

# VAT registration – sooner or later?



## Introduction

Once a business is up and running, the next major administrative area to be faced often concerns the subject of VAT. At first glance, it looks complicated - not to mention time-consuming - particularly for small businesses. However, taken one step at a time, the rules governing VAT registration and invoicing are generally quite straight-forward and relatively easy to navigate.

The law states that all traders – whether sole traders, partnerships, or limited companies – are obliged to register to charge and pay VAT once their taxable turnover reaches a pre-set annual threshold, which is currently £85,000. Broadly, a business must register for VAT if:

- its taxable outputs, including zero-rates sales (but not exempt, non-business, or ‘outside the scope’ supplies), have exceeded the registration threshold in the previous 12 calendar months – unless the business can satisfy HMRC that its taxable supplies in the next 12 months will not exceed a figure £2,000 below the registration threshold (so currently £83,000); or
- there are reasonable grounds for believing that the business’s taxable outputs in the next 30 days will exceed the registration threshold; or
- the business takes over another business as a going concern, to which the two bullet points above apply.

A business can register for VAT voluntarily if its turnover is below the threshold and it may actually save tax by doing so, particularly if its main clients or customers are organisations that can reclaim VAT themselves.

## Example

Sandra is a non-VAT registered carpenter and a basic rate taxpayer. She buys a new saw to use in her business, which cost £100 plus VAT, so she pays a total of £120 (£100 plus VAT at 20%), which can be set against her business profits for income tax purposes. As Sandra is a basic rate (20%) taxpayer, she will save tax of £24 (20% of £120), so the saw actually costs her £96. However, if the business is VAT-registered, the £20 VAT paid on the item (the input tax) can be reclaimed and £100 is set against business profits for income tax. The tax reduction is therefore £20 (20% of £100) and the saw actually costs him £80 – saving £16 by being registered for VAT.

## Is non-registration preferable?

VAT-registered businesses supplying goods and services to private individuals often feel dis-advantaged compared with their non-registered counterparts because they have to charge an additional 20% on every bill issued.

A trader who does not want to have to register for VAT, may be able to stay below the annual VAT registration threshold by supplying labour-only services and getting customers to buy any goods needed themselves.

## Example

Bob is a non-VAT registered plumber, but his turnover is creeping up towards the VAT registration threshold. He could ask his customers to buy materials for a job directly from a DIY shop. Although the customers will have to pay the VAT on these items, they won’t have to pay VAT on Bob’s invoice for labour services. This will also have the additional advantage of reducing Bob’s annual turnover for VAT registration purposes.

## Registration benefits

Deciding whether to register for VAT voluntarily before the registration threshold is reached is a big decision that can have lasting implications for the financial health of the business. It is vital therefore, that the matter is given careful consideration. There are several positive reasons supporting voluntary registration, including:

- Reclaiming VAT - although a registered business will have to charge VAT on goods and services (known as charging 'output tax'), it will also be able to reclaim VAT that it is charged by other businesses (known as 'input tax'). Where input tax exceeds output tax in a given period, the business will generally be able to reclaim the difference from HMRC.
- Marketplace perceptions - some businesses choose to register for VAT in order to appear larger than they are. Customers are likely to be aware of the £85,000 registration threshold and where a business is not registered, its customers will know that the business turnover is lower than this. A business may therefore consider registration as a way of increasing its standing amongst competitors, and in the eyes of clients.

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## Recommendation

Before making the decision, it is important to take advice to assess the benefits of registering for VAT early. But remember, with Making Tax Digital, you will provide significantly more information to HMRC, so the quality of your financial records is vital to help reduce the risk of scrutiny. Call me and I would be happy to talk this through with you.

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