Introduction to VAT

Who is this document for?

- Existing businesses looking to understand how VAT works in the Isle of Man
- Anyone considering starting a business in the Isle of Man

Sales Taxes

Sales taxes are a common form of taxation used around the world. These taxes are charged to consumers when they buy goods and services. One type of sales tax that is used in the United Kingdom and the Isle of Man is Value Added Tax (VAT).

Revenue Sharing Agreement

The Isle of Man is part of the UK for VAT. The IOM and UK have a revenue sharing agreement where VAT is charged in both jurisdictions, the receipts pooled together and the tax shared under the terms of the agreement.

Principles of VAT

The purpose of VAT is to raise revenue through taxing the end consumer based on the additional value added in the creation of a good or service.

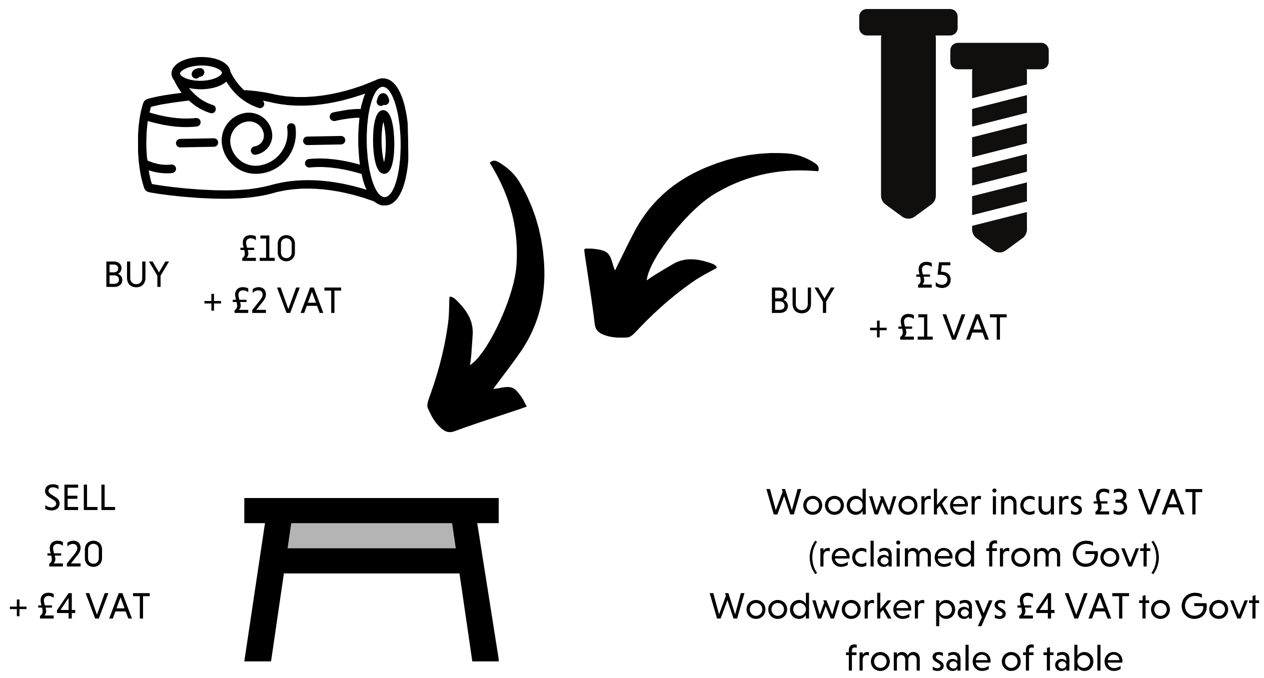
How VAT works - example

The below simple illustration uses the example of a woodworker producing a table to demonstrate how the VAT system works at its' most basic level.

A VAT registered woodworker buys materials (£10 Wood and £5 Nails) in order to produce a table. The woodworker is charged £15 (plus £3 VAT) in total. The woodworker is not the 'consumer' of these goods though, as they are using these to produce goods for resale. They therefore reclaim this £3 VAT from the Government. When they sell the table to a consumer (who is the final user), they charge £20 plus £4 VAT which they pay to the Government.

From the Government perspective, they have refunded £3 to the woodworker, and received £4, giving +£1 net position. As the woodworker turned £15 of inputs into a £20 output, this £5 'value added' equates to £1 VAT i.e. 20% VAT on the value added.

VAT is recoverable on costs incurred by VAT-registered businesses in so far as the cost relates to making taxable supplies. For example if the table in the previous example was bought by a VAT-registered Accountant for business purposes, the 'input' VAT would be recoverable as a cost to their business and 'output' VAT will be payable on the Accountants taxable supplies of services.



Who has to charge VAT?

VAT must be charged on most goods and services sold in the Isle of Man & UK – these are called 'taxable supplies'. The rate of VAT varies depending on what type of goods & services are being supplied.

Standard - 20% rate

Goods & Services are standard rated in the IOM/UK unless the VAT law says otherwise

Reduced - 5% rate

- Children's car seats
- Home Energy
- IOM Domestic Property Repairs
- IOM Holiday Accommodation
- Hospitality & Attractions - temporary rate in response to the COVID-19 pandemic

Zero - 0% rate

Most food, books, and children's clothes

Exempt / Out-of-scope - Nil

- Healthcare, welfare, education
- Postage stamps
- Financial & Insurance services
- Donations to charity
- Government grants

Additional Considerations

Some supplies can have different VAT rates depending on the circumstances. For example supplies of construction services are 20% VAT on commercial property but, subject to meeting conditions, they can be 5% VAT on existing IOM residential property or 0% VAT on new dwellings.

Registering for VAT

If your business is making taxable supplies you must consider if you have a requirement to register. It is important to register at the correct time or you may be liable to penalties. Please note if you are a sole trader all of your income streams will account towards your turnover figures.

It is compulsory to register if

- at the end of any month the total value of your taxable supplies you have made in the preceding 12 months, on a rolling 12-month basis, exceeds £85,000, or
- at any time you expect that the value of your taxable supplies in the following 30 days will be more than £85,000

If you have bought a VAT-registered business as a going concern you may have to register from the date of business transfer; this can also apply for a new lease for premises where the new tenant carries on the same kind of business activity as the previous occupant.

Once you have registered for VAT you will be able to reclaim VAT on your inputs that relate to the taxable supplies you make. You cannot recover VAT if the purchases do not relate to your business or relate to exempt supplies you make. You must charge the relevant VAT on all your taxable outputs. If you have not registered for VAT you cannot charge or recover VAT.

Is there a benefit to staying below the £85,000 turnover threshold?

The £85,000 VAT threshold was put in place to help small businesses avoid the administrative burden of collecting VAT. While this means you may be able to charge a lower price to your consumers (compared to businesses that do charge VAT), it is unlikely to be a sustainable long term solution as you will not be able to grow your business. You will also not be able to reclaim input VAT, which will make your supplies more expensive.

When setting up a business you should carefully consider how VAT will fit with your pricing model, even if you are not required to register straightaway.

VAT receipts and invoices

If you are registered for VAT and are providing taxable supplies, you must charge VAT on goods and services you supply. This should be noted on receipts and invoices so your customers can reclaim VAT if they are entitled to.

There are specific rules regarding the information you must include on any VAT invoice and what records you must maintain. The information can be found at https://www.gov.uk/guidance/record-keeping-for-vat-notice-70021#vat-invoices

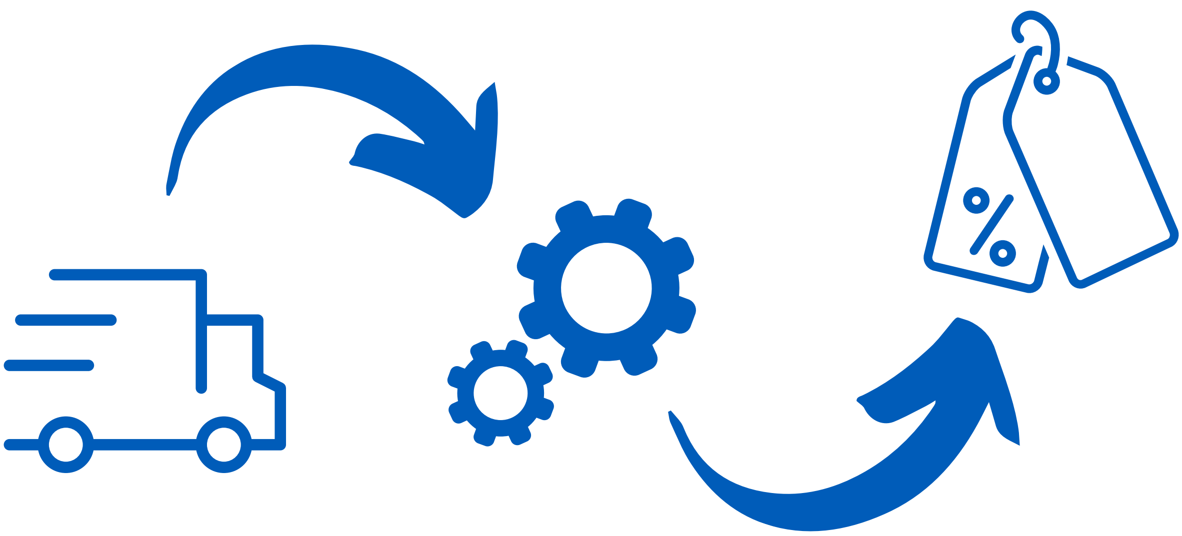
Even if you do not raise VAT invoices, if you are registered for VAT and providing taxable supplies then the price you charge will be treated as including VAT.

Reporting & paying VAT

Under the Standard VAT accounting Scheme, VAT-registered businesses usually submit their VAT returns to Customs and Excise 4 times per year. The amount of VAT you must pay, or the amount of refund you are entitled to depends on your input and output tax. If the amount of VAT on sales is higher than VAT on your costs you will pay the difference to Customs and Excise. Alternatively, if the VAT on your costs is higher than the VAT collected from your sales you will be refunded the difference.

For most companies this standard scheme is the most widely used offering businesses the ability to claim back VAT on purchases. However it is important to note that there are other schemes which can offer support for smaller businesses. It is important to consider if these schemes would be of benefit to your business. If you receive repayments it is unlikely that any of these schemes would be of benefit. Talk to an accountant or tax advisor if you want advice on if the schemes could benefit you.

The following pages include information on some of the main schemes.



VAT Flat Rate Scheme

The flat rate scheme is designed to simplify VAT accounting for small businesses, reducing the amount of paperwork they are required to complete. Flat rate allows businesses to apply a fixed flat rate percentage to gross turnover to arrive at the VAT due.

Fixed rate percentages depend on the type of business. You do not recover input tax when using the flat rate scheme however there are special rules if you purchase capital goods.

Eligibility for the Scheme

- You are eligible to be VAT-Registered
- Your taxable turnover in the next year will be no more than £150,000 excluding VAT

Who cannot use the Scheme?

- Those who have recently left the scheme will not be eligible to rejoin for a period of 12 months.
- Businesses that have committed a VAT offence within the past year, such as VAT evasion
- Businesses that are closely associated with another business – for example, two businesses which have close financial or organisational ties.

Some small businesses may be liable to pay more VAT on the flat rate scheme than on other accounting schemes.

More information can be found in public notice 733
https://www.gov.uk/government/publications/vat-notice-733-flat-rate-scheme-for-small-businesses/vat-notice-733-flat-rate-scheme-for-small-businesses

Cash Accounting Scheme

With the cash accounting scheme you pay VAT on the sales when your customer pays you and recover VAT on your purchases when you have paid your supplier.

Eligibility for the Scheme

- You are VAT-Registered
- Your taxable turnover in the next 12 months will be no more than £1.35m

Who cannot use the Scheme?

- You use the Flat Rate Scheme (which has its own cash-based turnover method)
- You're not up-to-date with your VAT returns or payments
- You've committed a VAT offence in the last 12 months, for example VAT evasion.

More information can be found in public notice 731
https://www.gov.uk/guidance/vat-cash-accounting-scheme-notice-731

Annual Accounting

With annual accounting you submit one VAT return a year and make advanced payments towards your VAT bill. This figure is based on the total VAT due on your previous years' returns, Once you have submitted your return you will make a final payment or apply for a refund if you have overpaid.

This scheme may not be suitable for you if the total VAT due varies significantly from year to year e.g. if your business is growing.

Eligibility for the Scheme

- You are VAT-Registered
- Your taxable turnover in the next 12 months will be no more than £1.35m

Who cannot use the Scheme?

- Those who have recently left the scheme will not be eligible to rejoin for a period of 12 months.
- You're not up-to-date with your VAT returns or payments
- You have committed a VAT offence within the past year, such as VAT evasion

More information can be found in public notice 732
https://www.gov.uk/guidance/vat-annual-accounting-notice-732

Margin Scheme

The VAT Margin Scheme is an optional scheme that can only be used for specified goods, in specified circumstances, and subject to strict conditions.

Under the margin scheme VAT is due on the difference ('margin') between what you paid for an item and what you sold it for, rather than the full selling price. The margin is treated as VAT-inclusive so you pay VAT at 16.67% (one-sixth) of the difference.

Eligibility for the Scheme

- You sell Second-hand goods, works of art, antiques, or collectors' items

Please note there are strict rules that need to be adhered to or you will have to pay VAT on the full selling price of each item.
More information can be found in public notice 718
https://www.gov.uk/guidance/the-margin-and-global-accounting-scheme-vat-notice-718

Electronic Point of Sale (EPOS) Systems

EPOS systems have developed beyond merely being used for stock control purposes and their functionalities are now being utilised as important tools to support VAT accounting. Many existing business systems have the capabilities to report sales at different VAT rates and therefore migration to using EPOS for output tax accounting can be straightforward and extremely beneficial to many businesses.

Benefits of using EPOS systems for VAT accounting

- By integrating your accounts to an EPOS system all your data is on one program which can lead to a reduction in errors and more accurate VAT accounting
- Time savings can be achieved through the automatic generation of VAT calculations
- Increased ease of investigation into any problems or discrepancies

Where can I find out more?

You may wish to engage the services of an agent to help with accounting for VAT and dealing with Customs & Excise on your behalf and/or contact Customs & Excise yourself for VAT advice.

Further guidance or can be obtained from Isle of Man Customs and Excise Business Advice Centre team.

https://www.gov.im/customs/

In person - Custom House, North Quay, Douglas
(Next to Douglas railway station)

By telephone – 01624 648130

By Email – customs@gov.im

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