Cake or biscuit? A beginners guide to VAT

Mark Kingston - Today we are going to talk about the weird and wonderful world of VAT and before you press pause or skip or stop or jump on your podcast player, do just give us the next 10 minutes of your time because I hope it will be actually quite helpful and worthwhile for you. Instead of going into lots of deal about VAT which is probably something better read than listened to, I did want to have just a brief conversation with Critchleys very own superman of VAT, James Sherbourne. James welcome to your debut Critchleys Conversation recording.

James Sherbourne - Thanks Mark, it's good to be here.

Mark Kingston - And I just wanted James to talk about VAT, sort of head line in a pretty shallow level in one sense, just because in all the years that I have been working with an advising and listening to and talking to small business, VAT comes up time and time again as one of those things and people dislike or fear or get confused over quite easily. It is something that seems to create more than its fair share of pain and suffering to people. So I just thought if we could talk around the area of VAT and just cover off some of the those simple basis particularly for people who aren't long in the tooth as far as VAT is concerned, I thought that would be quite helpful. But before we do that, perhaps you could just set the scene for people in terms of your own background because you have been VAT for quite some time. What were you doing before your life in Critchleys.

James Sherbourne - I was working at the University of Oxford, in more of accounting role, a secondment came up within their tax team which I thought would be quite interesting and without boring you with all the details I never left, so remained in VAT all that time.

Mark Kingston - So that is six years.

James Sherbourne - Yes about six years.

Mark Kingston - And that is before you came here. So you have been dwelling in this world for quite a while. Just start by something really simple, defining what is VAT, we understand what the letters mean Value Added Tax. But what is it really?

James Sherbourne - It is essentially a tax on goods and services that a business sells, so as a consumer when you buy stationery for example you are going to pay VAT on that stationery.

Mark Kingston - And so that's the point, that it is a tax really designed to be paid for by the consumer not by the businesses supplying them. Even though those businesses have to pay VAT, just share and example how that works?

James Sherbourne - So in a normal business that buys and sells vatable goods or services it will be recovering VAT on the bits that it buys, charging VAT on the things it sells, so it will go in and out of the supply chain.

Mark Kingston - So it is something that businesses need to process but it is not going to affect their bottom line.

James Sherbourne - Exactly. It is an indirect tax so it is collected by a business on behalf of HMRC but it should end up with a final consumer. It is not always that simple with charities and some institutions.

Mark Kingston - So for example if we were in a furniture making business and we had to buy in wood for the frame and we had to buy in foam for the cushions and some upholstery martial and things like that, our supplies would charge us VAT on those products. We would then, when we make our sofa and sell it to a consumer we would have to obviously add on 20% VAT onto the final price, to make it the final price.

James Sherbourne - Yes.

Mark Kingston - And we get to claim the VAT we have spent, so effectively it is cost neutral to everyone apart from the end consumer.

James Sherbourne - That right, so if the final output is taxable in some shape or form you will recover all the bits that are in the supply chain along the way, so as you said the wood, the upholstery materials, those sort of things, they will be subject to VAT that the business will recover.

Mark Kingston - Now is it also true James, that there are different rates of VAT just to make things a little bit more complicated.

James Sherbourne - Yes, just to keep things interesting you have got three different rates at the minute, so as of today the standard rate is 20%, that's on most goods and services but some things are subject to 5% which is a lower rate and then you have got zero rating as well.

Mark Kingston - Can you give me an example, so we have talked about sofas and most things actually are 20%. Give me an example of the 5% and the zero percentage please.

James Sherbourne - So 5%, fuel and power, so gas and electrically that you use in your home, if you look at your energy bills, they should be subject to 5% for residential use. Also randomly children's car seats

Mark Kingston - Children's car seats?

James Sherbourne - Yes I am not sure where that one comes from, but yes children's car seats are on the list.

Mark Kingston - And zero rated?

James Sherbourne - Zero would be things like books, magazines, and certain food.

Mark Kingston - So the more basic food items and ingredients, things like that?

James Sherbourne - Basic food yes, not covering the actual catering in a restaurant or café or something like that.

Mark Kingston - So this brings us to that, I seem to remember that there was a great ad campaign or discussion around Jaffa Cakes. Is it a cake or is a biscuit? And that matters because of VAT.

James Sherbourne - It matters, the relevance being that you don't pay VAT on a cake, but if was a biscuit, because it was chocolate coated you would pay VAT.

Mark Kingston - I would have thought it would have been the other way round that a cake seems more luxurious and therefore we would expect to pay tax on it.

James Sherbourne - Yes quite, and oddly you can have a chocolate cake not subject to VAT but a chocolate biscuit is subject to VAT.

Mark Kingston - So it really matters, that definition really matters. Aright, because another thing I remember from the news, I can't remember when this was, two years ago, something like that, when there was big things around hot pasty's.

James Sherbourne - Yes that pasty tax.

Mark Kingston - The pasty tax. What was that all about?

James Sherbourne - It was essentially food heated and taken away from the premises of a café or where ever it might be is subject to VAT where I think there was some sort of wonderful ways of manufacturing the VAT that it would still be seen as cold takeaway.

Mark Kingston - So if I went into a Greggs and I brought a couple of cold beef sandwiches let say that was zero rated?

James Sherbourne - Zero rated yes

Mark Kingston - Presumably if I brought a code pasty and took it out that is also zero rated

James Sherbourne - Also zero, but if you have it heated,

Mark Kingston - Have it heated, it was deemed to be

James Sherbourne - Standard rated

Mark Kingston - Even if I took it out?

James Sherbourne - Yes

Mark Kingston - Ok, so there you go folks it really matters whether if you pasty is hot, or cold, and just to emphasis this point one step further, to the business owner this obviously can be very complicated if you are in a business where some of things you sell are zero rated, some of the things you sell are 5% rated and other things were 20%. For example, let's see if get this right, let's see if I have been listening to you, if I run a baby shop selling stuff to parents who are expecting a new born baby, so they come in and they can buy a car seat because that is an important thing, that obviously you said is 5%.

James Sherbourne - 5%

Mark Kingston - Ok and might decide to buy a magazine which was just by the checkout something to do with having a new baby, that would be

James Sherbourne - That would be zero.

Mark Kingston - Zero percent. And another thing I remember us getting when we had our first child was born was a little baby diary where you could record critical moments in the child's early days.

James Sherbourne - That will be standard rates, but it is not designed to be read, you are going to write in it, it's like diary,

Mark Kingston - So I can take those three items to the checkout and that business, and this is the point, that business would need to account accurately and faithfully not just for the sale of three items but for the sale of three items that had different levels of VAT applied to them at the point of sale.

James Sherbourne - That's right, in that sort of business their till systems will hopefully do that for them otherwise it would be a bit of headache.

Mark Kingston - Which just underscores the fact that it is complicated and as you say it is even more complicated if your business is relying on perhaps older forms for point of sale, or a manual point of sale.

James Sherbourne - Absolutely.

Mark Kingston - Which some people are some people aren't. OK so it is a complicated thing that is obvious. What about businesses who are either getting started or have remained quite small, but are approaching a threshold, I am familiar with the idea of the VAT threshold. Tell us a little bit more about that.

James Sherbourne - So once your sales turnover hits a certain level, so as of today 9 October 2017, its £85,000. Once your business hits that limit you have to register for VAT. So if your sales are taxable you could ignore things that might be exempt, that won't go towards a threshold, but yes you have to hit the £85,000 threshold and then you have to register.

Mark Kingston - But in your experience James, some people would choose sometimes to register even before they research that threshold?

James Sherbourne - You might want to so you can start recovering VAT that you have incurred on your cost sooner if you are already registered, but also you might want to as a bit of a marketing campaign, the businesses you are serving a bit of kudos and PR thinking maybe that you bigger than you are

Mark Kingston - So it makes you look more established as bit more profitable than perhaps you are, which can be I suppose quite a helpful thing in the early days of your business, right.

James Sherbourne - Absolutely.

Mark Kingston - Ok, so then it obviously quite important in terms of figuring out whether you need to register, so forget about registering early, for those businesses that decided not to, but neither the less they are approaching that threshold, presumably then it is really important for businesses to know their numbers in as close to real time as possible particular if you turnover and dial is heading up towards that £85,000.

James Sherbourne - Defiantly, yes, keep an eye on your turnover month by month, so the minute you hit the £85,000 or over the £85,000 you need to do something basically.

Mark Kingston - As just as little segway James I thought it would be useful for listens to know that we have also recovered a podcast with one of our head or accounts on reasons to move your business to the Cloud and one of those reasons that we didn't actually mention I don't think was specifically about VAT, knowing your turnover in real time with a definite benefit and one of the implications of that is that you will be more timely in this decision which then plays into the point about the fact that there is penalties and implications for being late on registering.

James Sherbourne - Absolutely, so HMRC can penalise you if you haven't registered on time, they may be lenient, but you could incur penalties which is obviously an extra cost to the business.

Mark Kingston - So if your accounts system is on more of a manual basis or it is on a computer in the corner of the office and it doesn't get up loaded to the accountant for another few months or perhaps you are just on a cashbook basis and it is all written down, you need to really be careful about this because it can come back and hurt you.

James Sherbourne - Yes absolutely, just monitor your levels of income and if you are approaching the VAT threshold, keep a closer eye on it basically.

Mark Kingston - And perhaps on the flip side of that coin is that if your business has been paying VAT and has been VAT registered for a long time and is actually doing quite well and the turnover is growing and going to 6-7 figures or more, it can also be quite easy to overpay VAT.

James Sherbourne - Yes, you could. So in the examples we have given before you could be classifying perhaps the magazines as standard rated, so you will be declaring VAT on those sales when you don't need too, so do keep an eye out for that sort of thing.

Mark Kingston - And some of those, the more complex the business and the bigger the business the more complex the transactions the less clear it is perhaps that

James Sherbourne - They will have a lot of transactions, so yes keeping an eye on it is a bit of headache

Mark Kingston - So I know in Critchleys that some, without giving any confidential information away, I know we have been able to save clients 5-6 figures sometimes in terms of the benefit of getting correct VAT advice. Well James I am sorry that has been a bit of a whistle stop tour. Thank you for talking to us, not just about VAT but pasties, cakes and biscuits, for that we are grateful, we do hope you come back again and help us dig into VAT a little bit deeper next time, but thanks for coming.

James Sherbourne - Thanks Mark.