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Published in Japanese
Eikoku News Digest
June 2017

VAT Enquiries and Risk Areas

Introduction

HM Revenue & Customs reported recently that they raised an additional £3.3bn VAT in the last year through enquiries into the underpayment of VAT by small and medium-sized entities. This figure includes penalties and interest as well as the additional VAT from correcting errors and fraud. A significant proportion of this is likely to have come from a small number of relatively simple error types. This article outlines the initial VAT enquiry process and looks at some of the key risk areas that are routinely picked up on by VAT officers, leading to the recovery of additional VAT and levying of penalties and interest charges.

Main body

HMRC have sophisticated systems in place to check the reliability of VAT returns submitted, including computer-based risk analysis tools. Businesses are selected for compliance visits or other enquiry measures based on their risk profile in the context of parameters set by HMRC. If a business has submitted a repayment VAT return and not had a visit, HMRC are likely to want to check that the return is correct prior to payment. In the first instance the Officer will check any information held on their file and then telephone the business. The Officer will normally ask why a repayment return has been submitted and, depending on the answer to this and several other questions, will decide whether or not a visit is required. If the return has been submitted by your accountant you would be well-advised to suggest to HMRC that they contact your accountant.

Whether the Officer decides that a site visit is necessary or that a desk-top review is sufficient, they are likely to request the following documentation :-

- Copy of the VAT account
- Schedules of purchases and sales
- Sample of purchases invoices
- Sample of sales invoices

Prior to supplying this information you should check that the purchase and sales invoices comply with the regulations. If you discover any errors at this point you should point them

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out to the Officer, but unfortunately they will be considered to have been prompted by the enquiry and will not be treated as a "voluntary disclosure".

One of the first checks by HMRC will make is whether the supplier's VAT registration number is on the invoice. If there is no supplier's VAT number then HMRC will disallow the VAT claimed on the invoice. This will also usually lead to a penalty of 30% of the VAT reclaimed. If such errors emerge from a desk-top review then HMRC is likely to make an on-site visit prior to repaying the remaining VAT claimed. Depending on the amount of VAT reclaimed, HMRC may also check that the supplier has accounted for the VAT on their sales invoice.

HMRC are normally successful when raising VAT assessments from errors on repayment returns. It is therefore important to take extra care prior to submitting a repayment return. Please note that there is no direct tax deduction for any penalties.

As a result of the recent increase in successful enquiries, HMRC are likely to conduct more enquiries into the kinds of businesses that have raised this additional VAT. Businesses now need to be more aware in completing VAT returns.

The following areas are particularly susceptible to error and commonly lead to VAT assessments:

Motor Vehicles.

It is extremely rare for businesses to be entitled to recover VAT on the purchase of a car. If VAT has been recovered and you cannot provide satisfactory evidence that the car has been used exclusively for business use and there is no private element this will result in an assessment and penalty.

Reverse Charges.

This is particularly confusing and counter-intuitive area of VAT. Briefly put, if you purchase a service from outside of the UK you must account for a "reverse charge" – i.e. you account for the output VAT on your VAT return in a similar way to a sale from your business, as well as reclaiming the input VAT (if you are entitled to) as a purchase by your business. We have covered this point in previous articles but if you are in the financial sector in particular this could be a major cost to the business in both the loss of VAT and potential penalties.

One example of the reverse charge would be where a UK subsidiary purchases software from its parent company based in Japan. If the cost of the programme was £10,000, the UK company would declare it as a sale on their VAT return, and report £2,000 VAT payable . If they are entitled to reclaim any VAT incurred they would recover the £2,000 as purchase VAT on the same return. If the UK company was restricted in their recovery of VAT then this would be a cost.

Exports outside of the EU

In order to zero rate the export of goods businesses must have evidence of export. HMRC will require copies of export entries. Failure to provide documentation will result in a VAT assessment. Businesses must also export the goods within three months from the date of sale otherwise VAT will be payable.

Exports to other EU Countries.

It is important that you obtain the customers' VAT number for both goods and services. It's also important to check periodically with your customer that they are still VAT registered. HMRC do carry out checks.

Recharge of Expenses.

If you are supplying goods or services and recharging expenses, the total supply will be liable to VAT if the invoice is to a UK customer. This applies to any expense, including those on which VAT was not incurred initially. This is because such expenses are considered to be auxiliary to the main supply of goods or services, and are treated for VAT purposes in the same way as the main supply.

There are numerous other areas which can result in VAT assessments but the above are the most common with which HMRC are often successful.