



# VAT Rate Increase

## The standard rate of VAT will rise to 17.5% from 1 January 2010.



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This raises a range of questions and issues for businesses to consider. For example:

- Should you take advantage of special rules that allow you to charge the old rate or apportion your supply between rates?
- Can your purchase system cope with posting invoices with multiple rates?

Although HMRC has agreed to adopt a 'soft touch' in respect of penalties, at least for the first VAT return errors

could still prove costly. It is as well to consider how you will deal with the rate change as soon as possible. There are not only systems issues but also potentially staff issues – the rate change occurs at a time when many traditionally take leave.

**Our VAT team can assist you with any rate change questions. We will be available between Christmas and New Year. Please contact Peter Ladanyi, Sharon Parker or visit [www.cvsdfk.com/services/vat](http://www.cvsdfk.com/services/vat)**

## The rate rise

**The VAT rate rise will apply to all standard rated supplies. These are supplies that are not otherwise relieved by a zero rate, a reduced 5% rate or a VAT exemption. The change does not alter the VAT treatment of any supplies with these VAT liabilities.**

The VAT rate rise will take effect on 1 January 2010. This will generate different issues to those which accompanied the December 2008 fall in rate. The reason is in part because of the transitional provisions which allow VAT to be accounted for at the rate which applied when a supply occurred rather than when invoiced.

Since more businesses get paid after they have done work than before, these transitional provisions are used more when the VAT rate rises.

A rise in the VAT rate last occurred in April 1991 and under different legislation, which means that the issues have not been recently rehearsed. The principles at stake relate to **tax points** which determine when a supply takes place for VAT purposes. Although these normally have a cashflow consequence this is usually inconsequential and as a result both taxpayers and HMRC have tended to overlook whether the rules are correctly applied. With a rate change they become fundamental as they will determine what rate of VAT applies. It is therefore important you consider the tax point rules and whether you apply them correctly.

### Tax points

Tax points determine when a supply has been made and what rate of VAT will apply.

There are two types of tax points. A **basic tax point** occurs when a supply is made. In the case of goods, this will be when you make the goods available. In the case of services it will usually be when you finish performing the service.

However, you normally account for VAT at the time of the **'actual tax point'**. This can be before the basic tax point if you obtain payment or issue an invoice in advance. Alternatively, providing an invoice is issued within 14 days it can occur after the basic tax point. If you do not issue an invoice within 14 days then you must account for VAT at the time of the basic tax point. Regardless, all businesses have an obligation to issue an invoice within 30 days of the basic tax point.

There are special rules for **'continuous supplies'**. These are supplies made under an ongoing engagement. Here there is no basic tax point and VAT is accounted for at the time of the invoice or payment if this is before – the actual tax point. Examples may include the services of: equipment hire, consultants and accountants.



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## Tax point examples

### A business has July, October, January and April VAT return periods

- 1 Supply goods on 20 October 2009 = Basic tax point.  
Issues invoice on 1 November 2009 = Actual tax point  
VAT accounted at actual tax point, as invoice issued within 14 days i.e. on the November – January return.
- 2 Supply goods on 1 October 2009 = Basic tax point.  
Issue invoice on 1 November 2009 = Not an actual tax point  
Here the invoice has been issued more than 14 days after the basic tax point. Unless permission has been given to extend the invoice period then VAT will be accounted at the basic tax point i.e. on the October VAT return.
- 3 Supply service on 1 November 2009 = Basic tax point.  
Receive payment in advance of work on 19 October after issuing Invoice = Actual tax point.  
Account for VAT at date of actual tax point – on the October return.

## Charging VAT - What rate of VAT to account for when the VAT rate changes

### Normal 'single' supplies

When the VAT rate changes there is an optional accounting treatment that allows you to account for VAT at the rate applicable at the time of the basic tax point.

Since a supply is more usually paid for after it occurs this alternative treatment was not much used when the VAT rate fell in 2008. When the rate rises there is obviously far more potential

If you decide to use the alternative treatment you can opt for all or some of your supplies. You do not need to notify HMRC or seek their permission. Obviously if you do then your accounts system will have to be able to cope with being able to issue invoices with different rates of VAT.

If you take a deposit prior to 1 January and make the supply afterwards you can account for VAT on the deposit at 15% and the balance at 17.5%.

### Examples

- 1) You make a supply of goods on or before 31 December 2009 and issue a VAT invoice on 5 January 2010. If you wish, instead of accounting for VAT at 17.5% you can account for VAT at 15% as the basic tax point created by the date of the supply was prior to the 1 January rate change.
- 2) You made a supply on 18 November 2009 and issued an invoice at the time. You have yet to be paid in January 2010. Here you must account for VAT at 15% as there was both an actual and basic tax point in November.

### Services in progress

If you provide a supply of a service to a customer that straddles the rate change but which is not a continuous supply then you can apportion. An example might be a building project that runs over 1 January 2010. The apportionment should reflect when the work was done. We can advise as to methods.

### Continuous supplies of services

Under the normal rules for continuous supplies you must account for VAT at the higher rate if you issue a VAT invoice for your services (or receive a payment before issuing an invoice) after 1 January 2010. It does not matter when the work you are invoicing took place.

Professional firms that make supplies to private individuals or commercial clients who cannot recover VAT may wish to consider advancing the issue of an invoice to before the rate change – although this will be subject to special 'anti forestalling' provisions described below.

Fortunately when the rate changes you also have the option of charging a rate of VAT that reflects when the work was done meaning that for work undertaken between 1 December 2008 and 1 January 2010 you can charge VAT at 15%.

If you wish to apportion your supply you should check that your billing software can cope with multiple VAT rates and fee apportionment. Alternatively consider relying on the 'normal rules' and billing all work in progress by 31 December 2009.

Many professional firms (including ourselves) make use of a 'request for payment' (RFP) system. Here the firm does not issue a VAT invoice but a request that falls short of the invoice requirements. This means that a tax point is created only when

payment has been received, at which point an invoice is sent. It should be noted that the recipients of an RFP cannot use it as evidence for VAT recovery but must await the VAT invoice.

Under the normal rules firms using an RFP system will account for VAT at 17.5% for all payments received after 1 January 2010; this will be regardless of what rate of VAT was on the RFP.

Under the optional rate change rules firms issuing RFP's will be in a similar position to firms that initially issue VAT invoices; they can apportion any fees issued after 1 January 2010 to reflect work undertaken whilst the 15% rate was in force. This should help prevent the problem of what happens when clients who receive an RFP at 15% pay after the rate rises. However, there will still be issues if you issue RFP's in advance of work taking place and you may wish to take advice if this is the case.

#### **Advance invoicing**

HMRC has introduced legislation to prevent businesses in the run up to the rate change either issuing invoices or taking pre payments for supplies that will be made after 1 January. These apply when you issue invoices that do not have to be paid within 6 months or issue an invoice or receive a pre payment for more than £100,000 when this is not normal practice in your industry. This means there is scope for pre-invoicing. We can advise further.

#### **Credit notes and adjustments**

Credit notes serve the purpose of altering the value of a supply, but not its original tax point and VAT rate. It follows that where a credit note is issued after 1 January 2010, in relation to an invoice issued in the period of 1 December 2008 – 31 December 2009, the VAT rate will be the same as for the original supply, -15%. Similar rules apply to debit notes.

#### **Cash accounting**

This is a form of VAT accounting optional for businesses with a taxable turnover of less than £1.37 million. It allows VAT to be accounted for when payment is received. It does not affect the rate which should be charged.

Thus if you are paid after 1 January for a supply invoiced at the 15% VAT rate you only need to account for VAT at 15%.

#### **Recovering VAT**

If you receive a VAT invoice you can recover the VAT identified upon the invoice. This will be true even if the VAT rate changes. However, following 1 January you are likely to receive invoices with different rates of VAT and you must ensure the correct amount of VAT is posted. You cannot assume that all VAT invoices will be at 15% if received before 1 January or 17.5% afterwards and should not rely on any automation in your accounts package.

## **Special rules for certain types of business**

#### **Charities and membership organisations**

Charities suffer irrecoverable VAT. The VAT rate increase will obviously increase this amount and is bad news for the sector.

If you apply the Lennartz method of recovering VAT incurred for business and non business purposes then the rate you use to calculate the VAT on the self supply will need to be adjusted.

Membership organisations often charge a membership subscription that covers the next calendar year. The tax point will usually be the invoice date, the day payment is received or the day that the membership year starts, whichever is first.

If your subscription is standard rated it should be possible to obtain an advantage by bringing forward your membership renewals for the 2010 membership year to before 1 January 2010.

If you operate your subscription partly in arrears then you can apportion the VAT to reflect the part covered by the old rate.

#### **Property**

If you let property and invoice partly in arrears and your tenant is unable to recover VAT you may wish to apportion any invoice that covers a period that includes a period before 1 January 2010.

If you intend to purchase a property remember that the basic tax point occurs on completion. If you cannot recover VAT it therefore pays to do this before 1 January. If this is not possible it may be possible to bring the tax point forward and we can advise upon this.

#### **Professional firms**

The professions are treated differently by HMRC in respect of whether their supplies are single supplies or continuous. Solicitors are generally treated as making single supplies with some exceptions whereas the opposite is true of auditors. In practice there will not be a difference here for work that is invoiced in 2010 and which was completed in 2009. Under both regimes the VAT can be accounted for at the lower rate that applied when the work was undertaken. Special rules apply to barristers.

#### **Construction industry - retention payments**

In considering the rules for retention payments, it is necessary to differentiate between the 'time of supply' rules for construction services that are supplied under contracts providing for stage or interim payments, and those that are supplied under single payment contracts.

Under single payment contracts, the retention element of the contract does not fall within the basic time of supply rules. This would establish the tax point of the main payment as being when the work has been completed. Instead, the tax point of the retention is the earlier of:

- 1) The time when a payment in respect of any part of the retention is received by the supplier; and
- 2) The date that the supplier issues a VAT invoice relating to the retention payment.

If the tax point falls on or after 1 January, VAT should be accounted for at 17.5%.

Contracts that provide for stage or interim payments have different tax point rules to single payment contracts, meaning that a tax point is created at the earliest of the following times:

- 1) Each time a payment is received by the supplier; and
- 2) Each time the supplier issues a VAT invoice.

Retention payments will also fall within these time of supply rules.

The consequence of this is that the creation of a tax point for retention payments is essentially the same for both stage

/ interim and single payment contracts. If the tax point falls on or after 1 January, VAT should be accounted for at 17.5%.

It will be worth issuing VAT invoices for retention payments due at around this time prior to 1 January, in order to benefit from the 15% VAT rate.

**The VAT rate changes will impact on every business differently. Chantrey Vellacott DFK can assist you with implementing it whether it be questions as to what rate to apply or how to implement it with your systems. If you are unsure then taking advice is the safest option.**

## Fuel scale charges

**These are charges for private use of business fuel. The new three month figures are below. If your VAT quarter straddles the change you should apportion.**

CO2 band	VAT fuel scale charge, 3 month period, £	VAT on 3 month charge, £	VAT exclusive 3 month charge, £
120 or less	126.00	18.77	107.23
125	189.00	28.15	160.85
130	189.00	28.15	160.85
135	189.00	28.15	160.85
140	201.00	29.94	171.06
145	214.00	31.87	182.13
150	226.00	33.66	192.34
155	239.00	35.60	203.40
160	251.00	37.38	213.62
165	264.00	39.32	224.68
170	276.00	41.11	234.89
175	289.00	43.04	245.96

CO2 band	VAT fuel scale charge, 3 month period, £	VAT on 3 month charge, £	VAT exclusive 3 month charge, £
180	302.00	44.98	257.02
185	314.00	46.77	267.23
190	327.00	48.70	278.30
195	339.00	50.49	288.51
200	352.00	52.43	299.57
205	365.00	54.36	310.64
210	378.00	56.30	321.70
215	390.00	58.09	331.91
220	403.00	60.02	342.98
225	416.00	61.96	354.04
230	428.00	63.74	364.26
235 or more	441.00	65.68	375.32

## Who to Contact

**For further information or advice, please contact Peter Ladanyi, Sharon Parker, your usual Chantrey Vellacott DFK partner or one of the following:**

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