



[Read this article online](#)

VAT stands for Value Added Tax. And no, I don't think there has been a more boring acronym before.

But if you're setting up a business in the UK, VAT is an important thing that your business needs to understand. If you don't understand it, you won't be able to correctly register for it, or perhaps even miss out on much-needed tax relief and help that your business can benefit from.

So, to help you navigate this tax minefield, we've created this complete beginners guide for you. Or, VAT explained for dummies if you prefer.

So, sit down, make yourself comfortable and put your learning hat on. We're about to dive in deep to VAT here.

So, what is VAT?

The first section in our VAT explained for dummies guide needs to tell you exactly what VAT is.

As mentioned, VAT stands for Value Added Tax. It's also sometimes known as a goods and services tax. Now, that's not super helpful, so let's break that down some more.

VAT is a consumption tax placed on almost all goods and services that are sold. If it's not essential, the government wants to tax it. It's a way for them to raise revenue from customers spending habits.

The good thing about VAT tax is that it's percentage-based. That means instead of the government charging a flat sales tax for every non-essential item you buy, you get charged a small percentage. So, the higher value the item, the more VAT you pay.

- If you purchased a children's toy worth £1, the tax you pay on that toy would only come to 20p.
- However, if you purchased a brand new laptop worth £1,000, you would be paying £400 in tax.

This means the level of VAT is always proportionate to the good or services you're buying. If the government were to use a flat sales tax of say, £20, you would instead have to pay a £20 tax on both a £1 toy and a £1,000 laptop. That wouldn't be fair at all.

Do all businesses charge VAT?

Not at all. VAT is only charged if a company is VAT registered.

In some cases, it's an obligation for companies to be VAT registered, which we'll cover in the below section.

For most small businesses or start-ups, you don't need to charge VAT. This is great for you, because it means you can offer your customers lower prices while you get your business up and running.

It also gives you an advantage over bigger companies, making sure that the market stays competitive and isn't monopolised by the bigger firms.

Do I need to be VAT registered?



No, not every business needs to be [VAT registered](#). In fact, most small businesses and start-ups choose not to be VAT registered.

You only need to be VAT registered by law if ALL of the below points apply to your business (as of 2021).

- You are a business that is actively selling goods or services;
- Selling products or services that are NOT exempt from VAT. Non-VAT products or services include things like food and drink, betting, antiques, healthcare or education. You can see a more detailed list of these items in the following section.
- Live in the UK, or your place of business is in the UK. (For more information on [setting up a business in the UK as a non-resident, see this guide](#)).
- You have an annual turnover of [more than £85,000](#).

If that sounds like your business, then you're going to need to [register for VAT](#) within 30 days.

If you realise that your annual turnover is going to be more than the £85,000 threshold, you must register your business within 30 days of realisation, not when you exceed the threshold. So for example, if you realise on May 7th that your turnover will go over the threshold by July, you need to register within 30 days of May 7th.

If your annual turnover goes over £85,000 and you haven't registered, you have 30 days to register since the point of exceeding your turnover.

If you don't meet these requirements, you can also register for VAT voluntarily. There are some plus sides to this, which we'll cover later in the article.

What products or services are VAT-exempt?

VAT applies to most non-essential products or services. So, if something can be classed as essential, it doesn't usually qualify for VAT.

There are, of course, exceptions to that rule. By their very nature, food and drink are essential for us to survive. But, some items of this category qualify for VAT, such as alcohol, confectionery or snacks, takeaways, restaurants, ice cream, soft drinks or catering services.

Basic food, such as vegetables, fruits and the like will always be exempt. But those premium snacks and items that you don't really need? They'll be charged at 20% VAT.

I get it. Sometimes I feel like chocolate is essential to my life. But, really, I can live without it.

The following products and services are also VAT exempt:

- Sports activities, and physical education like tennis or ice skating lessons for children;
- Betting or gaming services, such as bingo, online lottery games or lottery tickets;
- Cultural events or exhibits, such as theatre performances, museums or even zoos;
- Antiques;
- Charitable goods or services;
- Building services or equipment for disabled people, including ramps, wheelchairs, canes, vision or hearing aids;

- Healthcare goods or services, including prescriptions, sanitary pads, incontinence products, or professional health care;
- Educational goods or services as long as they are provided by schools, universities, colleagues or any other eligible body. (Classing something as educational doesn't quite cut the mustard here);
- Power and utilities, including energy-saving services, materials or heating;
- Certain building and construction services, such as building ramps or passageways for disabled access or charitable purposes;
- Parking or garages;
- Freight transport or containers;
- Printing brochures, leaflets or pamphlets;
- Postage costs or packaging;
- Publications, including books, magazines, music and newspapers;
- Children's clothing, footwear or babywear;
- Protective and safety equipment;
- Insurance or financial services and investments.

For a full list, [see the HMRC website here](#).

What happens if I don't register for VAT?

If you're a UK business that sells VAT goods and has an annual turnover of more than £85,000, you are legally obligated to register for VAT.

If you don't register within 30 days of exceeding your threshold, you will be accountable for a late registration fee, which will cover how much you would have owed in the period you weren't VAT registered.

Depending on how late your registration is, you may also have to pay a penalty. The bottom line? If you're obligated to pay VAT, get registered as soon as you can.

Can you get an exemption for being VAT registered?



Yes, you can get a VAT exemption from the HMRC in certain circumstances.

This happens if your annual turnover temporarily goes over the threshold, but is expected to drop again in the next 12 months. For example, if you've seen a recent boom that has affected your income, but is not expected to last.

In order to get your exemption, you will need to [write to the HMRC](#) and send them the evidence of your turnover and how it's projected to drop below the threshold. They will review your case and issue and confirm an exception in writing, or register you for VAT.

When should you volunteer for VAT registration?

Volunteer VAT registration can be beneficial for a lot of businesses, particularly if your primary audience is other businesses (B2B).

This is because all VAT registered businesses can claim back the VAT that they have spent. So if you're selling to VAT registered businesses, they'll be able to claim back any VAT that comes with your goods.

And more importantly, you'll be able to claim back any VAT that you purchase. If you're buying a lot from other businesses, this can make a big difference to your tax returns at the end of the year.

Secondly, registering for VAT might give the impression that you're a much larger, and more well-established business than you currently are. This could help you win some new clients and increase your profits.

However, there are downsides to voluntary VAT registration. If you sell directly to customers, you might notice a loss in sales as they don't want to pay your VAT increased prices. It can also have a negative effect on your tax returns – and cost you more in accounting fees or [bookkeeping practices](#).

If you're not sure, it may be worth talking to an accountant before you make a decision, as they'll be able to help forecast what being VAT registered will mean for your businesses' finances.

How do I register for VAT?

Need to register for VAT? This process is actually a lot simpler than you might think.

In fact, most businesses can [register online](#) through a simple form. Make sure you have details such as your turnover, business activity and bank details to hand, as you'll need to enter this information to complete the process.

There are some cases where you cannot register for VAT online. This includes:

- If you're joining the [Agricultural Flat Rate Scheme](#), which is an alternative VAT scheme designed exclusively for farmers;
- If you're an EU business that's distance selling or importing goods to Northern Island;
- If you want to apply for a VAT exception, which we'll cover in a later section.

If any of the above applies, you'll need to complete a separate form in the post, or write directly to HMRC.

If you don't want to register yourself, you can always appoint an accountant or agent to register and submit VAT returns on your behalf. If you're not sure what the best thing to do for your business, it might be best to go through an accountant or agent for less stress and that added peace of mind.

Our recommended 'done-for-you' VAT registration service:

The screenshot shows the website for 1st Formations. The header includes the logo, navigation links (Home, Packages, Address Services, Company Services, Help & Advice, Blog, About, Contact, Client Login), and a 24/7 Customer Support phone number (020 3897 2233). The main banner features a blue-tinted image of London with the text 'VAT Registration Service', 'Register for VAT with HMRC', and the price '£39.99 + VAT'. Below the banner, the 'Service Details' section explains the process: preparing and submitting the VAT registration application to HMRC, and providing confirmation of the VAT Registration Number by email. It also states that VAT is charged on most goods and services provided by VAT-registered businesses in the UK, who are able to reclaim VAT paid on the goods and services they buy. A final note mentions that any company that is trading can register for VAT, even if their turnover is less than the VAT threshold of £85,000. On the right, there is a 'VAT Registration Service' box with a 'Click 'Order' and complete the short application form with details of your name, company name and contact details.' and a price of '£39.99 +VAT'. A green 'Order' button and a blue 'Chat with us!' button are also visible.

While it's relatively straightforward to register for VAT yourself, it is also a legal requirement for many business so it's important it's done correctly.

Our top-rated company formation agent, 1st Formations (you can see our review of them, [here](#)) offer a complete 'hassle-free' [VAT registration service](#) that includes:

- Preparation and submission of your VAT registration application to HMRC by a VAT application expert
- Access to a VAT registration expert to answer questions you may have
- Confirmation of your VAT Registration Number, sent to you by email

- Instructions on how to create your own HMRC Government Gateway account to activate your VAT registration online, sent to you by email

[Click here to get VAT registered for just £39.99 +VAT](#)

Do I need an accountant to register for VAT?

No, you don't need an accountant to register for VAT. But for some businesses, having one is preferred to deal with your registration and tax returns on your behalf.

If you don't have an accountant yet, take a look at our [best questions to ask when hiring an account](#) to make sure that you hire the best match for your business.

What is a VAT return?

If you are VAT registered, you will have to complete a VAT return each year. This will detail your total sales and purchases, and how much VAT is on them.

Your VAT return will be used to calculate:

- How much VAT you owe to the HMRC. This is the amount of VAT that you have charged your customers.
- How much VAT you can claim from the HMRC. This is the amount of VAT that you've paid for as part of a business purchase.

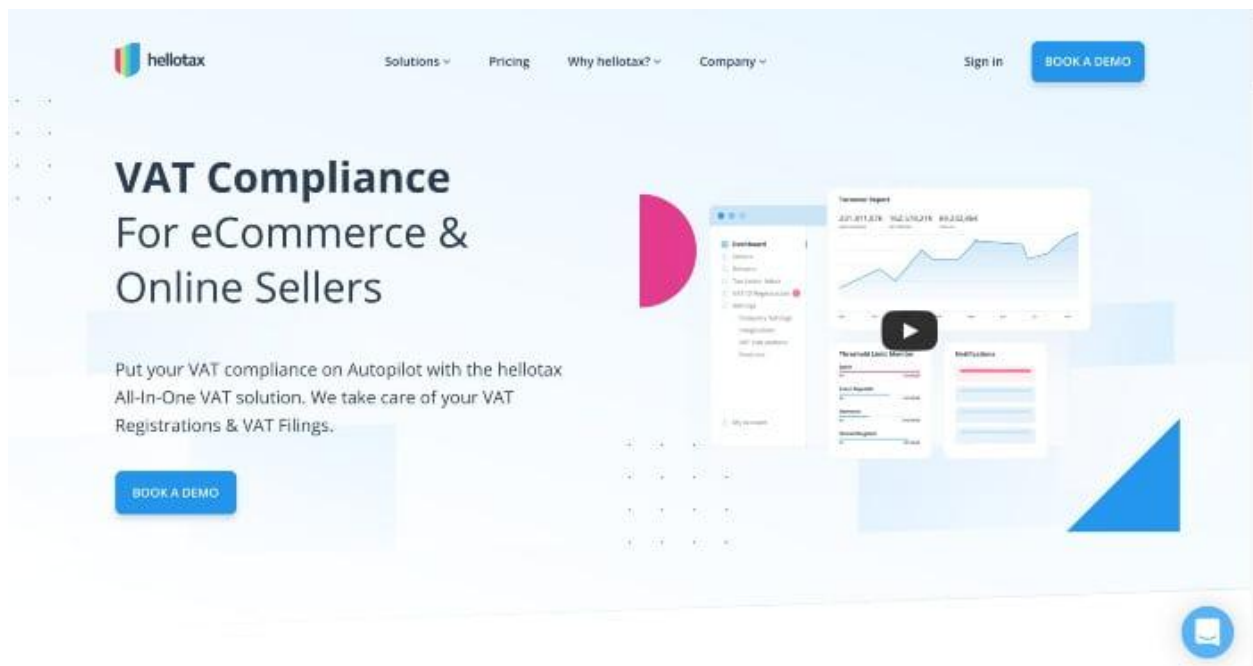
- The total amount that you will have to pay HMRC, or that will be refunded to your account.

Even if you have no VAT to claim, or pay to HMRC, you still need to complete these returns to keep your records up to date and accurate.

To make your VAT returns easier, you may want to consider using an accountant to manage your finances, or investing in accounting software instead. Accounting software is a great way to automatically keep a track of your income, expenses and records to make tax returns easy, quick and accurate.

At Buiness4Beginners, we've reviewed all of the [accounting software on the market](#) for you to find a match that fits your business needs and budgets.

One of our best picks of accounting software to handle VAT returns is [Hellotax](#).



Rated 9.2/10 by our team, [Hellotax](#) is a free VAT software offering an easy way to calculate your tax, calculate your returns, create tax levels and get in touch with local tax accountants for detailed guidance and support.

They also offer a range of paid features if your business needs more VAT help, making it a great fit for both start-up and growing businesses.

At a glance:

- Ease Of Use = 9.8
- Value For Money = 9.8
- Customer Support = 8.5
- Services Offered = 8.8
- Overall rating = 9.2

You can [read the full Hellotax review here.](#)

How do you charge VAT?

This one is pretty simple. If you're VAT registered, you just need to add the VAT cost to the final price tag.

If you have a brick and mortar retail shop, for instance, you would just have to update your existing price tags with the new VAT price.

If you invoice for your services, you just need to add VAT to your invoices. When doing this, it's always good practice to break down the cost in the invoice and include VAT as a separate charge, rather than just increase the final price.

So on an invoice, you might have your expenses listed like this:

- Materials – £40
- Labour – £160
- Subtotal – £200
- VAT – £40
- Total payable – £240

This also makes it easier if you are charging another VAT registered company, as they'll be able to record and see how much VAT they are paying to later claim back on their returns.

How much VAT should you charge?

In the UK, the standard rate of VAT is 20%. So, in most circumstances, if you're VAT registered you'll charge an extra 20% for VAT.

So if something costs £50, you'll charge an extra £10 in VAT. This brings the total price to your customers to £60.

However, there are some items that have a reduced rate of 5%. This is for items like:

- Children's car seats;
- Home energy or power;
- Energy-saving materials, such as insulation or solar panels;
- Mobility aids for the elderly;
- Nicotine patches and gum.

Certain building and construction services also have a 5% tax rate, such as renovating a dwelling that's been empty for at least 2 years or converting premises to increase the number of dwellings in a building.

And just to be clear, a dwelling means a house, flat or another place of residence. So in this guide, if an old home got converted into a set of flats, it would fall under the 5% reduced VAT rate.

It's always good to keep an eye on these lists and changes for your business. For example, last year sanitary products fell under the 5% VAT rate. But as of the [1st of January 2021](#), [the government has stopped charging VAT](#) on these products.

Changes like this don't happen often, but they do happen. In fact, this change was only brought about after years of campaigns by those who work with vulnerable women and girls who cannot afford access to sanitary products. If you're selling custom artwork, it's very rare that you'll have a set of campaigners wanting to make that VAT free.

When not to charge VAT



There are some things that you don't charge VAT on, including items like health services, insurance or postage.

You can view other examples of non-VAT items in the earlier section, or view this full list on [the gov.uk website](#).

You also shouldn't charge for VAT if your business is not VAT registered.

How does VAT impact your tax returns?

Being VAT registered can make a big impact on your tax returns because you can claim back any VAT that you have paid on your purchases.

So, for example, if you're a builder that pays VAT on materials, you can claim back all this VAT at the end of the year.

What VAT can you claim back?

You can claim back on any VAT that your business has paid for. This is calculated through your VAT returns, which will basically deduct all the VAT you've paid for from the VAT you have charged as a business.

If you've paid for more VAT than you've charged, you'll get a nice big return from the HMRC.

Do you need to be VAT registered to charge VAT?

Yes. It's illegal to charge VAT if you are not VAT registered.

But that doesn't mean your company will need to register for VAT. In fact, for most small businesses or start-ups, VAT is something that you don't need to worry too much about, unless your threshold is exceeding £79,000 a year or if you are selling products or services that are not VAT exempt.

Or, of course, if you volunteer for VAT. Just jump to the relevant section in this article to find out all this information and more.

But for this question, let us break it down real simple.

Are you registered for VAT?

- Yes? Charge for VAT!
- No? Do not charge for VAT! It's illegal!

What happens if I charge VAT and I'm not VAT Registered?

As we've stated in the previous section, charging for VAT when you're not VAT registered is illegal. This means you're going to face some penalties here.

And by penalties, we mean you're going to have to pay up.

- As a minimum, the HMRC will charge you 10% of the VAT.
- At a maximum, the HMRC will charge you 100% of the VAT, plus interest until the amount is paid in full.

The exact percentage they'll charge you depends on how the situation came about. If it was down to a careless error or mistake that you disclose to them, they'll typically go easy on you. However, if you're deliberately tried to conceal VAT charges from them, you can expect to get hit with the full penalty here.

And here's a little heads up: don't try and sneak this past the HMRC. They'll find out and it won't be pretty.

What if I've charged VAT by mistake?



First up, don't panic. We can rectify this.

There are two things that you need to do if you've charged VAT by mistake.

1. Issue a credit note and refund to your customer

When you're doing this, take the time to explain the situation and what went wrong, so they can amend their own VAT tax records if they've claimed for it. It's best if we don't start a chain reaction of wrong tax returns from one mistake.

If you have more than one customer, you'll need to do this for everyone that you've incorrectly charged VAT to.

2. Make an unprompted disclosure to HMRC

You're going to have to come clean to the HMRC here before they find out and punish you.

It's like making a confession to your parents that you've broken one of their ornaments before they find it broken. This is one of those situations where you need to bite the bullet, rather than face the wrath when they eventually find out. And trust me, they'll always find out.

So, make a disclosure to HMRC and tell them how the situation came about. Make sure to show records of how you've refunded your customers as well.

The best-case situation here is that HMRC will go easy on you and charge the minimum 10% penalty to your business. It may seem harsh, but remember they could charge you a 100% penalty, and interest until it's paid in full.

The HMRC will look kindly to unprompted disclosures though, so take the 10% penalty as a slap on the wrist and let's learn from your lesson here.

VAT explained for dummies: a summary

VAT is a tax that applies to any non-essential goods or services. Most start up businesses won't need to charge for VAT, but if you:

- Have an annual turnover of over £85,000 a year;
- Sell goods or services that are NOT exempt from VAT;
- Are based in the UK.

You are legally obligated to register for VAT and you'll need to complete a VAT return.

You can also voluntarily register for VAT, which can be a benefit to some businesses as they'll be able to claim back VAT spent.

If you're unsure if you should be VAT registered, or if you need help completing your VAT forms, you'll want to talk to an accountant or make use of free VAT software like [Hellotax](#) for help and guidance.

For more information about accounting and starting your online business, be sure to check out the [Business4Beginners](#) website for more.