However, if the surcharge payable for either the 2% or 5% penalty periods is less than £400, then it is waived. So, if the tax owed on a return is £30,000 and a 2% surcharge will be levied on any late payment, then a part payment on time of £10,001 will avoid a surcharge ie £19,999 x 2% is less than £400. This is because a surcharge is based on unpaid tax by the due date, not the full amount of VAT included in Box 5 of the return.

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