Your quick guide to VAT in the UK

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Making a start with VAT? Want to know more about how MTD for VAT impacts you? Follow our guide and you'll soon be on top of it.

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What is VAT and how much is it?

You've probably heard about VAT before – it stands for Value Added Tax and is added onto prices in the UK.

How can VAT affect my business?

- You may need to add VAT to your prices
- You will need to send that extra money to HMRC
- You can claim back any VAT that you're charged on business supplies

How much is VAT

- 20% is the VAT rate for most goods and services
- 5% is applied to some health, energy, heating, and protective products and services
- 0% is applied to a range of products and services to do with health, building, publishing and kids' clothing

Find out about the different VAT rates on the gov.uk site.

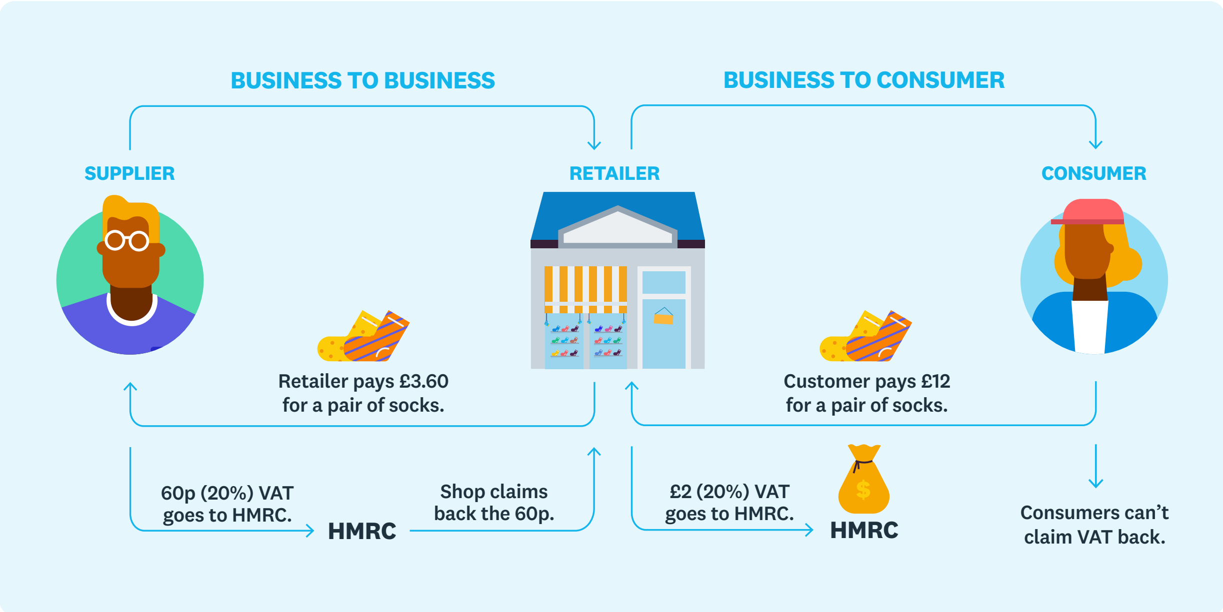
VAT exemptions and out-of-scope sales

VAT does not apply to all products and services. Some things, such as insurance, antiques, arts, and educational training are exempt. Other things, like statutory fees, are out of scope (they sit outside the tax system). Being exempt or out of scope is different from charging 0% VAT.

Learn more about VAT-exempt items.

How does VAT work?

The VAT on any item is designed to be paid by the consumer in the end, rather than by the businesses involved in its supply. Take this example:



VAT on imports

You're generally required to pay VAT on goods that you import into the UK. That VAT will probably be added to the price when you pay customs. You can generally claim it back when submitting your VAT return.

Learn more on import VAT from gov.uk

VAT on exports

If you sell goods and services to customers within the EU, you'll probably need to add export VAT. The rate will depend on what you're selling and who you're selling to.

Learn more on export VAT from gov.uk

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How to register for VAT

Find out if your business needs to worry about VAT. And, if so, learn how to register for VAT.

Who needs to register for VAT?

Some businesses have to register for VAT, some aren't allowed to, and others can choose.

- **Who must register for VAT:** Businesses with an annual taxable turnover of more than £90,000. You may be fined if you don't register (check out the penalties on this gov.uk page).
- **Who is not allowed to register for VAT:** Businesses that sell only VAT-exempt goods and services.
- **Who can choose to register for VAT:** Businesses with an annual taxable turnover of less than £90,000.

Benefits of registering for VAT

Once you're VAT registered, you don't end up paying VAT on business expenses. You'll still get charged the VAT-inclusive price when you make the purchase, but you can claim that money back when you file your return with HMRC.

What do I need to register?

To register, you need:

- a National Insurance (NI) number or your tax identifier (Unique Taxpayer Reference - UTR)
- details of other businesses you've owned within the past two years
- your business bank account details

If you bought the business, you'll need to supply records of the sale.

How to register for VAT

It's easy to register for VAT on your own and it costs nothing. Your best bet is to do it online through the HMRC website. Start the registration process here.

Want to know how to register for VAT by post? You can download a form from this gov.uk page.

Choosing a VAT accounting scheme

Now you know the basics of how to register for VAT. But during the process you'll be asked to identify what VAT accounting scheme you'll use. The accounting scheme is how HMRC calculates whether you owe VAT, or get a refund.

Most businesses must use standard VAT accounting
You record the VAT collected on each sale and the VAT paid on each purchase, then submit a VAT return to HMRC every quarter.

You may be able to use annual VAT accounting
Some businesses can submit a VAT return once a year, however they are still expected to pay quarterly. Those quarterly payments are based on your last return, or an estimate.

You may be able to join a flat-rate scheme
Certain smaller businesses can skip all the VAT accounting and simply pay a percentage of their turnover as VAT. An accountant or bookkeeper can help you decide if this makes sense for your business. You can see the flat rates for specific industries on this gov.uk page.

You may be able to use a cash accounting scheme
Under cash basis accounting, you're assumed to have collected or paid VAT when money changes hands. Under all the other schemes, you're assumed to have collected or paid VAT as soon as an invoice is raised.

Once you're registered for VAT

After VAT registration you need to:

- add VAT to your prices
- issue VAT invoices to your customer
- file VAT returns and pay any VAT due to HMRC
- keep digital VAT records and a VAT account

Why do I need to keep digital records?

If you've signed up for Making Tax Digital for VAT (which all VAT registered businesses need to do by April 2022), the records you must keep are the same as any VAT-registered business. The difference is that you'll need to keep some of them digitally. For specific details of records that must be kept digitally for MTD-registered businesses, see here.

It's important that you comply with Making Tax Digital. HMRC can visit your business to inspect your record keeping and charge you a penalty if your records are not in order.

How do I keep digital records?

VAT-registered businesses must:

- keep records of sales and purchases
- keep a separate summary of VAT (called a VAT account)
- issue correct VAT invoices

The records must be:

- kept for at least 6 years (or 10 years if you used the VAT MOSS service)
- accurate, complete, and readable

Learn more about Making Tax Digital and who needs to register in the chapter on Filing your VAT return through Making Tax Digital.

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Calculating VAT and issuing VAT invoices

If you're a VAT-registered business you must add VAT to your prices. You also need to issue VAT invoices to customers. Let's take a look at the maths and requirements of both.

How to add VAT to prices

There's a very simple formula for each VAT rate. You multiply your price by 1.05 for a 5% VAT rate, by 1.20 for a 20% VAT rate, or leave the price as is for a 0% VAT rate.

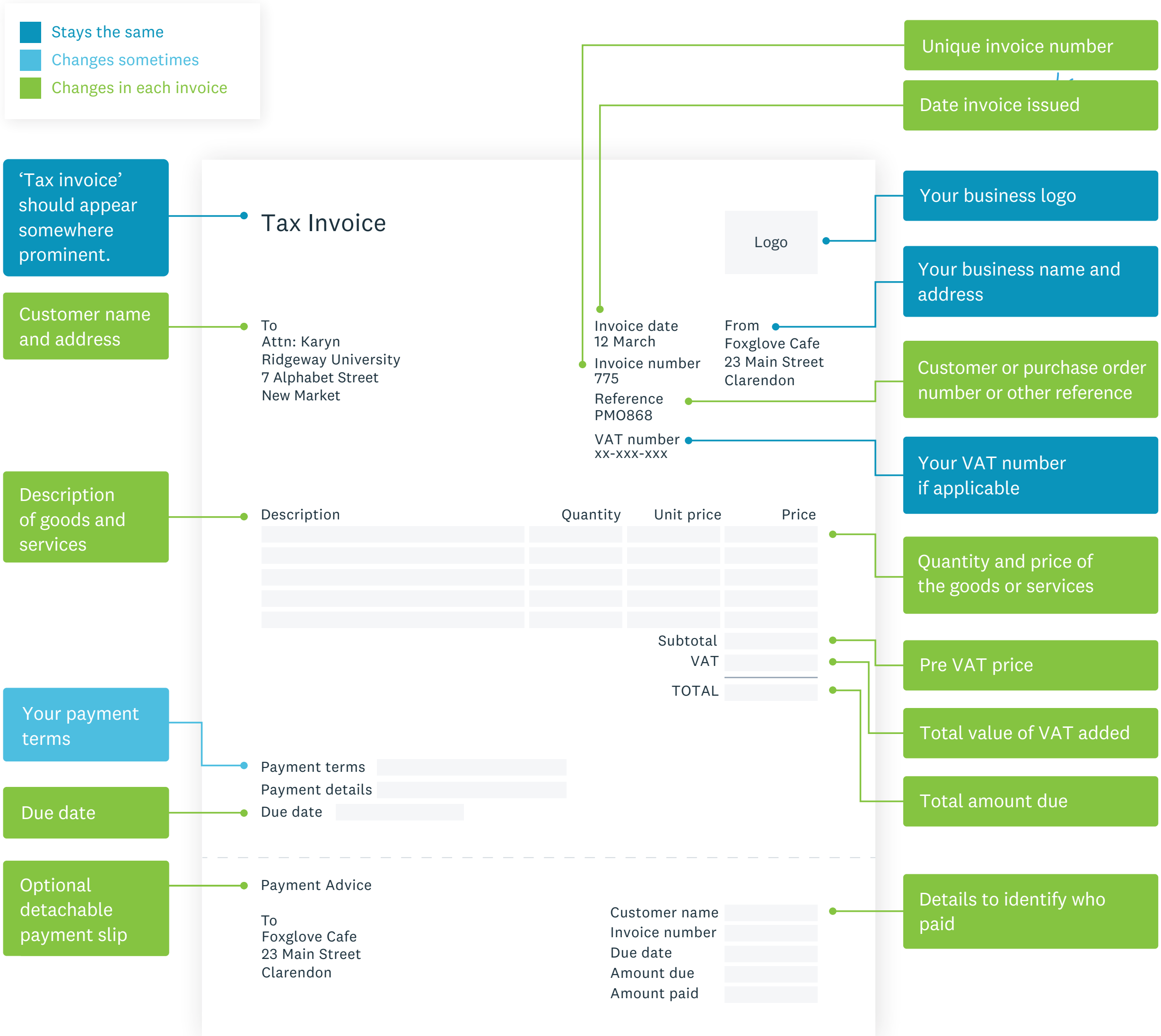
You don't add any VAT to out-of-scope or VAT-exempt products or services that you might sell.

What are VAT invoices?

A VAT invoice tells a customer how much VAT they paid on a purchase. It's important information because some of your customers may be able to claim that VAT back. If you're VAT registered, you must issue VAT invoices.

VAT invoice example

Here's what you need to put on a VAT invoice. A logo and payment terms aren't required but will help your invoice look more professional.



VAT tax point

If you're issuing an invoice more than two weeks after goods or services were delivered, add an extra line to your invoice saying 'VAT tax point' with the date of delivery next to it. This can help your business customers claim the VAT back sooner.

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Claiming VAT

VAT-registered businesses can claim back the VAT they pay on business expenses. They can also sometimes claim back VAT paid on income. Let's learn how.

When you can claim VAT back

You can claim VAT back when:

- you've purchased goods or services for your business
- a customer leaves you with a bad debt

VAT on business expenses

When you buy something for your business, you're usually charged VAT. If you're registered for VAT, you can claim that back. You do this by reporting how much VAT you paid during a period of time. HMRC balances the amount you've paid against the VAT you've collected to work out your refund or bill (learn more in working out your VAT).

Business expenses include things like stock, work tools, computers, phones, and stationery. You can't claim VAT on client entertainment.

When expenses are split between business and home

If you buy something like a laptop that you use at home and in the business, you can claim part of the VAT back. You will need to work out what portion of the purchase is business-related and show how you arrived at that number.

When you're not collecting any VAT

You can claim back VAT on supplies even if the end product or service that you sell is 0% VAT rated. But you can't claim VAT back if the end product or service is VAT exempt.

VAT relief on bad debts

If you raise an invoice and pay VAT on the expected income but your customer doesn't pay you, then you have a bad debt. You can claim back the VAT from HMRC on your next return. If the customer pays later, you can repay the VAT then.

Learn more about VAT and bad debts.

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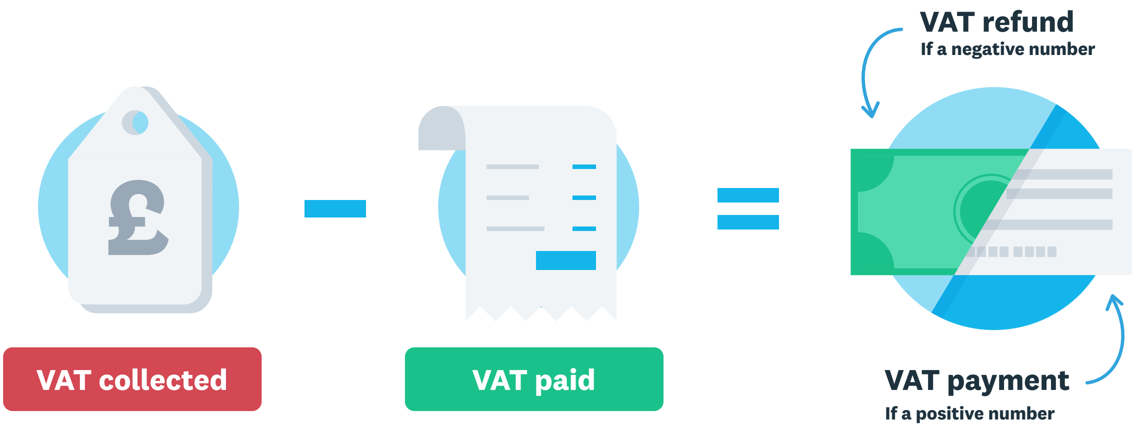
Working out VAT - refund or bill?

Working out VAT is straightforward maths. Keeping track of all your transactions is the trickiest part. Let's take a look at the process.

VAT is a simple formula

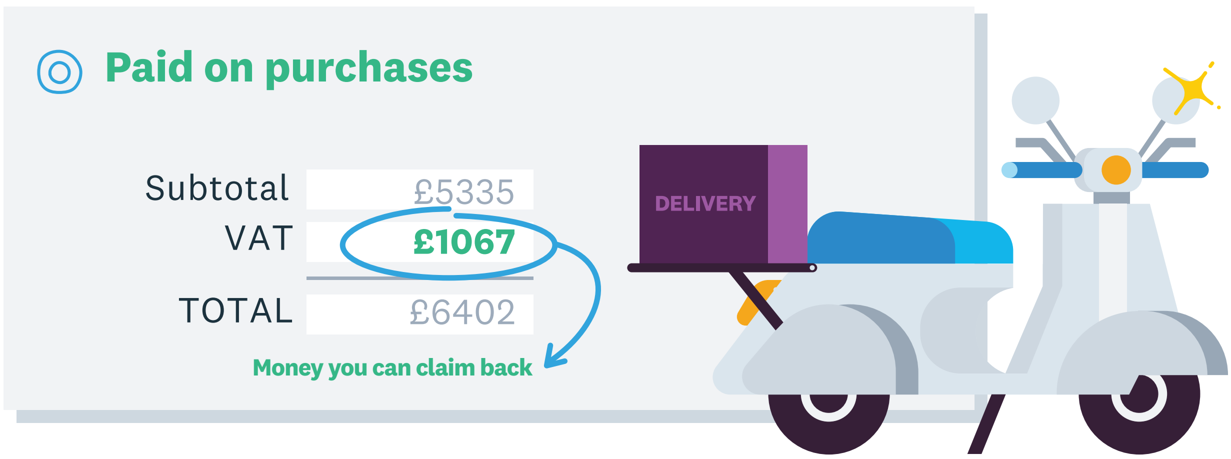
Unless you're using the flat rate scheme, you'll work out VAT by comparing the amount you paid on purchases to the amount you collected on sales.

If you get a positive number, you need to pay that amount to HMRC. If it's a negative number, you'll get refunded that amount.



How to work out VAT in four steps

1. Make a note of the VAT paid on your business purchases



2. Make a note of the VAT collected on sales

Collected on sales

Subtotal	£304.35
VAT	£60.87
TOTAL	£365.22

Money you owe HMRC

3. Add both types of VAT

VAT collected	VAT paid
April	April
May	May
£2819.74	£1342.87

4. Run the VAT formula

£2819.74 - £1342.87 = £1476.87 **Money you owe HMRC.**

If it's a negative number, you'll get a refund for that amount.

Avoid nasty surprises with smart bookkeeping

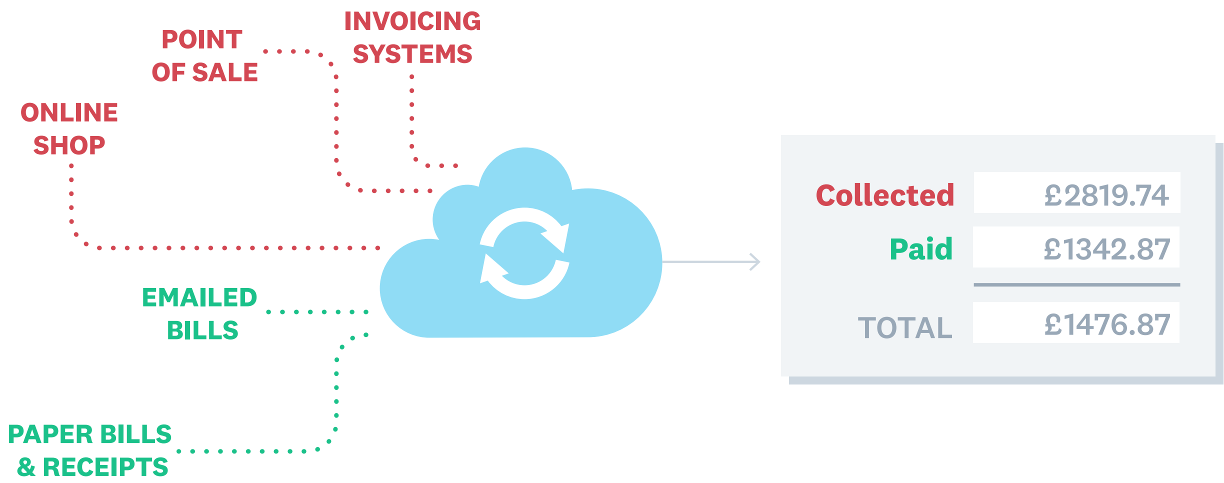
Like any business, you'll aim to sell more than you buy. If you succeed in doing that, you'll most likely end up with a VAT bill. Run the four-step VAT equation regularly so you can:

- work out how big your VAT payment is shaping up to be
- transfer cash to a separate bank account to cover the bill

Automate your VAT calculations

You can use online accounting software like Xero to stay on top of VAT. It automatically records VAT collected and paid, and does the maths for you.

The software keeps a running count of your VAT situation so you always know where you stand. When the VAT period is over, you just connect to HMRC and submit your return online. All the information is ready to go.



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Filing your VAT return through Making Tax Digital

Once you've registered for VAT, you'll need to submit returns online regularly – and square up with HMRC. Here's how to file and either pay your bill, or get your refund.

What is Making Tax Digital (MTD)?

MTD means you must submit your VAT returns using software that is recognised by HMRC, like Xero. This means that you can no longer submit your VAT returns manually.

The use of this software is mandatory for VAT periods starting on or after 1st April 2022, so it's a good idea to ditch the spreadsheets, upgrade your software, or migrate your accounts before the end of your next VAT period.

Once they're up and running, many business owners find it far easier and quicker to calculate and submit returns using online MTD software.

How do I register for Making Tax Digital?

You must have compatible software before you sign up.

To sign up you need:

- your business email address
- a Government Gateway user ID and password - if you do not have a user ID, you can create one when you use the service
- your VAT registration number and latest VAT return

You may need additional details to sign up. Check here for more information.

When to sign up:

If you already pay VAT by direct debit, don't sign up too close to the date that your return is due, or you may pay twice.

To avoid this, don't sign up less than:

- 7 days before your return is due
- 5 days after your return is due

If you don't pay by direct debit, sign up at least 3 days before your return is due.

Methods for submitting VAT

1. **Accounting software:**
   Businesses above the VAT threshold must submit VAT using Making Tax Digital-compliant software. From April 2022, all VAT registered businesses must use MTD software, regardless of turnover. Learn more about Making Tax Digital.

2. **Spreadsheets & MTD bridging software:**
   If you use spreadsheets for VAT, you can still connect to HMRC's MTD system via Xero. You can use Xero as bridging software that lets you upload VAT amounts, then send MTD VAT standard rate returns to HMRC. Find out more on this gov.uk page.

VAT due dates

Your due dates will depend on when you registered for VAT and what accounting scheme you use. Most businesses are required to submit every three months. You can get the specific dates from HMRC, by looking it up in your VAT online account.

Paying VAT to HMRC

If you have a VAT bill, you generally get one month and seven days to pay. You can do this via internet banking, debit card, or credit card. But perhaps the easiest way is to set up a direct debit. This allows HMRC to withdraw the VAT you owe directly from your bank account on the due date.

If you miss your deadline, you may face penalties. Find out more about surcharges and penalties on this gov.uk page.

Getting a VAT refund

If you paid more VAT than you collected, HMRC will owe you a refund. They aim to pay within 10 days of you filing your return. Make sure they have your bank details.

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Where to next? Tools and guides for your business

Now you know the ins and outs of VAT, but it can be a stretch to keep on top of it all. Xero's got resources and solutions to help.

Free resources for small businesses

Guides
Handy tips and tricks to help you do business better.
Read guides

Tax invoice template
Use our free template and it will calculate VAT for you.
Get your template

Bookkeeping tips
Learn how to keep tabs on taxes and profitability.
Read the guide

Tech solutions for small businesses

Xero for VAT
Streamline VAT accounting and returns.
Check it out

Xero for accounting
You'll be surprised by how much of your financial admin can be automated.
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