

Sales on or after 4 January 2011

For any sales of standard rated goods or services that take place on or after 4 January 2011 businesses should charge VAT on standard rated supplies at the new rate of 20%.

This means that businesses currently calculating their VAT using the VAT inclusive fraction of 7/47 should, from 4 January 2011, use the new VAT fraction of 1/6.

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.

Goods/ services provided before the change

The new rate generally applies to all VAT invoices issued by a business on or after 4 January 2011. However, where a business issues an invoice on or after 4 January 2011 and the goods or services were provided prior to 4 January 2011, the business may apply VAT at 17.5%.

Goods provided after the change

If a business has received a payment or issued an invoice before 4 January 2011 but the goods will be provided (or services delivered) after 4 January 2011 then the supplier has a choice, either:

- to leave the VAT charged at 17.5%; or
- to account for VAT at the new 20% rate

Deposits and payments made in advance

The normal rule is that VAT on a deposit or a payment made in advance is accounted for at the rate in force when the payment is received.

Example

A deposit of £250 is received for bathroom furniture on 28 December 2010, with the balance of £500 being payable on 15 January 2011, when the furniture is delivered. The deposit of £250 includes VAT at 17.5%, but as the balance is received after the rate change, the £500 will be treated as including VAT at 20%.

Planning

This gives an opportunity for planning, to maximise cashflow for the business and minimise the VAT cost. If the business asks for payment prior to 4 January 2011, or issues a VAT invoice for the goods prior to 4 January 2011, the balance of £500 will include VAT at 17.5%.

This has the benefit of improving profits for the business, as less VAT is included in the balancing payment. Alternatively, the business could pass on the VAT saving to the customer, thus encouraging early sales and speeding up cashflow.

Please contact us to discuss whether your business could take advantage of advance invoicing or payments.

Anti-avoidance rules

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.

A supplementary 2.5% charge will apply, becoming due on 4 January 2011, where:

- a supply spans 4 January 2011
- 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 architect issues a full VAT invoice to an individual in December 2010 for the preparation and submission of their planning application at the end of January 2011. The correct rate is 17.5% and this transaction is not caught by the anti-avoidance rules.
2. An accountancy firm issues a full VAT invoice in December 2010 to a fully taxable business client for due diligence services to be performed in March 2011, for the amount of £50,000, plus VAT, payable by 1 July 2011. The invoice is correctly chargeable to VAT at 17.5%. The anti-avoidance rules do not apply as the customer can recover all of the input tax.

3. A legal practice issues a full VAT invoice to an individual in December 2010 in respect of its 2011 retainer, payable on 1 July 2011. VAT at 17.5% is chargeable on the invoice but an additional 2.5% VAT will become due on 4 January 2011, since there is more than six months between the date of the invoice and the due date for payment.
4. A kitchen retailer takes full payment on 31 December 2010 for a new kitchen to be delivered to his customer on 1 February 2011. VAT is correctly accounted for at 17.5%, since none of the anti-avoidance rules apply to these circumstances (unless the price of the kitchen is over £100,000!).

A single supply of service which spans 4 January 2011

Where a business issues an invoice on or after 4 January 2011 for a single supply service, which is carried out over a period of time spanning 4 January 2011 (HMRC quotes the example of a decorator decorating a house) the whole supply can be charged to VAT at 20%. However, VAT may be accounted for at 17.5% on the work done up to and including 3 January 2011, with the remainder of the work being charged to VAT at 20%. The apportionment must accurately reflect 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, 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. The tax point is the earliest of the date an invoice is issued or the date a payment is received.

Any invoices issued or payments received on or after 4 January 2011 should be subject to 20% VAT. However, any services supplied in the charging period before 4 January 2011 can be subject to VAT at 17.5%, even where payment is received in arrears, where a reasonable apportionment can be calculated. This means that if an annual invoice was issued, it must be replaced by a new invoice, detailing the revised payments due after 4 January 2011 at the new 20% rate. It should specifically refer to and cancel that part of the old invoice which has been superseded.

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

Credit notes

Where credit notes are issued against sales, the VAT should be credited at the same rate as the original invoice.

Retail businesses

If a business makes mainly cash sales to customers not registered for VAT, for example a shop, restaurant or hairdressing salon, all takings on or after 4 January 2011 should be subject to 20% VAT.

To increase gross prices for the extra VAT, you must multiply your current prices by 120/117.5. It is up to each individual business to decide whether it wants to pass the VAT increase onto its customers in this way. If you do not want to pass on the increases, you will simply apply the new fraction of 1/6 to your existing prices.

The main exception to this rule will be where a customer pays for something they have taken away (or the supplier has delivered) before 4 January 2011. In this case, the sale took place before 4 January 2011 and VAT must be accounted for at the rate of 17.5%.

Retail VAT invoices, if issued, must show the correct rate of VAT applied to the transaction, so you must ensure that your invoices are updated on 4 January 2011.

It is common for retailers to give refunds, particularly in the period after Christmas. If you give a refund on or after 4 January 2011 for a sale made before 4 January 2011 you will have to account for this at 17.5% VAT.

Electronic tills and accounting software

Electronic tills and accounting software will also need to be adjusted to reflect the new 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. It may be preferable to create a new 20% rate, rather than delete the 17.5% rate, as some businesses (especially those who use cash accounting) will need the old standard rate for certain transactions for some time to come. 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 will then use it to claim back the VAT charged in the normal way. If you receive an invoice prior to 4 January 2011 for goods which are to be received on or after 4 January 2011, the supplier can choose whether to charge VAT at 17.5% or 20%, so either amount may be shown and therefore reclaimed.

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 2010 but the VAT element has been recalculated.

The new amounts applicable from 4 January 2011 can be found in Annex C of HMRC's guide VAT – Change in the Standard Rate on the HMRC website at www.hmrc.gov.uk/vat/forms-rates/rates/rate-rise-guidance.pdf.

Mistakes

Mistakes should be corrected in the normal way by correcting it on the next VAT return (subject to the normal limit). You may also want to consider making a voluntary disclosure.

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 due. Receipts and payments after 4 January 2011 should be correctly identified as supplies made or received at either the 17.5% or 20% rate.

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

New flat rate percentages apply from 4 January 2011. The revised table of percentages which are to apply to supplies made from 4 January 2011 can be found in Annex D of the guide referred to above.

Please note that the flat rate percentages do not automatically increase by 2.5%!

The appropriate flat rate must be applied to each transaction. Therefore, if you account for VAT using Cash Accounting, you must look at the date of the original supply in order to determine the correct flat rate to apply.

The scheme limits are changing due to the increase in the standard rate of VAT. From 4 January 2011, a business must leave the scheme when income in the last twelve months exceeds £230,000, unless this is due to a one off transaction and income will fall below £191,500 in the following year. A business must also leave the scheme if there are reasonable grounds to believe that total income is likely to exceed £230,000 in the next thirty days.

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