

## Don't end up in hot water over VAT

The VAT registration threshold currently stands at £85,000 and has been frozen until 2020. Only businesses with a turnover above this figure need to register for VAT. This is however one of the highest thresholds globally and can discourage growth, with many businesses remaining below the threshold in order to avoid VAT liability and the administrative costs involved. In comparison the average EU threshold is £20,000.

The current VAT rate structure is over-complicated and unfortunately VAT mistakes can be very expensive. To highlight this issue a recent First-Tier Tribunal case shows just how easy it can be to get things wrong. The way VAT is charged on hot food was changed in 2012 when the then Chancellor, George Osborne, was forced into a U-turn over his proposed 'pasty tax'. The result is one of the oddities of the VAT system, where VAT is only charged on takeaway food if it is hot when sold.

The tribunal case involved the sale at a market of rice, wraps and curries. Despite the food being allowed to cool after cooking, it was kept hot for sale. This temperature was considerably higher than the ambient air temperature of the premises and so the judge sided with HMRC. The taxpayer ended up with a VAT bill for £114,122 covering a four-year period.

HMRC can normally go back four years when assessing VAT errors, but they can go back further if dishonesty is involved. In addition, a penalty may be applied depending on a taxpayer's conduct. There is no penalty if the taxpayer has taken reasonable care, but there can be a 30% penalty for carelessness. This can be reduced to zero if unprompted disclosure is made, and 15% with prompted disclosure.

The way VAT is charged on sales can be confusing because the system contains so many peculiarities. Here we list a few examples:

- Peanuts in shells are zero rated, but shelled salted peanuts are standard rated.
- A gingerbread man with chocolate eyes is zero rated, but by giving him chocolate trousers he becomes standard rated!
- Although children's car seats are a legal requirement they are not listed as 'essential' zero rated items, and are subject to a 5% VAT charge.
- 'Physical' publications such as books and magazines are zero rated whereas e-books, classed as a digital service, are standard rated.
- Services are affected as well – a tutor's services are zero rated unless the tutor has incorporated, in which case the tuition is standard rated.

With such heavy penalties and complicated system to untangle, it is essential to understand and charge your VAT accordingly. We would recommend that you speak to your accountant or tax advisor if you need any clarification.

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