

VAT rate change on 4 January 2011 – practical considerations for VAT registered businesses



CLIENT ALERT

On 22 June 2010, as part of his “tough but fair” budget, the Chancellor announced an increase in the standard rate of VAT to 20%, effective 4 January 2011.

This change will affect any VAT registered businesses that sell or purchase goods or services that are subject to the standard rate of VAT. Businesses should charge VAT at the rate of 20% on any sales of standard rated goods or services made on or after 4 January 2011. There are no changes to sales of goods or services that are charged at another rate of VAT.

Practical implications

How to account for the VAT rate change

If you are a retail business (e.g. a restaurant or a shop) making sales to non business customers and you do not have to raise VAT invoices, you must charge VAT at 20% on all takings received on or after 4 January 2011, unless the customer pays for something which was dispatched before 4 January 2011. In such cases, you must charge VAT at 17.5%.

If you are a business that sells mainly to other VAT registered businesses, and you have to issue VAT invoices, you must use the 20% rate for all VAT invoices that are issued on or after 4 January 2011 and which are issued within 14 days of you providing the goods or services.

Time of supply – a reminder

To determine when a sale of goods or services takes place, businesses must apply the “tax point” or “time of supply” rules.

The basic tax point for goods is normally the date when the goods are taken away by (or dispatched to) the customer or, in the case of services, the date the service is performed.

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However, the basic tax point is overridden if an actual tax point is created. If a business issues a VAT invoice or receives a payment before the basic tax point – then an actual tax point is created on the date the invoice is issued or payment is received, whichever is earlier. Similarly, if a business issues a VAT invoice up to 14 days after the basic tax point, then the date when you issue the invoice becomes the tax point.

Where a tax point occurs before 4 January 2011, the supply will remain liable to VAT at 17.5%. Where the tax point occurs on or after 4 January 2011, the supply will be subject to the standard rate at 20%.

Deposits or pre-payments

The rule for deposits and pre-payments is that you should account for VAT at the rate in force when you receive them. Therefore, if you receive the deposit or pre-payment before 4 January 2011, you should account for VAT at the rate of 17.5% on the deposit and at 20% on the balance. Businesses do have the option to charge VAT at 20% on the deposit which may simplify matters if the customer can recover VAT in full.

Special rules

There are special **optional** change of rate rules which businesses may be interested in applying. These rules can be adopted without reference to HMRC and can be applied selectively to different customers.

Goods or services provided before 4 January 2011

Where you provide goods or perform services before 4 January 2011 and raise a VAT invoice and, in some cases, receive payment after the VAT rate change, you can apply the 17.5% rate. You can do this even if you have already issued a VAT invoice showing the 20% rate provided you issue a special credit note giving credit for the 2.5% within 45 days of the VAT rate change. If your customer is VAT registered and therefore able to recover the VAT charged, this will not save them any tax.

Goods or services provided on or after 4 January 2011

Where you receive a payment or raise a VAT invoice before 4 January 2011 for goods or services you will be providing after that date, VAT would normally be applicable at 17.5%. However, under the special rules you may account for VAT at 20%. It may be more convenient to do this where your customer is VAT registered and can recover all the VAT you charge them. However, this will represent an increase in the cost to your customer if they

are unable to recover the VAT charged in full.

Supplies in progress on 4 January 2011

For supplies in progress on 4 January 2011, the normal rule is that where an invoice is issued or a payment received on or after that date, VAT is due at 20% even if part of the supply was undertaken before 4 January 2011.

However, the special rules apply here both in relation to continuous supplies of goods (gas, electric) and services (leasing equipment) and single supplies carried out over a period of time.

For continuous supplies, businesses may account for VAT at the 17.5% rate on that part of the supply made before 4 January 2011, even if the normal tax point occurs later (e.g. where a payment is received in arrears of the supply).

For single supplies of services (such as building contracts) which commence before 4 January 2011 but are not completed until after that date, the normal rule is that the whole supply should be charged at 20% - unless payment is received or a VAT invoice is issued before 4 January 2011. Under the special rules, businesses may choose to charge VAT at 17.5% on the work done up to and including 3 January 2011 and 20% on the remainder. However, businesses must be able to demonstrate that the apportionment accurately reflects the work done in each period.

Anti-forestalling legislation

In addition to the Special Rules detailed above, VAT anti-forestalling legislation has been introduced as part of the Finance (No. 2) Act 2010. The legislation is designed to restrict the extent to which businesses can apply the 17.5% rate to supplies of goods or services provided after 4 January 2011. The legislation will affect businesses if they receive a payment or issue a VAT invoice before 4 January 2011 for goods or services to be provided on or after that date and one of the following conditions is met:-

- you provide or arrange funding of your customer's payment;
- you supply the goods or services directly or indirectly to a connected person (such as another business controlled by you);
- you issue a VAT invoice to your customer that does not have to be paid in full within six months; or
- the payment or VAT invoice is in excess of £100,000 and this is not



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normal commercial practice.

Even so, this legislation will not affect a business whose customer (the recipient of the supply) can recover VAT on that supply in full. In practice, therefore, this legislation is unlikely to affect many businesses.

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