

## Ecommerce part 4 - VAT rules

If you have a business based in the UK, for most people the tax system is relatively simple. Although if you sell digital products online, then the EU rules on automated digital services may apply. Read on to find out what your tax situation is...

### Should I be VAT Registered?

If you earned more than £81,000 in the last year (based on 2015 tax rates) you must be VAT registered. If you earn below this, you can still register for VAT, but the benefits of doing so will be limited. See this page for more information about UK domestic tax rates

### What VAT rates do I need to charge in the UK?

What you charge in VAT depends on what you are selling, and who you are selling to. If you are selling within the EU, then there are 3 rates of VAT. These rates are:

#### **Standard Rate - 20%**

At the present time the standard rate is 20% on most items (thanks to the Clegg-Cameron cover upping the VAT in January 2011 from 17.5% to 20%). If the Tories win the next election, some have predicted that they might increase VAT rate after the May 2015 election. If this is the case, I will edit this article when that happens.

#### **Reduced Rate - 5%**

To qualify for reduced rate certain conditions have to be met. These conditions are affected by:

- who's providing them or buying them
- where they're provided
- how they're presented for sale
- the precise nature of the goods or services
- whether you obtain the necessary evidence
- whether you keep the right records

examples of reduced rate goods are sales of new houses, energy saving materials such as loft insulation (if they are installed in domestic houses, if they are installed in a prison, they do not qualify), mobility aids for the elderly, electricity and gas for domestic customers, child car seats,

#### **Zero Rate - 0%**

There is a long list of items that qualify for zero rate tax, including financial services, cycle helmets, newspapers and magazines, children's clothing, parking spaces, aircraft repair and maintenance, domestic water supplies, low vision aids and advertising services for charities and most food and drink. Although alcohol has its own duty level and you have to pay standard rate tax on confectionery, sports drinks, ice cream, soft drinks and hot takeaways.

## Tax Exempt and Outside the Scope of VAT

Some items are classed as tax exempt such as insurance or dental services. Other services are classed as 'outside the scope of VAT' - this includes charitable donations, road and bridge tolls, and selling personal possessions privately, or items sold outside of the EU.

There are some key differences between Tax exempt and Zero rated items. If you only sell tax exempt goods and services, then you cannot register for VAT. If you sell mainly zero rated items then you are taxed on a rate of zero, you can however apply to be exempt from registering for VAT in this case read this page for more information on the differences between zero-rated and tax exemption rules.

There is a full list of the VAT rates for goods on the HMRC website.

### [Do I Need to Show VAT Charges on my Ecom Website?](#)

If you are VAT registered, then the prices displayed on the website must be VAT inclusive. If you sell to both trade and standard customers, then you can display an ex-vat price in addition, but the inc. VAT price must be clearly indicated.

### [International VAT Charges](#)

If you are based in the UK and are selling goods within the EU, then you need to charge the domestic rate of VAT regardless of the member state's VAT rates. The amount you charge should be based on your home tax rules (see the tax rates section above).

Things start to get a bit more complicated when you have a business that has international connections. For example, if you have a server hosted in a different country, you cannot use the tax laws of that country to get away without paying VAT. It is where the business is based that determines the domesticity status. Even if you have registered a company in a different country, if your headquarters are based in the UK, or if you provide most of the services in the UK, then you are considered liable for UK tax.

### [US Nexus Regulations](#)

If your e-commerce website sells to the United States, then normally you are considered to be an off-shore tax case. However there are cases where your business could be liable to pay local US tax. If you have any employees, business premises, or even if you heavily advertise in a particular state of the US, you can be asked to pay that state's tax rates. This is called the 'Nexus Law'. The law was initially introduced in 1959 to cover goods and services that are offered in a particular state and to charge tax on those activities within their state. At the time, it was a relatively simple procedure to prove whether the business was liable under the Nexus Law, however, with the advent of online sales, this has become much more difficult to prove where the actual transaction takes place, for example if you are based in New York, and buy something from a UK based business as a present for your aunt living in California, where does

the tax jurisdiction take place? From the vendor's perspective, the tax should be paid in the UK, but what if the supplier is also based in New York so when you buy the product, you are buying items in New York sending money to the UK, but the goods are shipped to California.

Most states are currently grappling with this problem and there is an excellent page here: [http://www.cob.sjsu.edu/nellen\\_a/taxreform/economic\\_nexus.htm](http://www.cob.sjsu.edu/nellen_a/taxreform/economic_nexus.htm) which shows what each state is doing to address the confusion.

Recently, Amazon was ordered by Pat Quinn, the governor of Illinois, to pay taxes on sales generated by affiliates based in the state because those affiliates constituted a business Nexus. Amazon responded by immediately sending a notification to terminate all affiliate accounts for the state.

It is entirely possible that if you start doing a lot of business with some US states then you may find yourself being considered under the Nexus law - especially if you generate more than £10,000 net income from those states. In this situation, you may find that you will have to alter your business to allow for such eventualities, possibly by splitting your business into different segments, or by targeting business to more tax friendly locations.

#### E-commerce Tax Off-Shore

Elsewhere in the world, there is some competition to entice international online companies to host their businesses in different countries and enjoy the lower tax, regulation relaxed, modern infrastructure environment. Gibraltar is one such country which has good links to the eurozone (although Spain has been a slight barrier to this free trade). If you are based in Gibraltar, then you pay less VAT, and lower international shipping charges.

#### EU Rules for Automated Digital Services

Recently, it was announced that all businesses registered in the UK which sell 'automated digital services' will have to register for tax, regardless of their income. Essentially the rules govern businesses that sell online content only, including apps, digital music files, e-books, website hosting, online courses, online advertising or any other product that is automatically generated. This means that many small businesses who fall beneath the £81,000 threshold will have to register for VAT. Additionally, if you sell to any country in the EU, then you have to charge the applicable tax in the recipient's county. With 28 member states in the EU, each with different vat rates and rules, this could become very tricky indeed. The Inland Revenue attempted to simplify this process by creating a Mini One Stop Shop (MOSS) which allows you to pay into a VAT account then the IR calculates the amount of tax applicable for each member state. <https://www.gov.uk/register-and-use-the-vat-mini-one-stop-shop>.

There is a campaign at the minute to change the rules for small businesses, as registering for VAT is an expensive and time consuming process. Dave Cameron has announced that he will raise the issue at the summit in Brussels this week, but I wouldn't expect him to make much progress, especially since there an election in May and not many EU leaders look unfavourably

on him since he used a veto block and EU treaty in 2011, and has committed himself to a referendum in 2017.

In the meantime, if your business falls into this category, there are a few things you can do. Firstly, if you can, try to manually approve and deliver sales. For example, if you sell online courses, you could have a registration system that authorises funds, but requires you to manually capture the funds to approve the sale. One tactic is to write an email template, then when someone buys something from you, you physically send the email with the download link in it. Secondly, you could deliver a physical item to accompany your sale. Whether it's a printed certificate on completion of a course, a thank you letter or even a small postcard with their download password on it, it doesn't matter. If there is any manual activity that accompanies your business process, then you are excluded from the automated digital services rules.

### [Do I Need to Add VAT to Shipping Costs?](#)

In the UK, the rules governing VAT charges on shipping are detailed on this page of the UK Customs website.

At the minute, postal services offered by the Post Office are exempt from VAT (although this might change if the government decide to privatise this aspect of the Post Office). On 31st January 2011, the rules were changed so that special delivery and airsure are now standard rated.

If you are charging customers separately for postal services, then you might have to pay VAT depending on what you are sending. If you are delivering zero rated items like books then you do not pay VAT on the shipping costs. If you are sending standard rate items like jewellery, then you will have to pay VAT.

If you buy stamps from the post office as all or part of the shipping costs and then pass that cost on to your customers, then you need to add VAT on the whole price of the shipping.

### [What if I offer Free Delivery?](#)

If your delivery cost is included with the price of items (e.g., if your ecommerce website includes a Free Delivery service) then the VAT is added to the whole of the price of the items and therefore, the tax implication is already catered for, so if you are selling books with free delivery, then no vat is added, but if you are selling DVDs including free delivery, then you need to add VAT to the total price.

### [What if there is a separate charge for packing or gift wrapping?](#)

If you have a gift wrap option on your website, or if you have a separate charge for packing (eg if shipping delicate items you might add a surcharge to cover the extra padding costs), then the VAT rate is charged at the standard rate if the goods are to be delivered within the EU. This applies regardless of whether the items you are posting as standard rated or not. This is because

you are offering a separately charged service and does not fall within a single contracted supply of goods.

#### What if I offer a 'pick up in-store' option

Essentially, you are making a single contracted supply of goods if your ecom website has to deliver the items to the recipients address (or their friends/relatives address or their own customers address) and if your website does not have a 'customer pickup' option e.g. if you run a small shop and offer the option of customers coming in to the shop to pick up their goods. If you do offer a pickup service, then the option to deliver the items to the customer counts as an additional service and as such will be liable to VAT based on the nature of the delivered items. This is not affected by whether the charge you make for shipping is itemised separately or invoiced to the customer.

To be on the safe side, it is better to assume that you have to add VAT if the goods you are sending are rated for VAT.

What if I send both Zero rated and Standard rated items in the same shipment?

There is a lot of differing opinions online about how to handle mixed orders. According to this site, if you ship differently rated items from your online store, the VAT on the shipping charge should be apportioned according to the items being delivered, so if you are posting an order including a £10 book and a £20 mug, then the book is zero rated and the mug is standard rated (20%). If your shipping cost is £6 then the VAT on postage should be calculated based on 2/3rds of the shipping cost - i.e. 20% of £4 = £0.80. Obviously you only have to add this VAT cost if you are VAT registered and posting items to destinations within the Eurozone. This sounds like the most sensible way to handle VAT on postage costs for Ecommerce websites.