



Reduction in the standard rate of VAT

As you are no doubt aware Chancellor Alistair Darling has announced a reduction in the standard rate of VAT from 17.5% to 15% for the period 1 December 2008 to 31 December 2009.

This note sets out some of the key issues for businesses and you personally as an individual consumer.

Sales on or after 1 December 2008

For any sales of standard-rated goods or services that take place on or after 1 December 2008 businesses should charge VAT at the new rate of 15%.

This means that businesses currently calculating their VAT using the VAT inclusive fraction of 7/47 should, from 1 December 2008, use the new VAT fraction of 3/23.

Tax point

The rate of VAT that businesses charge depends on the date that goods or services are supplied. For VAT purposes this is the earlier of the date that:

- goods physically change hands (or a service is provided); or
- payment is received; or
- an invoice is issued.

The rules are modified slightly in certain situations including the circumstance when there is a change in the standard rate of VAT.

Sales to VAT registered businesses

The new rate generally applies to all VAT invoices issued by a business on or after 1 December 2008. There are, however, two main exceptions to this rule:

- where a business has provided goods or services more than 14 days before the issue of a VAT invoice (HMRC uses the example of a business which issues a VAT invoice on 1 December 2008 for goods or services provided before 18 November 2008); or
- where a business has received payment before 1 December 2008.

In both of these cases, as the sale takes place before 1 December 2008, the old rate of 17.5% should be used.

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Sales that span the change in rate

However if a business has received a payment or issued an invoice using the old 17.5% rate before 1 December 2008 but the goods will be provided (or services delivered) after 1 December 2008 then the supplier has a choice, either:

- to leave the VAT charged at 17.5% (and account for that to HMRC); or
- to account for VAT at the new 15% rate and issue a VAT credit note to the customer for the reduction in VAT and, if appropriate, to make them a refund.

If the customer has paid, but the business hasn't yet issued a VAT invoice, it may account to HMRC for VAT at 15% and would normally be expected to refund the difference to the customer.

A single supply of service which spans 1 December 2008

Where a business issues an invoice after 1 December 2008 for a single supply service, which is carried out over a period of time spanning the 1 December 2008 (HMRC quotes the example of a solicitor preparing a Will) the whole supply can be charged to VAT at 15%. If any VAT has already been accounted for at 17.5% because a customer has made a payment on account, the business can still apply the 15% rate, issuing a refund/credit note as required.

Continuous supplies of services which span the date of change

Where a business makes continuous supplies of services, such as leasing of equipment (eg 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. Any invoices issued or payments received on or after 1 December 2008 should be subject to 15% VAT. This means that the annual invoice must be replaced by a new invoice, detailing the revised payments due after 1 December 2008 at the new 15% 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 for sales that span 1 December 2008, they must be issued within 45 days of 1 December 2008.

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 new rate will apply to all takings received on or after 1 December 2008.

The main exception to this rule will be where a customer pays for something they have taken away (or the supplier has delivered) before 1 December 2008. In this case, the sale took place before 1 December 2008 and VAT must be accounted for at the rate of 17.5%.

In the run up to Christmas it may well be that a retailer has taken a deposit before 1 December 2008 for goods intended as Christmas presents which will be delivered after the 1 December 2008. The business may choose, in this instance, to account for VAT at either the old or the new rate, but should remember to issue a credit note to the customer where an invoice at the old rate is already in existence.

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 15% 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. After 1 December 2008 most input tax claims will be for the amount shown on the invoice, with the only exception being where a supply is made on or after 1 December 2008 and the supplier has incorrectly charged VAT at 17.5%. In these circumstances businesses are only entitled to claim 15% from HMRC and the remaining 2.5% is due from the supplier.

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 2008 but the VAT element has been recalculated.

The new amounts applicable from 1 December 2008 can be found in Annex D of HMRC's guide VAT – Change in the Standard Rate on the HMRC website at <http://www.hmrc.gov.uk/pbr2008/vat-guide-det.pdf>

VAT returns

For the majority of businesses the period of their VAT return will span 1 December 2008 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 due and receipts after 1 December 2008 should be correctly identified as supplies made at either the 17.5% or 15% 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 for most but not all categories of business. The revised table of percentages which are to apply to supplies made from 1 December 2008 can be found in Annex E of HMRC's guide VAT – Change in the Standard Rate. This can be found on the HMRC website at <http://www.hmrc.gov.uk/pbr2008/vat-guide-det.pdf>.

Please note that the flat rate percentages have not reduced by 2.5%!

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.

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