

A quick guide to the VAT rate change



The standard rate of VAT increases from 17.5% to 20% on 4 January 2011. The reduced rate (5%), the zero rate and current exemptions are not affected by the change.

The VAT fraction used to calculate the VAT figure in an inclusive invoice will be 1/6.

Time of supply rules

Goods

A basic tax point is created at the date the goods are removed or made available to the customer.

An actual tax point overrides a basic tax point and is created if a tax invoice is issued or payment is received before the basic tax point or a tax invoice is issued within 14 days of the basic tax point.

Services

A basic tax point is created at the time a service is performed. This is usually the date when the service is completed.

An actual tax point overrides a basic tax point and is created if a tax invoice is issued or payment is received before the basic tax point or a tax invoice is issued within 14 days of the basic tax point.

Continuous supplies of services

A tax point is only created at the time an invoice is issued or a payment is received.

Application of tax point rules

Under the normal rules where a tax point occurs before 4 January 2011, the supply is liable to VAT at 17.5%. In the instances

where it occurs on or after 4 January 2011 the supply will be liable to VAT at 20%.

Special rules

There are special rules that apply to supplies completed before the change of rate. Under the time of supply, rules outlined above will apply VAT at 20% providing you raise a VAT invoice or receive a payment after 4 January for goods supplied or services performed before 4 January 2011. However, there are optional rules that can be applied in certain circumstances.

These optional rules can be applied selectively to different customers and can be applied without notifying HMRC.

The special rules apply if goods are provided or services completed before 4 January 2011 and invoiced or payment received after that date. In such circumstances you can, if you wish, apply the 17.5% rate to the supply. You can do this even after you have issued an invoice showing 20% VAT providing you issue a special credit note giving 2.5% VAT within 45 days of the rate change.

Supplies that are in progress on 4 January 2011, where a service commences before 4 January and is still in progress after that date, the normal rule would mean that 20% VAT would apply to any invoice or payment received after 4 January 2011. However, under the special rules, an invoice or payment can be apportioned between the work carried out up to 3 January 2011 with VAT charged at 17.5%, and that from 4 January 2011

subject to VAT at 20%.

It is also permissible under the special rules to apply the 20% rate to payments received or invoices raised before 4 January 2011 in respect of goods or services you will be delivering after that date.

If your client or customer is able to recover all the VAT he/she incurs there is little benefit in operating the special rules.

Anti-avoidance

There are anti-avoidance (forestalling) rules to prevent the use of schemes to advance tax points to a date before the rate change. These rules are unlikely to affect you unless:

- ▶ you receive prepayments from persons connected to you for future supplies
- ▶ you issue advance VAT invoices to persons connected to you for future supplies
- ▶ you provide or arrange funding for your customers to enable them to pay in advance for goods or services to be supplied by you
- ▶ you issue VAT invoices that do not have to be paid for at least six months
- ▶ you receive prepayments or issue advance VAT invoices in excess of £100,000, and this is not normal commercial practice
- ▶ you supply rights or options to receive goods and services from you free of charge or at a discount.

Retailers

Retailers that use one of the retail schemes where the rate change occurs part way through a VAT period will need to carry out two retail scheme calculations, one applying the 7/47 VAT fraction to receipts before 4 January 2011 and one applying the 1/6 VAT fraction to receipts after the 4 January 2011.

Retailers who normally collect direct debit payments between the 1st and the 3rd of the month will be affected by the New Year bank holiday, as payments cannot be collected until 4 January. This income will therefore be subject to VAT at 20%, unless direct debits can be advanced and invoices issued before 4 January to establish an actual tax point.

Special schemes

- ▶ The **agricultural flat rate scheme** will not be affected. The flat rate charge will remain at 4%.
- ▶ The **annual accounting scheme** - HMRC will not vary payments already notified.
- ▶ The **cash accounting scheme** - while the cash accounting scheme allows a business to account for its VAT liability when payment is received, it does not affect the tax point. The tax point is the time when the sale is made under the law and it determines the rate of tax applicable. This means that VAT will be due at 17.5% on supplies made before 4 January 2011, even if payment is received on or after that date.
- ▶ The **flat rate scheme** - Flat rate percentages will be adjusted to reflect the increase in the VAT rate.
- ▶ **Payment on Account Regime** - POAs apply to businesses with a current VAT liability of £2m. The payments are calculated on the VAT liability of the business in the previous year. HMRC will adjust the entry and exit thresholds of the scheme to reflect the change of rate.
- ▶ **Second hand margin schemes** - the normal rules for retail sales will apply.
- ▶ **Tour Operators Margin Scheme (TOMS)** - the special tax point rules for TOMS will apply. Where the financial year starts before and ends after 4 January 2011, the TOMS calculation must be modified.

Particular types of businesses

Barristers

The usual rule for barristers is that fee notes do not become VAT invoices until they are receipted, the tax point is therefore normally the date payment is received. If this is after 4 January, the income will be liable to 20% VAT. However, barristers may take advantage of the special rules and apply 17.5% for cases completed before 4 January.

Clubs and associations

The tax point for membership subscriptions is normally at the start of membership year when a VAT invoice is issued or the subscription is received, whichever happens first. However, there is no requirement to make any adjustment where VAT has previously been accounted for 17.5% on subscriptions renewed before 4 January 2011, even if the membership year extends into 2011.

Construction services

Stage payment contracts

Where there are supplies under a construction contract which involves the customer making stage payments, the tax point is normally the time a VAT invoice is issued or a payment is received, whichever happens earliest.

Work completed before 4 January 2011

Under the normal rules, VAT invoices issued and payments received on or after 4 January 2011 will be liable to 20% rate. This includes retention or final account payments. However, if they relate to work completed before 4 January 2011, the special change of rate rules can be used to apply the 17.5% rate.

Work in progress on 4 January 2011

VAT invoices issued or payments received under a stage payment contract on 4 January 2011 or after will be liable to VAT at 20%. However, the special change of rate rules can be applied if a VAT invoice is issued or a payment is received (including retention or final account payments) which covers work actually performed up to 4 January 2011. Where necessary, a contractor should apportion the amount involved (based on measurable work or

normal costing or pricing structures) and recalculate the VAT at 17.5% on the element of the work performed before 4 January 2011. The calculation must be carried out on a fair and reasonable basis.

Other (single payment) construction contracts

If the customer makes only a single payment (excluding any agreed retention), for example, when the work has been completed or is nearing completion, the supply is liable to the normal tax point rules including a final (basic) tax point when the work is completed.

Work completed before 4 January 2011 and work in progress on 4 January 2011

As above, the special change of rate rules can be used to apply the 17.5% rate.

Solicitors

Most supplies are covered by the normal tax point rules including a tax point on completion of the work. Where a VAT invoice is issued or a payment is received after 4 January 2011 for work that was completed before 4 January 2011, the special rules can be used and VAT accounted for 17.5%. Where work commenced before 4 January 2011 but will not be completed until or after 4 January 2011, a VAT invoice can be apportioned between the supply liable to 17.5% and that liable to 20%.

If Standard Monthly Payments (SMPs) are received from the Legal Services Commission for legal aid work, the VAT treatment under the agreed procedures depends on the extent to which each payment relates to completed cases. The special change of rate rules can be applied to cases in progress on 4 January 2011 that have not already been partly paid for through an earlier SMP. In other words, an SMP received after 4 January 2011 that relates to work on a case partly performed up to the date of the change can be apportioned.

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