



Tax Points

Background

As most optical practices will realise, HM Revenue & Customs now run a risk based assessment policy in deciding which businesses they want to visit to verify their VAT returns. Whilst optical businesses are generally compliant in declaring their VAT liabilities it has come to the notice of the optical representative bodies that a number of optical practices have been visited by HMRC. What has become clear is that optical businesses are not always fully aware of their obligations in respect of VAT accounting and for this reason we have provided the following guidance which you may want to consider in the light of your current VAT accounting practices.

1. Full Cost Apportionment (FCA)

Many practices have been operating FCA for a number of years and over this time the cost base on which FCA is based will have changed which can affect the result of the calculation. As a general rule HMRC expect a business to review its FCA method every 3 years and in most instances this was confirmed in writing when the FCA method was initially agreed with HM Customs & Excise (as was).

Furthermore, there is usually a clause within the original FCA method that requires a business to undertake a new FCA calculation if there is a material change to the business. A material change can arise in a number of situations, the most common being:

- Acquiring or selling part of a business
- Change in the composition of partnership
- Change of legal entity – partnership to sole proprietor, partnership or sole proprietor to a limited company etc
- Moving to or opening additional premises.

Where there has been a material change in the business or three years have elapsed since your review of the FCA method, you should undertake a new calculation to determine the exempt value of the proceeds from the sale of spectacles and contact lenses. This new percentage relating to both exemption and taxable sales should be applied from the date the new calculation is undertaken. There is no requirement to notify HMRC that you have undertaken a new calculation but it should be available for verification by any officer undertaking an inspection of your business records.

2. Separately Disclosed Charges

An alternative to undertaking a Full Cost Apportionment calculation every three years is to utilise the Separately Disclosure Charges (SDC) option.

HMRC state in their published internal guidance

“Opticians will not be required to perform an apportionment of charges for spectacle sales if they make separate charges for the spectacles and the dispensing, thus establishing a separate consideration for each of the supplies. One of the normal criteria for establishing separate

considerations is that customers should be able to obtain the supplies separately at the individual specified charges should they so wish. This is not usually possible with dispensing services which are normally "tied to" the supply of spectacles. Customs have therefore relaxed this requirement and will accept that separate considerations have been established for the spectacles and dispensing if the charges for each are stated and made known to all patients at the time of the supply."

Customs do not consider that separate considerations have been established where:

- the costs of each supply and the final charge to the patient are recorded in the optician's accounts but only a single charge is disclosed to the patient; or
- separate charges are only disclosed to those patients who request the information.

If patients are informed of the charge for each supply, Customs does not require the optician to reveal how much of each charge is attributable to the cost of the supply and how much is profit or "mark-up". Nor do Customs require the charges to be disclosed by any particular method. However, whatever method of notifying the patient is adopted, the optician must be able to satisfy the local VAT business advice centre that the information is actually being conveyed to all patients, whether they have requested it or not.

If an optician is to go down the route of SDC care should be taken in establishing a proper and correct policy for establishing the values to be attributed to the supply of the frames and lenses and the supply of the dispensing services.

You may consider it appropriate in this instance to seek the appropriate professional advice.

3. DVLA Sight Tests

A number of practices have been approached to undertake sight tests on 'patients' at the request of the DVLA. There has been some confusion as to the correct VAT treatment of this income from the DVLA.

HMRC have ruled that this income is subject to VAT at the standard rate, as what is being provided to the DVLA is a medical report, which falls outside the allowed exemptions in the UK.

You should ensure that VAT is both charged to the DVLA on a VAT invoice and that output VAT is declared on your VAT returns.

This ruling by HMRC raises the question of the correct treatment of VAT incurred on sight testing equipment. This is dealt with in the partial exemption section below.

4. Partial Exemption

Regardless of the size of the optical practice, all VAT registered businesses are required to undertake a partial exemption calculation when they submit a VAT return (although this requirement has been relaxed to allow an annual calculation in certain circumstances). This calculation, undertaken when a VAT return is submitted, is provisional and subject to an annual adjustment which is normally carried out at the end of your VAT accounting year.

This partial exemption calculation allows you to determine the amount of input tax incurred, which can be attributed to the making of exempt supplies.

You are required to attribute the input VAT to the making of:

- Taxable supplies (frames, lenses and accessories); and
- Exempt supplies (sight test equipment)

Any other VAT, such as the overheads of the business, has to be attributed to the making of taxable and exempt supplies by use of what is known as the 'Standard Method', unless a business has agreed an alternative 'Special Method' with HMRC. It is only after undertaking this calculation that a business can decide whether it has to restrict the amount of input VAT it can recover on its VAT return as being attributable to the making of exempt supplies.

Generally any VAT which is attributed to the making of exempt supplies is irrecoverable. However, HMRC operates a de-minimis limit where you can be treated as fully taxable and able to recover all your Input Tax in any tax period if your exempt input tax is not more than:

- £625 per month on average; and
- Half of your total Input Tax in the relevant period.

So, if your exempt Input Tax is less than £7500 per annum (12 x £675 per month), you can recover all of the Input tax you have incurred in the year, but if the amount of Input tax attributable to the making of exempt supplies is more than £7500 you cannot recover any of that tax.

Partial Exemption rules require you, as stated earlier, to attribute VAT you incur to the exclusive making of taxable and exempt supplies and any VAT that cannot be attributed in this way falls to be treated under the Standard or agreed Special Method. Where a business purchases sight testing equipment, the VAT incurred on the equipment is treated as being used exclusively for the making exempt supplies and becomes potentially irrecoverable. However, if a business uses the equipment for making supplies of eye sight testing which are exempt from VAT and for preparing reports for the DVLA which are subject to VAT, then the VAT incurred is no longer exclusively being used in making exempt supplies and falls to be treated under the standard or special partial exemption method, which will provide an increased recovery of the VAT incurred.

The position regarding the recovery of the VAT incurred on the purchase of sight testing equipment for larger businesses is more complicated because HMRC have introduced additional requirements in order that the VAT can be recovered based on usage and professional advice should be sought on this matter.

Change in VAT rate effective from Jan 1 2010.

The standard rate of VAT was temporarily reduced to 15 per cent on 1 December 2008 and will return to 17.5 per cent on 1 January 2010.

For any sales of standard-rated goods or services that you make on or after 1 January 2010 you must charge VAT at the rate of 17.5 per cent. If you have a cash business and calculate your VAT using the VAT fraction you must revert to the VAT fraction of seven fortysevenths from 1 January 2010.

The change only applies to the standard VAT rate. There are no changes to sales that are zero-rated or reduced-rated for VAT. Similarly, there are no changes to the VAT exemptions. Any sales you make at these rates are unaffected by this change.

HMRC have clarified that, where a tax point occurs before 1 January 2010, the supply (or the part of it covered by the tax point) will remain liable to VAT at 15%. Tax points occurring on or after 1 January 2010 will be liable to VAT at 17.5%. This means that, where a prepayment or deposit is received before January 1 2010, VAT will be calculated at the 15% VAT rate if it relates in part or full to goods or services subject to the standard rate of VAT. If the balance of the transaction price is paid after Jan 1 2010, any part of this consideration attributable to the supply of standard rated goods or services will be accounted for at the 17.5% VAT rate.

Where the rate change falls part of the way through your VAT accounting period (return periods ending Jan or Feb 2010) you will have to undertake two apportionment calculations to reflect the Vat rate of 15% up to Dec31 2009 and 17.5% from Jan 1 2010.

If you give a refund after Jan 1 2010 which relates to a supply of goods made before the date of change, you will have to calculate the VAT refund based on a 15% VAT rate.

For purchases, Input VAT can only be recovered based on the amount shown as VAT on the purchase invoice regardless of whether or not the amount shown is at the incorrect VAT rate.

This change in the rate of VAT may well require your business to make changes to your accounting software to accommodate the increase in the VAT rate and consideration will also need to be given to any statements shown on invoices provided to customers where there are Separately Disclosed Charges.

You will also need to monitor the level of Exempt Input Tax your business incurs for the purposes of the Partial Exemption de-minimis limits as the value of your Exempt Input tax will rise by 2.5% but there is **no** corresponding rise in the monthly and annual limits.

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December 2009