

VAT Change

What Happens Now?



The standard rate of VAT was reduced in the Pre-Budget Report on 24 November 2008, the first cut in standard rate VAT since 1974. The reduction from 17.5% to 15% only applies for the period from 1 December 2008 to 31 December 2009 – it will then revert back to 17.5% on 1 January 2010.

The rate change presents a number of challenges to clients – here are some of the key issues:

VAT fraction

The VAT fraction is used to calculate the VAT element of a price inclusive of VAT. For a 15% rate of tax, the relevant fraction is 3/23. So if you fill up your car with petrol costing £50, the amount of VAT you have paid after 1 December is £6.52, ie $£50 \times 3/23$. The VAT fraction for the 17.5% rate is 7/47.

Price adjustments

For clients who need to reduce the price they charge for goods or services sold on a VAT inclusive basis, the key fraction is 46/47 of the current selling price. So if an item sold before 1 December is priced at £11.75, the new price to ensure the VAT saving is fully passed on to customers is $£11.75 \times 46/47$, ie £11.50.

It is important to remember that the price of zero-rated, reduced rate (5% VAT) or exempt items is unaffected by the VAT cut (eg food, books, newspapers). Only the price of standard rated items needs to be changed.

Deposits paid or invoices raised in advance

If a business has raised invoices or received payments from customers before 1 December 2008, then VAT will have been correctly accounted for at 17.5%. This is fine – but if the goods or services are actually supplied after 1 December, then the supplier may make an adjustment so that VAT is only charged at the rate of 15%.

The adjustment must be made by issuing a credit note to correct the original invoice – the supply is then based on the 15% rate of VAT. This process is optional for a supplier and will only be worthwhile if the customer is unable to fully reclaim the VAT himself.

Work overlapping 1 December

There is good news for clients providing services (eg a builder) where the work is started before December and finished after this date. In such cases, the VAT charge is based on the new rate of 15% when an invoice is raised or payment received at the end of the job. There is no need to apportion the VAT on a time basis between, for example, November and December work.

Credit notes raised after 1 December

In cases where an invoice was raised before 1 December (charging 17.5% VAT) then any credit note subsequently raised against the invoice (eg to correct a pricing error or if some of the goods are returned) will be based on the percentage of VAT charged on the original invoice. So the credit note will refund VAT based on 17.5% even though it is being raised after 1 December. This may cause some software problems for clients using computerised systems – a manual credit note may be the best option.

Flat rate scheme

Many businesses with annual taxable sales of £150,000 or less adopt the flat rate scheme, ie where VAT is paid by applying a specific flat rate percentage to the gross sales made by the business. The positive news is that most of the flat rates have been reduced from 1 December to reflect the lower rate of VAT.

A full list of revised rates can be found in Appendix E of the VAT technical guide on the HMRC website at <http://www.hmrc.gov.uk/pbr2008/vat-guide-det.pdf> or by telephoning the VAT National Advice Service helpline on 0845-010-9000 (open Monday to Friday from 8am).

Road fuel scale charges

Many businesses reclaim input tax on the road fuel they purchase for cars and account for output tax using scale charges published by HMRC to reflect private use. New scale charge rates apply from 1 December – details are again available in Appendix D of the VAT technical guide on the HMRC website at <http://www.hmrc.gov.uk/pbr2008/vat-guide-det.pdf>, or from the National Advice Service helpline.

Fee bills and invoices

Many professional businesses will have raised 'request for payment' notes to clients in October or November in relation to work carried out on an ongoing basis. These documents are not tax invoices. For VAT purposes, this is known as a 'continuous supply of services' arrangement and VAT is payable according to the date when any tax invoice is raised or payment received from the customer, whichever happens first.

In the case of 'request for payments' notes raised in October or November, these will have requested VAT to be paid at 17.5%. If these requests are paid after 1 December, then VAT is actually only due at 15%. So this will create a credit balance on the customer's ledger, which must either be repaid to the customer or carried forward to the next period.

