

Return of the standard rate of VAT to 17.5%

As you are no doubt aware the standard rate of VAT is set to revert to 17.5% from 15% on 1 January 2010.

This briefing sets out the key issues for businesses and, in certain cases, you personally as an individual consumer.

Sales on or after 1 January 2010

For any sales of standard rated goods or services that take place on or after 1 January 2010 businesses should charge VAT at the new rate of 17.5%.

This means that where a business currently calculates their VAT using the VAT inclusive fraction of 3/23, they should, from 1 January 2010, revert back to using the VAT fraction of 7/47.

Tax point

The rate of VAT that businesses charge depends on the date that goods or services are supplied. For VAT purposes this is generally when goods physically change hands (or a service is provided). However, this basic rule is modified in certain situations so that the effective supply date may be earlier or later. For example, one key exception where the effective VAT date is later is where a business invoices within 14 days of the supply. An example where a supply is treated as made earlier is where a payment is received or an invoice is issued in advance.

However, special rules have to be considered in the circumstances when there is a change in the standard rate of VAT.

Special rules for sales that span the change in rate

The 17.5% rate generally applies to all VAT invoices issued by a business on or after 1 January 2010. However, if the goods were provided or the services completed before 1 January 2010 and the invoice is issued on or after 1 January 2010, you may apply the 15% rate.

This is of particular relevance where the customer cannot recover the input VAT because a 17.5% charge is an increased 2.5% cost.

This would include sales to:

- the general public
- a non VAT registered business
- a VAT registered business which can only recover a portion of the VAT due to the fact that it makes exempt sales.

Where the sale is to a fully taxable VAT registered business, as all the input VAT is recoverable there is no overall difference in the cost.

Credit notes

You can decide to apply this rule even if you initially issue a VAT invoice showing 17.5% VAT. If you do, you must issue a special credit note giving credit for the extra 2.5% VAT within 45 days of the rate change (ie by 14 February 2010) and, if appropriate, make a refund. You should not cancel the original invoice.

Deposits and advance payments

The normal rule is that VAT on a deposit or a prepayment is accounted for at the rate in force when you receive it.

Example

A deposit of £100 is received on 25 November 2009 for a bed that retails for a total cost of £1,000. The balance of £900 is paid when the bed is delivered on 11 January 2010.

The deposit is received before 1 January 2010 so VAT at 15% is due - $£100 \times 3/23 = £13.04$. The balance is received after 1 January so VAT at 17.5% is due - $£900 \times 7/47 = £134.04$.

Planning

There would be an advantage to the business and the customer of making an advance payment in this situation. If the bed is sold on the basis that the customer will receive a 2.5% VAT discount for full payment before 1 January 2010 then the business benefits from a cash flow boost.

Clearly you would expect there to be certain anti-avoidance legislation to limit the extent to which this type of planning could be used and some has been introduced. This is outlined for you below but, in practice, should affect very few businesses.

Anti-avoidance rules

A supplementary 2.5% charge will apply, becoming due on 1 January 2010, where:

- a supply spans 1 January 2010
- is liable at the standard rate
- is made to a person who cannot fully recover the VAT and
- one of four relevant conditions applies.

The relevant conditions are:

- A. the supplier and customer are connected parties; or
- B. the supplier funds the purchase of the goods or services (or grant of right); or
- C. a VAT invoice is issued by the supplier where payment is not due for at least six months; or
- D. the value of the supply (or aggregated amount of related supplies) is in excess of £100,000 (excluding VAT).

Some examples are included here to demonstrate whether the anti-avoidance rules will have an impact. If you are concerned as to whether any proposed transactions may be affected by these measures please contact us to review your position.

Examples

1. An accountancy practice issues a full VAT invoice to a personal tax client in December 2009 for the preparation and submission of their income tax return in January 2010. The correct rate is 15% and this transaction is not caught by the anti-avoidance rules.
2. A legal practice issues a full VAT invoice in December 2009 to a partly exempt business client for their retainer for 2010 in the amount of £50,000, plus VAT, payable by 31 March 2010. The invoice is correctly chargeable to VAT at 15%, since none of the anti-avoidance rules applies.
3. The same legal practice issues a full VAT invoice in December 2009 in respect of its 2011 retainer, payable on 1 January 2011. VAT at 15% is chargeable on the invoice but an additional 2.5% VAT

will become due on 1 January 2010, since there is more than six months between the date of the invoice and the due date for payment.

4. A car dealer takes full payment on 31 December 2009 for a new car to be delivered to his customer on 1 March 2010. VAT is correctly accounted for at 15%, since none of the anti-avoidance rules apply to these circumstances (unless the price of the car is over £100,000!).

A single supply of services which spans the change of rate

Where a business issues an invoice after 1 January 2010 for a single supply of services, which is carried out over a period of time spanning the 1 January 2010 (an example might be the decoration of a house which starts in November but is not completed until mid January), the whole supply would normally have to be charged at 17.5%. However, you may, if you wish, charge VAT at 15% on the work done up to 31 December 2009 and 17.5% on the remainder. You will have to be able to demonstrate that the apportionment between the two amounts accurately reflects the work done in each period.

Continuous supplies of services which span the date of change

Where a business makes continuous supplies of services, such as leasing of equipment (ie computers), it can normally choose either to issue regular invoices at intervals during the year or to issue one invoice covering a period of up to a year ahead, setting out the amounts due (including VAT) and payment dates.

Where an invoice is raised in 2010 (effectively partly in arrears) for say the three months to 28 February 2010, then the business could either charge 17.5% VAT on the full invoice or it may account for VAT at 15% on that part of the supply made before 1 January 2010.

Where an invoice has been issued in 2009 in advance, such as an annual invoice, then this must be replaced by a new invoice detailing the revised payments due on or after 1 January 2010 at the revised 17.5% rate. It should specifically refer to and cancel that part of the old invoice which has been superseded.

These rules also apply to continuous supplies of goods (ie gas and electricity).

If this applies to your supplies or if you wish to discuss the process of issuing annual invoices, please contact us.

Retail businesses

If a business makes mainly cash sales to customers not registered for VAT, for example a shop, restaurant or hairdressing salon, then the situation is generally more straightforward. The reinstated 17.5% rate will apply to all takings received on or after 1 January 2010.

The main exception to this rule is where a customer pays for something they have taken away (or the supplier has delivered) before 1 January 2010. In this case, the sale took place before 1 January 2010 and VAT must be accounted for at the rate of 15%.

Welcoming in the New Year

HMRC will allow certain businesses operating beyond midnight on 31 December 2009 to account for VAT at 15% on takings received up to the earlier of:

- the end of trading of the 31 December session or
- 6am on the morning of 1 January 2010.

This treatment is restricted to those businesses open at midnight on 31 December 2009 that account for VAT at the point of sale, such as businesses on a retail scheme - pubs, shops, restaurants, etc.

Electronic tills and accounting software

Electronic tills and accounting software will also need to be adjusted to reflect the revised standard rate. This will be a particular issue for those tills which are set up to provide VAT information.

Most accounting software packages do have a facility to change the rate of VAT or create an additional rate of VAT. If you would like any advice on adjusting your accounting package, please contact us.

Input VAT on business purchases

It is generally up to the supplier to ensure that the VAT is correct on any invoice that they issue. The customer can only claim back the VAT charged on the invoice in the normal way. If a supplier incorrectly charges 15% on or after 1 January 2010 instead of 17.5%, the customer can only claim back 15%. In such cases the customer can request that the supplier issues a credit note to cancel the incorrect invoice and a new invoice to show the correct amount.

Less detailed VAT invoices will not have a separate amount of VAT identified but since the rate used should be specified a similar procedure should be followed.

Fuel scale charges

There is no change to the fuel scale charges which have applied since 1 May 2009 but the VAT element has been recalculated.

The new amounts applicable from 1 January 2010 can be found in Annex C of HMRC's guide VAT – Reversion of the Standard Rate to 17.5% on the HMRC website at www.hmrc.gov.uk/VAT/forms-rates/rates/rate-rise-guidance.pdf

VAT returns

For many businesses the period of their VAT return will span 1 January 2010 and particular care will have to be taken to allocate supplies and purchases to the correct accounting period and to use the correct rate.

This will particularly affect businesses using Cash Accounting and certain other special schemes.

Mistakes

HMRC have stated that they will adopt a 'light touch' in relation to errors or mistakes made as a result of the change. Mistakes should be corrected in the normal way by making a voluntary disclosure or correcting it on the next VAT return (subject to the normal limit).

Cash Accounting

For those businesses that use Cash Accounting care needs to be taken. Although the scheme allows the business to account for VAT at the point that payment is received it does not affect the amount of VAT actually chargeable. Therefore receipts after 1 January 2010 should be correctly identified as supplies made at either the 17.5% or 15% rate. This means that VAT will be due at 15% on supplies you made before 1 January 2010, even if you receive payment on or after that date. The same applies to purchases that you make before 1 January 2010. You may only reclaim VAT of 15% on these, even if you pay for them on or after 1 January 2010.

To put this another way, businesses on Cash Accounting must follow the same procedures set out in this letter as regards identifying the correct rate of VAT chargeable and must account on their VAT returns for the actual amount of VAT charged according to the date of payment.

Annual Accounting

The rules for Annual Accounting should not require any adjustment as a result of the change to the standard VAT rate but if you do expect your VAT liability to change significantly before the end of the accounting period, please contact us to help you calculate revised instalments for consideration by HMRC.

Flat rate scheme

When the standard rate returns to 17.5%, the flat rate percentages will be revised. **It should not be assumed that these will be restored to the same rates applicable in November 2008.** It is expected that revisions will be made to some categories of business. The revised table of percentages to apply from 1 January 2010 is expected to be issued shortly.

If you have any concerns as to whether using this scheme will still be appropriate for your business or would like any further information on any of the matters raised here, please contact us.

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