Chapter 1
VAT general principles

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VAT general principles

In order to appreciate the VAT implications of property transactions it is necessary to be aware of certain basic principles of the tax.

The VAT regime

VAT was introduced into the UK on 1 April 1973 as a condition of the UK joining the European Single Market. VAT is an indirect tax, under the care and management of H.M. Customs & Excise (Customs). VAT is a multi-staged tax which is imposed at each stage of a chain of supplies of goods or services.

VAT legislation

The UK law is contained in the VAT Act 1994 which is supported by numerous statutory instruments. Customs publish public notices and certain parts of the notices (always highlighted) have the force of law. Where a section does not have the force of law, the notice represents Customs’ interpretation and opinion of particular VAT issues.

Notwithstanding the terms of the UK legislation the UK Government is obliged to implement the provisions contained in EU Directives. The principal directive is the Sixth Directive. If the UK has not implemented EU provisions a UK taxpayer, but not Customs, can rely on the European directive where this would be to his or her benefit.

In effect EU law overrides domestic law. An example is the proceedings taken against the UK in 1988. The ECJ ruled that the UK had not upheld the provisions of the Sixth Directive by allowing zero rating of commercial buildings (and water, news services, fuel and power).

Where a question of European law is raised in the UK Courts or tribunals the matter can be referred to the ECJ for a preliminary ruling on the interpretation of the European law involved.
Judgements of the ECJ must be followed in the UK even where the cases concerned are those of another member state.

Registration

The UK has adopted a registration threshold which is currently £70,000 with effect from 1 April 2010. The threshold normally rises each year in line with inflation and is by far the highest in any of the member states of the European Union. Businesses whose turnover does not reach the registration threshold are not required to register for VAT, but can register voluntarily. Once registered, a business has to charge VAT (where applicable) on income and subject to certain rules can recover VAT on related costs and expenses.

Group registration

Subject to certain conditions in respect of control, two or more companies established in the UK can, if they wish, register for VAT as a single entity. The principal advantage of choosing to group register is that most supplies between VAT group members are ‘disregarded’ for VAT purposes. Group registration means that only one VAT return is submitted for the group.

Rates of VAT

The rate of VAT rose from 17.5% to 20% on 4 January 2011. There is a reduced or lower rate of 5% and a zero rate (nil %) which applies to certain goods and services. The zero rated goods and services concerned are listed in the VAT Act 1994, Schedule 8, and those at the lower rate are specified in VAT Act 1994, Sch 7A. In addition, other supplies are exempt from VAT (VAT Act 1994, Schedule 9) and others are outside the scope of UK VAT.

Scope of VAT

In order to fall within the scope of UK VAT a supply has to meet the following conditions:

- it is a supply of goods or services;
- it takes place in the UK;
• it is made by a taxable person; and
• it is made in the course or furtherance of any business carried on by a taxable person.

A transaction which does not meet the conditions is outside the scope of VAT.

Supply
In broad terms a supply of goods occurs when the ownership of the goods is transferred. The freehold sale of a property is therefore a supply of goods.

A supply of services is anything which is not a supply of goods but is done for a consideration. The letting of property is a supply of services. A free supply of services is outside the scope of VAT, generally referred to as non-business.

Place of supply
There are complex rules for determining where a supply takes place. As far as property is concerned the place of supply is the UK if the property is located in the UK. The UK includes England, Scotland, Northern Ireland, Wales and the territorial waters of the UK. The Isle of Man, whilst not strictly part of the UK, is treated as though it is part of the UK for VAT purposes. This treatment does not extend to the Channel Islands.

Taxable person
A taxable person is defined in UK law as anyone who is or is required to be registered for VAT. However, the definition in the Sixth Directive is far broader. Article 4 paragraph 1 states:

“Taxable person” shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.’

The economic activities specified in paragraph 2 of Article 4 crucially for the purposes of this report include:

‘The exploitation of tangible or intangible property for the purpose of obtaining income there from on a continuing basis shall also be considered an economic activity.’
Business
The definition of business in UK law is in the VAT Act 1994, Section 94. This states that business includes ‘any trade, profession or vocation’. However, the term ‘business’ is far wider and covers activities not normally treated as a business under direct tax law, e.g. the letting of property.

Output tax
The tax charged on supplies is known as output tax. Output tax is calculated at the standard or lower rate (as appropriate) of the value of the supply. The value on which VAT is chargeable on a supply is determined in accordance with rules in the VAT Act 1994, Section 19:

‘If the supply is for a consideration in money its value shall be taken to be such amount as, with the VAT chargeable, is equal to the consideration.’

The effect of this is where the consideration does not specify VAT; the consideration shall be taken to be VAT inclusive.

Input tax
Input tax is defined in the VAT Act 1994, S24 (1), as the tax on goods or services supplied to a person, tax on the acquisition of goods from a member state (and the tax payable on importation) being, in each case, goods or services used, or to be used, by a person for the purpose of any business carried on, or to be carried on, by the person concerned.

A business can recover VAT on costs relating to taxable transactions (at the standard rate, lower rate and zero rates). A claim for input tax must be supported by a tax invoice unless Customs agree or direct otherwise.

It is critical to land and property transactions to remember that VAT cannot be recovered on costs relating directly or indirectly to exempt supplies. Where a business makes both taxable and exempt supplies, there are particular rules known as partial exemption rules (see Chapter 7) which may restrict the amount of VAT that a business can reclaim.
Time of supply

VAT becomes chargeable at a specific time (known as the tax point). VAT must be accounted for by reference to the VAT return period in which the tax point occurs (unless the business is operating a special cash accounting scheme). The rules for determining the tax point differ depending on whether the supply is a supply of goods or a supply of services. The tax point rules with an emphasis to property transactions are described below.

Goods

Where the supply is of goods the tax point is the date the goods are removed. For property sales the tax point is the date the property is made available to the purchaser, normally the completion date. However, this tax point known as the basic tax point is overridden by what are termed actual tax points. Actual tax points are payments received (i.e. deposits) or invoices issued in advance of the basic tax point, or the date of invoice provided the invoice is issued within fourteen days of the basic tax point. The facility exists to agree with Customs an extension of the fourteen day period, e.g. if the business concerned normally issues invoices monthly.

Services

The basic tax point for a supply of services is when the services are performed. Customs generally interpret this as meaning the date on which all the work, except invoicing, is completed. The basic tax point is overridden by actual tax points as described in the previous paragraph.

Continuous supplies of services

There are special tax point rules for what are termed continuous supplies of services. The rules are necessary because for continuous supplies there is no performance tax point as the services are never completed. The leasing and letting of property falls within the continuous supply rules. For leasing and letting the tax point is the earlier of date of issue of tax invoice or receipt of payment.