HMRC - VATSC42100 - Background

The term “deposit” is generally used to describe any payment received in advance of the making of a supply. Usually deposits are intended as a demonstration of good faith on the part of the customer or to assist the supplier finance the supply.

Most deposit payments represent consideration since the amount paid will be offset against the full purchase price once the supply is made. Such payments fall within the scope of VAT and follow the liability of the supply. The tax point treatment is described in in the Time of Supply Guidance

Where a deposit is returned, for example if a contract is cancelled, it ceases to be consideration for a supply. A deposit that is retained in the event of the contract being cancelled becomes compensation for breach of contract and so ceases to be consideration. The only exception is when part of the supply has already been made in which case the deposit is regarded as being consideration for that part of the supply and tax must be accounted for accordingly.

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