CHAPTER 13
ACCOUNTING FOR VAT

This chapter looks at the payment and repayment of VAT dealing with the following:
– when VAT should be paid;
– in which circumstances VAT will be repaid;
– the annual accounting scheme which allows businesses to submit VAT returns on an annual basis;
– the cash accounting scheme which allows businesses to account for VAT ignoring the normal tax point rules but instead looking at transactions passing through the cash book.

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 of VAT

VAT returns must be submitted electronically to HMRC not later than one calendar month plus 7 days after the end of the VAT return period in question. Electronic payment should also be made within the same timescale. Late returns and late payments of VAT due can result in penalties. SI 1995/2518, Reg. 25 & 40

An electronic payment, or an e-payment, is one of the following:

• Faster payments by online or telephone banking;
• Online debit or credit card using BillPay;
• BACS – Bankers Automated Clearing System;
• CHAPS – Clearing House Automated Payment System; or
• Bank Giro Credit transfer.

Direct debt is also a means of paying electronically. HMRC would normally take payments within three days of the normal 7 day point.

From 1 April 2012 all returns and payments are expected to be made electronically with the exception of businesses subject to an insolvency procedure and religious organisations where religious beliefs prevent them from using computers. Further relaxations were introduced from 1 July 2014 to allow additional exceptions from electronic filing. R&C Brief 29/14
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.

13.3 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.

A “very large trader” is one that has an annual VAT liability of at least £2.3 million.

Once the threshold is exceeded (in any period of 12 months or less), HMRC will notify the trader that they are liable to make payments on account.

Payments on account will start from the next VAT return quarterly period.

In this first period only one payment on account is required (at the end of the 3rd month) but in the following quarter two payments on account will be required (see below).

Illustration 1

Giant Ltd has submitted the following VAT returns since it became VAT registered:

<table>
<thead>
<tr>
<th></th>
<th>Liability</th>
<th>Cumulative Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>q/e 31 December</td>
<td>650,000</td>
<td>650,000</td>
</tr>
<tr>
<td>q/e 31 March</td>
<td>920,000</td>
<td>1,570,000</td>
</tr>
<tr>
<td>q/e 30 June</td>
<td>875,000</td>
<td>2,445,000</td>
</tr>
</tbody>
</table>

When does Giant exceed the ‘large trader’ threshold?

Giant Ltd has exceeded the £2.3m threshold by the quarter ended 30th June. (Note that it doesn’t matter that the threshold was exceeded in a nine month period.)

HMRC will notify Giant that it is liable to make payments on account. Payments on account will start for the VAT return for the next quarter (the quarter ended 30 September.)
Example 1

Enormous Ltd has submitted the following VAT returns since it became VAT registered.

When is it liable to start making payments on account?

(Assume the current £2.3 million threshold applies)

<table>
<thead>
<tr>
<th>Liability (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>q/e 31 December</td>
</tr>
<tr>
<td>q/e 31 March</td>
</tr>
<tr>
<td>q/e 30 June</td>
</tr>
<tr>
<td>q/e 30 September</td>
</tr>
<tr>
<td>q/e 31 December</td>
</tr>
<tr>
<td>q/e 31 March</td>
</tr>
<tr>
<td>q/e 30 June</td>
</tr>
</tbody>
</table>

13.4 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.

The normal 7 day extension for electronic submissions does not apply to payments on account traders.

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.

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 amount of each payment on account is calculated by taking the annual liability in the period in which the threshold was exceeded and dividing it by 24.

Looking back to Example 1 with Enormous Ltd, it exceeded the threshold in the quarter ended 30 June in its second year. Its annual liability was £2.4m at that point. Enormous Ltd’s payments on account will be £100,000 (1/24 of £2.4m.)

If the period in which the threshold was exceeded is less than 12 months, the payments are calculated on a proportionate basis.

Payments on account will remain at that level until the beginning of the ‘annual cycle’ for payments on account. The ‘annual cycle’ begins April, May or June each year depending on which stagger group the trader falls within.

Coming back to Enormous Ltd in Example 1, it falls within stagger group 1, having a March year end. This means its ‘annual cycle’ begins on the 1st of April. Payments on account for the year commencing 1st April will be determined by the annual VAT liability for what is known as a ‘reference year’.

For stagger group 1 the ‘reference year’ is the 12 months leading up until the previous 30th September. For stagger group 2 we use the 12 months leading up until the previous 31st October and for stagger group 3 we use the 12 months leading up until the previous 30th November. (You will note that effectively you always look back 6 months regardless as to which stagger group you are in.)
Therefore, for a trader in stagger group 2 that has a VAT year ended 30th April 2015, we would use their annual VAT liability for the year ended 31st October 2014 and divide by 24 to arrive at each payment on account.

You will be removed from the payments on account regime if your VAT liability in your ‘reference year’ falls below £2.3m. Removal will happen six months later. For example, if you fall in stagger group 1 and for the year ended 30th September 2014 you are below the threshold, you will be liable to make payments on account up until the end of March 2015.

If your annual VAT liability falls to less than £1.8 million (in any 12 months after your ‘reference year’) you can request removal from the payments on account regime.

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.

### 13.5 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, in the case of a business registered for at least 12 months immediately preceding the start of the accounting period, 10% of the total VAT due for those 12 months is due in equal monthly instalments.

If the business has not been registered for 12 months prior to the start of the annual accounting period, HMRC will estimate the amount of VAT the business will be liable to pay in the next 12 months and the monthly payments will be based on this amount. A business can write to HMRC if it does not agree with amount HMRC says it is due to pay and can agree a different amount with them.

90% of the amount set by or agreed with HMRC 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 submitted 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 normal 7 day filing extension will not be in point for traders on annual accounting.

The payments on account already made are deducted, and the balance is submitted 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 2016 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.

Using the information above, calculate Jane's payments of VAT under Annual Accounting.

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 2015.

Jane will then pay £2,500 every month until the 30th April 2016. Over 9 months she will pay £22,500.

Jane's payments were thus:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 August 2015</td>
<td>2,500</td>
</tr>
<tr>
<td>30 September 2015</td>
<td>2,500</td>
</tr>
<tr>
<td>31 October 2015</td>
<td>2,500</td>
</tr>
<tr>
<td>30 November 2015</td>
<td>2,500</td>
</tr>
<tr>
<td>31 December 2015</td>
<td>2,500</td>
</tr>
<tr>
<td>31 January 2016</td>
<td>2,500</td>
</tr>
<tr>
<td>28 February 2016</td>
<td>2,500</td>
</tr>
<tr>
<td>31 March 2016</td>
<td>2,500</td>
</tr>
<tr>
<td>30 April 2016</td>
<td>2,500</td>
</tr>
<tr>
<td>VAT balance due with VAT return on 30 June 2016</td>
<td>6,500</td>
</tr>
</tbody>
</table>

22,500
29,000

When the VAT return is sent in, Jane 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.

13.6 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.

### 13.7 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.

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. SI 1995/2518, Reg 56–65

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.

13.8 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, 6.1, 6.3

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.

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 2015 is £500,000 and for quarter ended 30 November 2015 £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 2015 and 30 November 2015.

3. When the VAT returns are due for quarters ended 31 August 2015 and 30 November 2015.
**ANSWERS**

**Answer 1**

Enormous Ltd first exceeds the £2.3 million threshold by the end of quarter ended 30 June in its second year. (Remember that the threshold covers a maximum 12 month period.)

<table>
<thead>
<tr>
<th>Liability</th>
<th>Cumulative (max 12 months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>q/e 31 December</td>
<td>£300,000</td>
</tr>
<tr>
<td>q/e 31 March</td>
<td>£400,000</td>
</tr>
<tr>
<td>q/e 30 June</td>
<td>£500,000</td>
</tr>
<tr>
<td>q/e 30 September</td>
<td>£600,000</td>
</tr>
<tr>
<td>q/e 31 December</td>
<td>£400,000</td>
</tr>
<tr>
<td>q/e 31 March</td>
<td>£550,000</td>
</tr>
<tr>
<td>q/e 30 June</td>
<td>£850,000</td>
</tr>
</tbody>
</table>

HMRC will notify Enormous that it has exceeded the threshold and it will be required to make payments on account starting the following quarter (i.e. q/e 30 September in its second year.) Don't forget though that for the first quarter it only has to make one payment on account.

**Answer 2**

1. Amount due for each instalment in advance is \( \frac{1}{24} \times 3,000,000 = £125,000 \).

2.

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Payment date</th>
<th>Amount £</th>
<th>Total for quarter £</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 August 2015</td>
<td>31 July 2015</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>31 August 2015</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>30 September 2015</td>
<td>250,000</td>
<td>500,000</td>
</tr>
<tr>
<td>30 November 2015</td>
<td>31 October 2015</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>30 November 2015</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>31 December 2015</td>
<td>150,000</td>
<td>400,000</td>
</tr>
</tbody>
</table>

3. 31 August 2015 return due 30 September 2015

30 November 2015 return due 31 December 2015