



HM TREASURY

Financial Reporting Advisory Board Paper

SSAP 5: *Accounting for Value Added Tax*

Issue:	Applying SSAP 5 <i>Accounting for Value Added Tax</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual.
Impact on guidance:	The proposed text in Annex A relates to the IFRS-based FReM.
IAS/IFRS adaptation?	No – there is no IAS/IFRS equivalent.
IPSAS compliant?	There is no IPSAS on this topic.
Interpretation for the public sector context?	Yes – the FReM interprets SSAP 5 for the public sector context.
Impact on budgetary regime?	No
Alignment with National Accounts?	Yes
Impact on Estimates?	No
Recommendation:	That the Board agree that SSAP 5 (as interpreted for the public sector context) continues to apply in full to those entities subject to the tax regime.
Timing:	Not yet known: depends on decision to move to EU-adopted IFRS.

DETAIL

Background

1. SSAP 5 *Accounting for Value Added Tax* seeks to achieve conformity of accounting treatment of VAT in financial statements and became effective for accounting periods starting on or after 1st January 1974.

2. VAT is a tax on the supply of goods and services, in the course or furtherance of any business, which is eventually borne by the final consumer but collected at each stage of the production and distribution chain. VAT rules are complex, but as a general principle the treatment of VAT in the accounts of a trader should reflect the tax collection role and be excluded from income and expenditure whether of a capital or revenue nature. Although SSAP 5 currently applies to all entities covered by the FReM, most government departments are not “businesses” for VAT purposes and are therefore outside the scope of the tax. Entities not accountable for VAT, will suffer VAT on purchases. For them VAT will increase the cost of all goods and services to which it applies and should be included in such costs. In particular, the VAT on fixed assets should be added to the cost of the fixed assets concerned.

Impact of SSAP 5 on public sector accounts

3. To avoid distortion of competition, section 41 of the VAT Act 1994 provides that HM Treasury can direct that supplies of goods and services by government departments should be treated as being within the course of a business if they are in general competition with the private sector. HM Revenue and Customs issue the directions covering supplies and the departments to which they relate. Departments are required to charge VAT whether or not the recipient of the supply is another government entity, provided that the supply is under a separate VAT registration to that of the recipient.

4. Section 41 of the VAT Act 1994 also provides that HM Treasury can direct that departments can claim refunds of VAT they incur on specified services acquired for non-business activities, with the aim of removing any disincentives to contracting out. Directions identify departments eligible to claim VAT refunds and the services for which refunds can be made. There are special rules in Northern Ireland that allow departments to reclaim all their VAT under section 99 of the VAT Act 1994.

IAS/IFRS compliance

5. There is no equivalent international accounting standard although the effect of this standard is achieved in IAS 18 ‘Revenue’, IAS 2 ‘Inventories’ and IAS 16 ‘Property, Plant and Equipment’. All are currently under revision.

IPSAS compliance

6. IPSASB does not consider UK GAAP against international public sector interpretations, there is therefore no IPSAS on this topic.

Impact on the budgetary regime

7. The current consolidated budgeting guidance follows the FReM, so continuing the interpretation of SSAP 5 for the public sector context in the IFRS-based FReM will have no impact on the budgetary regime.

Alignment with National Accounts

8. Where applicable, VAT payments are treated as public sector expenses in National Accounts while VAT receipts are treated as public sector income. Continuing the adoption of SSAP 5 will have no impact on National Accounts.

Impact on Estimates

9. The majority of government departments are outside the scope of the tax as their activities are not “businesses” for VAT purposes. Where, exceptionally, entities do account for VAT the estimates treatment follows the FReM.

Proposed text for the IFRS-based Government Financial Reporting Manual

10. See Annex A for the proposed IFRS-based FReM.

Summary and recommendation

11. SSAP 5 Accounting for Value Added Tax has no equivalent IAS/IFRS. Adopting IFRS will not change the UK tax regime therefore SSAP 5 will continue to apply in full to those entities covered by the IFRS-based FReM. The current interpretation of SSAP 5 for the public sector context will also continue in the IFRS-based FReM. Five RABIG members responded to consultation on this paper and are fully in agreement with its recommendations.

12. The Board is invited to approve the proposed text for the IFRS-based FReM at Annex A.

HM Treasury
11 December 2006

PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL

SSAP5 Accounting for Value Added Tax (VAT)

Applicability

SSAP5 applies in full to the entities covered by this manual. Most activities of government departments are not “businesses” for VAT purposes and are therefore outside the scope of the tax.

Objectives of SSAP5

The objectives of SSAP5 are to achieve, by presenting a standard accounting practice, uniformity of accounting treatment of VAT in financial statements.

Interpretation of SSAP5 for the public sector context

To avoid distortion of competition:

- a) section 41 of the VAT Act 1994 provides that HM Treasury can direct that supplies of goods and services by government departments should be treated as being within the course of a business if they are in general competition with the private sector. HM Revenue and Customs issue the directions covering the supplies and the departments to which they relate. Departments are required to charge VAT whether or not the recipient of the supply is another government entity, provided that the supply is under a separate VAT registration to that of the recipient;
- b) section 41 of the VAT Act 1994 provides that HM Treasury can direct that departments can claim refunds of the VAT they incur on specified services acquired for non-business activities, with the aim of removing any disincentive to contracting out. Directions identify departments eligible to claim VAT refunds and the services for which refunds can be made; and
- c) there are special rules in Northern Ireland that allow departments to reclaim all their VAT under section 99 of the VAT Act 1994.