INDIRECT TAX

STUDY TEXT

Qualifications and Credit Framework
AQ2016

Finance Act 2019
For assessments from 1 January to 31 December 2020

This Study Text supports study for the following AAT qualifications:

- AAT Advanced Diploma in Accounting – Level 3
- AAT Advanced Certificate in Bookkeeping – Level 3
- AAT Advanced Diploma in Accounting at SCQF – Level 6
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# INTRODUCTION

## HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

## STUDY TEXT

This study text has been specially prepared for the AAT qualification.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- ‘pitfalls’ and ‘examination tips’ help you avoid commonly made mistakes and help you focus on what is required to perform well in your assessment
- ‘Test your understanding’ activities are included within each chapter to apply your learning and develop your understanding.
ICONS

The study chapters include the following icons throughout. They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained, or to direct you towards other areas of your studies (past or future) where you will encounter similar issues or skills.

<table>
<thead>
<tr>
<th>Icon</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>📋</td>
<td>Definition</td>
</tr>
<tr>
<td>💡</td>
<td>Example</td>
</tr>
<tr>
<td>📝</td>
<td>Test your understanding</td>
</tr>
<tr>
<td>🗣️</td>
<td>Reference material</td>
</tr>
<tr>
<td>🌐</td>
<td>Links to other syllabus areas</td>
</tr>
</tbody>
</table>

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to: mykaplanreporting@kaplan.com with full details.

Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.
Progression

There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example ‘I will finish this topic by 30 June’, or for overall achievement, such as ‘I want to be qualified by the end of next year’.

Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another.

We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.
INDIRECT TAX

Professional Diploma
Level 4
- Financial Statements of Limited Companies
- Management Accounting: Budgeting
- Management Accounting: Decision and Control
- Accounting Systems and Control
  - Synoptic assessment

Advanced Diploma
Level 3
- Business Tax
- Personal Tax
- Credit Management
- External Auditing
- Cash and Treasury Management
  - Students must also complete two of the optional units and their associated assessments

Foundation Certificate
Level 2
- Bookkeeping Transactions
- Bookkeeping Control
- Elements of Costing
- Work Effectively at Finance
- Using Accounting Software
  - Synoptic assessment
UNIT GUIDE

Introduction

This Advanced level unit is about indirect tax: specifically, the tax that is referred to in the UK and throughout this unit as value added tax (VAT). The unit is designed to develop students’ skills in preparing and submitting returns to the relevant tax authority in situations where the transactions that have to be included are relatively routine. However, some non-routine issues are also included in this unit.

This unit provides students with the knowledge and skills that they need to keep their employers and clients compliant with the laws and practices that apply to the indirect taxation of sales and purchases. The content is designed to ensure that students can perform these tasks relatively unsupervised, particularly in terms of routine and some non-routine VAT tasks. However, it is expected that the student will still require some management for more involved and intensive VAT transactions. It is important that the student understands and applies the VAT rules from an ethical point of view. All VAT work must be carried out with integrity, objectivity and a high degree of professional competence. There must be due care with regard to confidentiality about any personal data being processed and, from a business protection aspect, with the correct approach to professional behaviour.

Students will learn about VAT legislation and the importance of maintaining their technical knowledge through monitoring updates. Students must be taught how to complete VAT returns accurately and must understand the implications of failing to do so. Inaccuracy and omission, late submission of returns and late payment or non-payment of VAT need to be understood in terms of the sanctions and penalties that are available to the relevant tax authority.

In particular, students will learn how to calculate the VAT value correctly in different circumstances, verify the calculations of the submitted return and correctly use an accounting system to extract relevant data for the return.
The VAT registration and deregistration rules are important aspects of learning at this level, and this includes the need to monitor sales closely to avoid breaching regulations. The existence and basic terms of special VAT schemes are also important.

Students will learn about how to deal with errors made in previous VAT returns and how and when these errors are corrected. They will also learn about communicating VAT matters to relevant individuals and organisations, including the special rules that apply when goods and services are imported into and exported out of the UK and the European Union (EU).

Indirect Tax is a mandatory unit. It links with Advanced Bookkeeping, Final Accounts Preparation and Management Accounting: Costing as core subjects, and with Spreadsheets for Accounting and Ethics for Accountants to create the Advanced Diploma in Accounting.

Learning outcomes

On completion of this unit the learner will be able to:

- Understand and apply VAT legislation requirements
- Accurately complete VAT returns and submit them in a timely manner
- Understand the implications for the business of errors, omissions and late filing and payment
- Report VAT-related information within the organisation in accordance with regulatory and organisational requirements
# Delivering this unit

<table>
<thead>
<tr>
<th>Unit name</th>
<th>Content links</th>
<th>Suggested order of delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced Bookkeeping and Final Accounts</td>
<td>VAT and its treatment is a key part of all the Bookkeeping units in this qualification, including the preparation of ledger accounts.</td>
<td>N/A</td>
</tr>
</tbody>
</table>
THE ASSESSMENT

Test specification for this unit assessment

<table>
<thead>
<tr>
<th>Assessment type</th>
<th>Marking type</th>
<th>Duration of exam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer based assessment</td>
<td>Computer marked</td>
<td>1 hour 30 minutes</td>
</tr>
</tbody>
</table>

The assessment for this unit consists of 8 compulsory tasks.

The competency level for AAT assessment is 70%.

<table>
<thead>
<tr>
<th>Learning outcomes</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Understand and apply VAT legislation requirements</td>
<td>30%</td>
</tr>
<tr>
<td>2. Accurately complete VAT returns and submit them in a timely manner</td>
<td>40%</td>
</tr>
<tr>
<td>3. Understand the implications for the business of errors, omissions and late filing and payment</td>
<td>20%</td>
</tr>
<tr>
<td>4. Report VAT related information within the organisation in accordance with regulatory and organisational requirements</td>
<td>10%</td>
</tr>
</tbody>
</table>

Total 100%

AAT reference material

Reference material is provided in this assessment. During your assessment you will be able to access reference material through a series of clickable links on the right of every task. These will produce pop-up windows which can be moved or closed.

The AAT reference material is available to study before the assessment, via the AAT website, and in the appendix to this study text.
STUDY SKILLS

Preparing to study

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the assessment and set yourself targets for each period of study – in your sessions make sure you cover the whole course and the associated test your understanding questions.

If you are studying more than one unit at a time, try to vary your subjects as this can help to keep you interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the assessment and develop good practice.

A good technique is to use SQ3Rs – Survey, Question, Read, Recall, Review:

1. Survey the chapter
   
   Look at the headings and read the introduction, knowledge, skills and content, so as to get an overview of what the chapter deals with.

2. Question
   
   Whilst undertaking the survey ask yourself the questions you hope the chapter will answer for you.
3 Read
Read through the chapter thoroughly working through the Test your understanding questions and, at the end, making sure that you can meet the learning objectives highlighted on the first page.

4 Recall
At the end of each section and at the end of the chapter, try to recall the main ideas of the section/chapter without referring to the text. This is best done after short break of a couple of minutes after the reading stage.

5 Review
Check that your recall notes are correct.

You may also find it helpful to re-read the chapter to try and see the topic(s) it deals with as a whole.

Note taking
Taking notes is a useful way of learning, but do not simply copy out the text.

The notes must:
- be in your own words
- be concise
- cover the key points
- be well organised
- be modified as you study further chapters in this text or in related ones.

Trying to summarise a chapter without referring to the text can be a useful way of determining which areas you know and which you don’t.

Three ways of taking notes
1 Summarise the key points of a chapter

2 Make linear notes
A list of headings, subdivided with sub-headings listing the key points.

If you use linear notes, you can use different colours to highlight key points and keep topic areas together.

Use plenty of space to make your notes easy to use.
3  Try a diagrammatic form

The most common of which is a mind map.

To make a mind map, put the main heading in the centre of the paper and put a circle around it.

Draw lines radiating from this to the main sub-headings which again have circles around them.

Continue the process from the sub-headings to sub-sub-headings.

Annotating the text

You may find it useful to underline or highlight key points in your study text – but do be selective.

You may also wish to make notes in the margins.

Revision phase

Kaplan has produced material specifically designed for your final examination preparation for this unit.

These include pocket revision notes and an exam kit that includes a bank of revision questions specifically in the style of the new syllabus.

Further guidance on how to approach the final stage of your studies is given in these materials.

Further reading

In addition to this text, you should also read the “Accounting Technician” magazine every month to keep abreast of any guidance from the AAT and chief assessors.
VAT REFERENCE INFORMATION

Note: This information is provided for use in this Study text. You do not need to memorise this information. It is all included in the AAT reference material.

Standard rate of VAT 20%
VAT fraction (standard-rated) (often simplified to 1/6) 20/120
Reduced rate of VAT 5%
VAT fraction (reduced-rated) (often simplifies to 1/21) 5/105

Annual registration threshold £85,000
De-registration threshold £83,000

Cash accounting:
Taxable turnover threshold (excluding VAT) to join scheme £1,350,000
Taxable turnover threshold (excluding VAT) to leave scheme £1,600,000

Annual accounting:
Taxable turnover threshold (excluding VAT) to join scheme £1,350,000
Taxable turnover threshold (excluding VAT) to leave scheme £1,600,000

Flat rate scheme:
Taxable turnover threshold (excluding VAT) to join scheme £150,000
Total turnover threshold (including VAT) to leave scheme £230,000
Additional information

In your assessment you are provided with the AAT reference material. This can be accessed by clicking the appropriate heading on the right hand side of the screen.

A copy of this AAT reference material is included in the Appendix to this textbook.

It is also available to download from the AAT website www.aat.org.uk.

It is very important that you become familiar with the content of each section of the material before you sit your assessment.

Within this text we make reference to areas of the AAT reference material which are particularly useful.
Introduction

This chapter introduces some of the basic ideas of value added tax (VAT), which is the only tax studied in this paper on indirect tax.

This unit requires you to have knowledge of VAT rules, to be able to prepare VAT returns, understand VAT penalties and correction of errors, and be able to communicate VAT issues to the relevant people within an organisation.

**ASSESSMENT CRITERIA**

<table>
<thead>
<tr>
<th>Identify and analyse relevant information on VAT (1.1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain the necessary interaction with the relevant tax authority (1.2)</td>
</tr>
<tr>
<td>Maintain knowledge of legislation, regulation, guidance and codes of practice (1.5)</td>
</tr>
<tr>
<td>Calculate relevant input and output tax (2.2)</td>
</tr>
</tbody>
</table>

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| 2 | Types of supply |
| 3 | Sources of information |
| 4 | Keeping up-to-date with VAT |
| 5 | HM Revenue and Customs |
1 Introduction

1.1 What is VAT?

VAT is:

- an indirect tax on consumer spending
- charged on most goods and services supplied within the UK
- suffered by the final consumer, and
- collected by businesses on behalf of HM Revenue and Customs (HMRC).

Overview of how VAT works

VAT is collected by businesses at each stage in the production and distribution process of supplying goods and services as follows:

- businesses account to HMRC for the tax (known as output VAT) on sales
- if the customer is VAT-registered and uses the goods or services for business purposes, they can recover the tax they have paid on the purchase of the item or service (known as input VAT)
- accordingly, businesses actually account to HMRC for the tax on the ‘value added’ to the product at that stage of the process.

Businesses are merely acting as collectors of VAT on behalf of HMRC and they do not suffer any tax.

It is only the final consumer who cannot recover the input VAT that suffers the tax.

VAT is therefore an indirect tax:

- because it is paid indirectly to traders when you buy most goods and services, rather than being collected directly by HMRC from the taxpayer as a proportion of their income or gains.

How VAT works is shown in the illustration below.

Assume that the rate of VAT throughout is 20%. 
**Who charges VAT?**

VAT is only charged

- by **taxable persons**
- when they make **taxable supplies** in the course of their business.

VAT is not generally charged on non-business transactions.

For example, you would not have to charge VAT if you simply sold some of your spare DVDs to a friend.

### 1.2 Taxable persons

**Definition**

Taxable persons are businesses which are (or should be) registered for VAT.

VAT registration rules are dealt with in Chapter 2.

A person can be an individual or a legal person such as a company.

### 1.3 Taxable supplies

Taxable supplies, or outputs, are mainly sales made by a taxable person.

Taxable supplies can also include gifts, and goods taken from the business for personal use.
1.4 Output tax

Definition
The VAT charged on sales or taxable supplies is called **output tax**.

Taxable persons charge output tax to their customers and periodically, (usually quarterly), they pay it over to HMRC.

1.5 Input tax

When a business buys goods from or pays expenses (inputs) to a VAT-registered supplier, then it will also be paying VAT on those purchases or expenses.

Definition
VAT paid by a business on purchases or expenses is called **input tax**.

VAT-registered businesses are allowed to reclaim their input tax. They do this by deducting the input tax they have paid from the output tax which they owe, and paying over the net amount only.

If the input tax exceeds the output tax, then the balance is recoverable from HMRC.

Example
A VAT-registered business makes sales of £10,000 plus £2,000 of VAT. Its expenditure on purchases and expenses totals £7,000 plus £1,400 of VAT.

How much VAT is payable to HMRC?

**Solution**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output VAT</td>
<td>£2,000.00</td>
</tr>
<tr>
<td>Less: Input VAT</td>
<td>(£1,400.00)</td>
</tr>
<tr>
<td><strong>VAT due</strong></td>
<td>£600.00</td>
</tr>
</tbody>
</table>

This means that registered businesses do not suffer VAT themselves. It is the end consumer of the goods (e.g. a member of the public like you) who suffers the VAT, as they cannot recover the VAT they have been charged.
Test your understanding 1

Which of the following is the correct definition of a taxable person?

A  A business which is registered for VAT
B  A business which should be registered for VAT
C  A business which is or should be registered for VAT
D  A business which makes standard-rated supplies

Test your understanding 2

Indicate whether the following statements are true or false. Tick one box on each line.

<table>
<thead>
<tr>
<th></th>
<th>True</th>
<th>False</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>VAT is a direct tax.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Jake is an AAT student working for a small accountancy practice. He advertises his bicycle for sale on the work notice board and sells the bicycle to one of his workmates for £100. He should not charge VAT on the sale.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Businesses may keep all the VAT they collect from customers.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Fred runs a small plumbing business which is registered for VAT. He replaces a tap for a customer and charges them £60 including VAT of £10. The VAT charge of £10 is retained by Fred.</td>
<td></td>
</tr>
</tbody>
</table>
2 Types of supply

2.1 Classification of supplies

Supplies can be taxable, exempt or outside the scope of VAT.

VAT is charged on taxable supplies but not on exempt supplies or supplies outside the scope of VAT. It is therefore important to be able to correctly classify supplies in order to determine whether VAT should be charged.

Exempt supplies are supplies that the law states should not have VAT charged on them, such as insurance. Specific knowledge of which supplies are exempt will not be tested in your assessment.

Supplies outside the scope of VAT include items such as wages and dividends. They are ignored for VAT purposes.

2.2 Taxable supplies – rates of VAT

Taxable supplies are charged to VAT at one of three rates:

- **Zero rate**: This is a tax rate of nil. No output VAT is charged but it is classed as a taxable supply. Therefore it is taken into account in deciding whether a trader should register for VAT and whether input VAT is recoverable.

- **Reduced rate**: Some supplies, mainly for domestic and charitable purposes are charged at the reduced rate.

- **Standard rate**: Any taxable supply which is not charged at the zero or reduced rates is charged at the standard rate.

Currently the standard rate of VAT is 20% and the reduced rate is 5%.

In order to calculate the VAT on a VAT-exclusive supply which is taxable at the standard rate, you multiply by 20%.

If taxable at the reduced rate, you multiply by 5%.

In order to calculate the VAT on a VAT-inclusive supply which is taxable at the standard rate, you multiply by 20/120. This is sometimes simplified to 1/6.

If the VAT-inclusive supply is taxable at the reduced rate then you multiply by 5/105. This is sometimes simplified to 1/21.
These rates are summarised in the following table:

<table>
<thead>
<tr>
<th>Rate of VAT</th>
<th>% to apply to VAT-exclusive amounts to calculate VAT</th>
<th>Fraction to apply to VAT-inclusive amounts to calculate VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>20%</td>
<td>20/120 or 1/6</td>
</tr>
<tr>
<td>Reduced</td>
<td>5%</td>
<td>5/105 or 1/21</td>
</tr>
</tbody>
</table>

**Example**

A business makes the following taxable sales.

What is the output VAT in each case (to the nearest pence)?

(i) a standard-rated supply which is £12,000 net of VAT

\[
(£12,000 \times 20\%) = £2,400.00
\]

(ii) £12,000 inclusive of the standard rate of VAT

\[
(£12,000 \times 20/120) = £2,000.00
\]

(iii) £15,479 net of reduced rate VAT

\[
(£15,479 \times 5\%) = £773.95
\]

(iv) £12,320 inclusive of reduced rate VAT

\[
(£12,320 \times 5/105) = £586.66
\]

Note that VAT on an invoice is rounded down to the nearest pence (Chapter 3). It is important that you do this in your assessment.

**Test your understanding 3**

Calculate the amount of VAT in respect of the following amounts.

Calculate to the nearest pence.

<table>
<thead>
<tr>
<th>Item</th>
<th>Rate of VAT</th>
<th>VAT-inclusive amount £</th>
<th>VAT-exclusive amount £</th>
<th>VAT £ p</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>20%</td>
<td>472.50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>20%</td>
<td></td>
<td>5,250.00</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>5%</td>
<td></td>
<td>4,230.00</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>5%</td>
<td>4,284.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.3 Effect of making taxable supplies

Trader makes taxable supplies

- Standard-rated
- Reduced-rated
- Zero-rated

Trader able to register

If registered then charge VAT on taxable supplies

Can reclaim input VAT
2.4 Differences between zero-rated and exempt supplies

You must be careful to distinguish between traders making zero-rated supplies and those making exempt supplies.

<table>
<thead>
<tr>
<th></th>
<th>Exempt</th>
<th>Zero-rated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Can register for VAT?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Charge output VAT to customers?</td>
<td>No</td>
<td>Yes at 0%</td>
</tr>
<tr>
<td>Can recover input tax?</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Test your understanding 4

Select which word(s) in italics complete(s) the following sentences correctly.

1. Traders making only exempt supplies …can/must/cannot…… register for VAT.
2. Traders who are registered for VAT must charge VAT on all of their ….taxable/exempt… supplies.
3. One of the differences between traders making zero-rated supplies and traders making exempt supplies is that zero-rated traders ……can/cannot… recover input VAT, whereas exempt traders ……can/cannot.

2.5 Examples of zero-rated and exempt supplies

You do not need to learn lists of zero-rated and exempt items. These examples are simply to show you the types of items in each category.

Zero-rated
- Water
- Most food
- Books and newspapers
- Public transport
- Children’s clothes and shoes
- New house building

Exempt
- Rent
- Insurance
- Postal services
- Finance (e.g. making loans)
- Education (not for profit)
- Betting and lotteries
Test your understanding 5

Indicate whether the following statements are true or false. Tick one box on each line.

<table>
<thead>
<tr>
<th></th>
<th>True</th>
<th>False</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Output tax must be charged on all sales made by a registered trader.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>VAT is borne by the final consumer.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Registered traders making zero-rated supplies cannot recover any input tax.</td>
<td></td>
</tr>
</tbody>
</table>

Reference material

Some information about the scope of VAT, taxable and exempt supplies is included in the indirect tax reference material provided in the real assessment, so you do not need to learn it. It can be found in the ‘Introduction’, ‘Rate of VAT’ and ‘Exempt and partly-exempt businesses’ sections. You need to be familiar with the location and content of the material as in the assessment you will need to access the correct part of the reference material from a series of clickable links. Why not look up the correct part of the indirect tax reference material in the appendix to this textbook now?

Sources of information

3.1 Legislation

The main source of law on VAT is the VAT Act 1994 as amended by annual Finance Acts and other regulations issued by Parliament.

3.2 GOV.UK website

HMRC expect taxpayers to be able to answer many of their queries by searching the HMRC section of the gov.uk website at: https://www.gov.uk/topic/business-tax/vat
HMRC publications can be searched online. Some sections are available as pdfs and can be downloaded.

Publications available include:

- VAT guide 700 (see below)
- VAT Notes (see below)
- Information sheets on particular topics.

HMRC also provide educational and explanatory material online including:

- YouTube videos
- Live webinars with links to recordings of past webinars.

Businesses can also sign up to receive emails about VAT.

3.3 VAT guide

HMRC issue a booklet called the VAT guide Notice 700. This is the main guide to VAT rules and procedures. There are a number of supplements and amendments to the guide to keep it up-to-date.

The VAT guide is also available online on the HMRC section of the gov.uk website. As it is a large document (over 250 pages long) it is broken into sections on the website. It can be searched online or downloaded.

If you are dealing with accounting for VAT and VAT returns in practice, then you should become familiar with the contents of the VAT guide in order to be able to refer to it when necessary.

<table>
<thead>
<tr>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you wish to look up more information about the topics covered so far in this chapter, then Section 3 of the VAT guide has the following:</td>
</tr>
<tr>
<td>3 General explanation of VAT: introduction and liability</td>
</tr>
<tr>
<td>3.1 Introduction to VAT</td>
</tr>
<tr>
<td>3.2 What VAT is</td>
</tr>
<tr>
<td>3.3 VAT rates</td>
</tr>
<tr>
<td>3.4 Reduced-rated supplies</td>
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<td>3.5 Zero-rated supplies</td>
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<td>3.6 Exempt supplies</td>
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<td>3.7 Further information on liability and rates of VAT</td>
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</table>
3.4 VAT Notes
HMRC also publish a quarterly bulletin called VAT Notes. This is sent to all registered traders and contains a summary of all recent changes to the VAT rules and announces future changes. It is also available online.

3.5 VAT enquiries helpline
If a taxpayer cannot find the answer to their queries on the HMRC website then a telephone helpline is available. When you call you should have a note of your VAT registration number and postcode.

Taxpayers can also email or write to HMRC with VAT queries.

Reference material
Some information about HMRC website and the VAT enquiries helpline is included in the indirect tax reference material provided in the real assessment, so you do not need to learn it.

It can be found in the ‘Finding out more information about VAT’ section.

You need to be familiar with the location and content of the material as in the assessment you will need to access the correct part of the reference material from a series of clickable links.

Why not look up the correct part of indirect tax reference material in the appendix to this textbook now?

4 Keeping up-to-date with VAT

4.1 Introduction
VAT changes regularly as a result of new legislation, VAT case decisions and changes in EU rules.

It is important for everyone involved in VAT work to keep up-to-date, as failing to apply VAT rules correctly can cost the business money and may lead to penalties for incorrect returns or underpayments.

From an ethical point of view, it is important for AAT members and students to keep up-to-date in order that they may give competent advice.

Changes in VAT regulations normally take effect on a specified date and a business must ensure that they comply with the new rules from that date.
4.2 Continuing professional development (CPD)

The AAT expects all full and fellow members to undertake continuing professional development (CPD) each year to ensure they are up-to-date and competent to do their work.

For a member involved in VAT work this would include being aware of any new rules and regulations.

4.3 Ways of keeping up-to-date

Information about VAT changes is circulated by HMRC in their quarterly VAT Notes mentioned above.

Other sources of information about changes would include:

• the UK government website which has a VAT section (see above)
• circulars from accountancy firms – most firms issue a newsletter to clients which can often be accessed on their website
• specialist tax journals
• CPD courses
• networking meetings with fellow professionals.

4.4 Ethical considerations

AAT members and students are required to follow the AAT Code of Professional Ethics. These require that AAT members act with:

• integrity
• objectivity
• professional competence and due care
• confidentiality
• professional behaviour.

It is important to keep up-to-date with VAT legislation and any changes in order to act with professional competence and due care.

4.5 Impact on an organisation’s recording systems

Legislative changes can have a significant impact on the recording systems of both HMRC and businesses with associated costs to be incurred to reflect the changes.

For example, when the rates of VAT change, supplies are reclassified, registration thresholds and/or registration rules change, significant costs can arise for a business.
Additional costs may include:

- staff training (and/or recruitment)
- adapting IT systems
- purchasing new software
- reprinting stationery, and
- additional time required for administrative (non-productive) work as opposed to profit-generating work.

More details on the impact of VAT rate changes on a business can be found in Chapter 3.

5 HM Revenue and Customs

5.1 Introduction

As mentioned above, HM Revenue and Customs (HMRC) is the government body that is responsible for administering VAT. VAT offices across the country are responsible for the local administration of VAT within a particular geographical area.

Local VAT offices deal with the collection of outstanding tax and carry out visits to taxpayers to check that they are complying with VAT rules. HMRC are also responsible for dealing with all other issues concerning VAT including registration and record keeping (see below for record keeping requirements).

5.2 HMRC powers

HMRC have certain powers that help it administer VAT. These include:

- inspecting premises
- examining records
- making assessments for underpaid tax
- charging penalties for breaches of VAT rules (more detail on penalties can be found in Chapter 6)
- determining whether certain supplies are liable for VAT.

5.3 Visits by VAT officers

VAT officers can visit premises to inspect records and make checks. (see Chapter 2 for more details on VAT records).
### Reference material

More information about visits by VAT officers is included in the indirect tax reference material provided in the real assessment, so you do not need to learn it.

It can be found in the ‘Visits by VAT officers’ section.

You need to be familiar with the location and content of the material as in the assessment you will need to access the correct part of the reference material from a series of clickable links.

Why not look up the correct part of the indirect tax reference material in the appendix to this textbook now?

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#### 5.4 HMRC rulings

HMRC will give rulings on how they will deal with particular transactions. Obtaining a ruling on areas of difficulty is recommended by HMRC.

You may need to write to HMRC in the following cases:

- you’ve looked at all the published information and can’t find the answer to your question
- HMRC published guidance is unclear when applied to your particular situation
- you’ve already contacted the helpline and they’ve asked you to write.

An HMRC ruling is binding on HMRC provided the taxpayer has disclosed all the necessary facts.

However, it is not binding on the taxpayer who may choose to ignore the ruling.

Ignoring the ruling will almost certainly lead to a dispute with HMRC that will need to be resolved by the Tax Tribunal.

#### 5.5 Communicating with HMRC

Note that in practice, HMRC expect taxpayers to adhere to the following sequence when they have a query about VAT:

- check the information publicly available in the VAT guide 700, on their website; and then
- raise the matter with the helpline
- before submitting a query.
If the query turns out to be something on which HMRC already publish information, they will reply explaining where the information can be found.

Reference material

More information about communicating with HMRC is included in the indirect tax reference material provided in the real assessment, so you do not need to learn it.

It can be found in the ‘Finding out more information about VAT’ section.

You need to be familiar with the location and content of the material as in the assessment you will need to access the correct part of the reference material from a series of clickable links.

Why not look up the correct part of the indirect tax reference material in the appendix to this text book now?

5.6 Disputes with HMRC

Most disagreements between the taxpayer and HMRC are resolved quickly, but if an agreement cannot be reached then the taxpayer has a choice of actions.

1 Ask for their case to be reviewed by another HMRC officer who has not previously been involved with the matter.

2 If they do not wish the case to be reviewed by another officer, or if they disagree with the review findings, the taxpayer can appeal to the Tax Tribunal. Such appeals are made initially to the First-tier Tax Tribunal. If the matter cannot be resolved there it may be appealed upwards to the Upper Tribunal and from there to the Court of Appeal and then the Supreme Court.

The ultimate legal authority on VAT matters is the European Court of Justice.
Test your understanding 6
Which one of the following is NOT a power of HMRC?
A Inspecting premises
B Completing your VAT return
C Examining records
D Determining whether certain supplies are liable for VAT

Test your understanding 7
Which of the following is NOT a good source of information on VAT?
A The HMRC website
B A taxation magazine with a VAT section
C VAT Notes
D A CPD course on direct taxation

Test your understanding 8
Which one of the following is NOT a good reason to keep up-to-date with VAT?
A It enables you to act with competence
B Keeping up-to-date means that you are able to advise the business you work for and make it less likely to incur a penalty for a breach of the VAT rules
C If you are up-to-date with the rules then it is easier to find ways around them and avoid paying over the VAT you have charged to customers
D It may save the business money if it applies the rules correctly
In this introductory chapter we have looked at some of the basic principles and terminology used when dealing with VAT.

You should now understand that VAT is an indirect tax borne by the final consumer but collected on behalf of the government by businesses.

An important area covered in this chapter is the distinction between taxable and exempt supplies. Businesses making only exempt supplies cannot register for VAT or reclaim input tax.

If you need to find out more about VAT then it is important to know where to look. The VAT guide 700 and the HMRC website cover everything a typical business would need to know about VAT. Of course, you do not need to know all this material; you simply need to know where you might look to find it.

It is important from a professional competence point of view to keep up-to-date on VAT and there are a number of ways in which you can find out the latest information about VAT.

It is also important to appreciate the cost implications of implementing new legislation and the significance and potential costs of mistakes made as a result of not being up-to-date.

Communicating with HMRC is an important issue in practice. You must understand the importance of obtaining rulings on contentious matters in writing.

In this chapter you learned about the ethical principles that guide AAT students and members. These are assessable in the AVSY synoptic assessment and are also fundamental to your AAT membership.
Test your understanding answers

Test your understanding 1

The correct answer is C.

Test your understanding 2

1 False – VAT is an indirect tax.
2 True – VAT is charged on business transactions so the statement is correct. Jake does not need to charge VAT on the sale of his bicycle.
3 False – Businesses collect VAT on behalf of the government so this statement is incorrect.
4 False – As Fred’s business is registered for VAT he must account to HMRC for any output VAT charged to his customers.

Test your understanding 3

1 £78.75 (£472.50 × 20/120)
2 £1,050.00 (£5,250 × 20%)
3 £211.50 (£4,230 × 5%)
4 £204.00 (£4,284 × 5/105)

Test your understanding 4

1 Cannot
2 Taxable
3 Can
   Cannot
Test your understanding 5
1 False – some sales may be exempt
2 True
3 False – zero-rated supplies are taxable supplies so VAT can be recovered

Test your understanding 6
The correct answer is B.
A, C and D are all powers of HMRC.

Test your understanding 7
The correct answer is D.
VAT is an indirect tax so a CPD course on direct taxation would not be a good source of information on VAT.
The other three options are all ways of finding information about VAT.

Test your understanding 8
The correct answer is C.
AAT members and students are required to act with professional competence.
Avoiding paying VAT due to HMRC is in breach of professional competence and will lead to penalties (and possible criminal charges).