

How to correct a VAT return

If you discover you have made a mistake on a past VAT return there are three things you should do:

1. Calculate the amount of VAT overpaid or under-claimed
2. Check if you must make a disclosure of the mistake to HMRC
3. If you do not have to make a disclosure to HMRC, check if you might be better off making a disclosure

1. Calculate the amount of VAT overpaid or under-claimed

At the end of the current VAT return period (quarter for quarterly returns and month for monthly returns), add up all the errors that were discovered during the current VAT period that relate to past VAT returns. Calculate the resulting amounts of output VAT and input VAT that are payable to/reclaimable from HMRC.

Normally an error must be corrected if it occurred in a VAT return period that ended within the last 4 years and an error cannot be corrected if it is in an earlier VAT return period. For example, if an error will be corrected in the VAT return for the quarter to 30 June 2011, the error corrections must include all VAT returns back to and including the return for the quarter ended 30 June 2007.

However the 4 year limit only applies if the error was not deliberate. If the error was deliberate, you must go back 20 years. Deliberate means the mistake was made knowingly and intentionally. Add up all the amounts that are due to HMRC and subtract all amounts that can be recovered from HMRC. The total is the net amount either owed to HMRC or to be reclaimed from HMRC.

Practical points:

- *Non-business / exempt -> taxable:* If you treated a supply as non-business or exempt and it should have been standard-rated or reduced-rate, you must pay over the output VAT due to HMRC. If the contract terms allow you to add on VAT retrospectively you can try sending customers belated VAT only invoices. Otherwise you must assume the amount charged was gross of VAT. You can now deduct any attributable input VAT that was previously treated as irrecoverable
- *Taxable -> exempt / non-business:* If you treated a supply as taxable and it should have been exempt or non-business, you must pay back any input VAT you originally recovered as attributable to the supply. You can in principle reclaim any output VAT paid to HMRC though HMRC may block the output VAT claim if they consider you would be "unjustly enriched" as a result of repayment
- *VAT methods:* You must take into account the effect on residual VAT recovery. This may necessitate the reworking of business/non-business and partial exemption methods, for each affected VAT period and again in any annual adjustment that includes an affected VAT period. The objective is to restate each affected VAT return, as if the error had never occurred
- *Adjustments that are not errors:* Normal adjustments due to the operation of the VAT system are not errors and do not have to be disclosed to HMRC, for example: claims for bad debt relief, the partial exemption annual adjustment, capital goods scheme adjustments, business / non-business annual adjustment, and adjustments due to the change of use of supplies ("pay back / claw back")

2. Check if you must make a disclosure of the error to HMRC

You must disclose errors discovered in the VAT quarter to HMRC if either:

- They are deliberate, or
- The net error (for all affected VAT returns) is greater than 1% of the figure in box 6 of the VAT return (total sales and other outputs, net of any output VAT) for the period in which the error was discovered, subject to a minimum of £10,000 and a maximum of £50,000

If the errors must be disclosed; write to: HMRC VAT Error Correction Team, Queen's Dock, 22 Kings Parade Liverpool L74 4AA Tel: 0845 601 0904. HMRC provide form VAT 652 (available on the HMRC website) for notify errors. There is no obligation to use the form but it is useful for indicating the information HMRC will expect to be provided with the disclosure.

If the errors do not need to be disclosed; you can adjust the current VAT return. Keep a detailed note of any adjustments made. However you may be better off disclosing the errors to HMRC. See following point.

Examples:

- In the quarter 06/11 a charity discovers errors in its VAT returns for the last two years. The charity assesses the error as non-deliberate. The net value of the errors is £15,000 owing to HMRC. The box 6 figure for the quarter 06/11 is £200,000. The error is greater than 1% of the box 6 figure (£2,000) and greater than £10,000 so must be disclosed to HMRC.
- The situation is as in a) above, but the box 6 figure for the quarter 06/11 is £2,000,000. The error is less than 1% of the box 6 figure (£20,000) and less than £50,000, so does not need to be disclosed to HMRC.
- The situation is as in a) above but the charity assesses the error as deliberate. The error must be disclosed to HMRC

3. Check if you must make a disclosure of the error to HMRC

Because of the way the penalty regime works, you may nevertheless prefer to disclose the error to HMRC. HMRC can charge a penalty for having submitted an incorrect VAT return. See the separate factsheet Penalties for incorrect VAT returns, for an explanation of how the penalty system for incorrect VAT returns works.

The amount of the penalty can be reduced if you make an unprompted disclosure of the mistake to HMRC. Simply correcting the current VAT return does not count as disclosure. Therefore to get any penalty reduction for unprompted disclosure you should disclose the error.

However you must weigh against this the risks of disclosure to HMRC:

Advantages of disclosure	Disadvantages of disclosure
<ul style="list-style-type: none"> • Obtain penalty reduction for unprompted disclosure • Provides certainty and finality • More likely to obtain penalty suspension if suspension is appropriate to the situation 	<ul style="list-style-type: none"> • Risk of HMRC imposing a penalty despite disclosure • Time involved in dealing with HMRC • Risk of triggering a wider HMRC inspection • May incur interest on amounts due