

Changes to the standard rate of VAT

In his Emergency Budget Report on 22 June 2010, Chancellor George Osborne announced an increase in the standard rate of Value Added Tax (VAT) from 17.5% to 20%, with effect from 4 January 2011.

Zero-rated supplies, such as basic foodstuffs, children's clothing and books; exempt supplies, such as education and health; and supplies subject to VAT at 5%, such as domestic fuel and power, are not affected by the change.

This guide provides a general overview of the effects of the change for most usual situations, but do contact us if you would like particular help and advice.

Implications for sales to VAT-registered business

When should the new rate be applied?

The rate of VAT that businesses charge depends on the date that goods or services are supplied. For VAT purposes this is the date that goods physically change hands (or a service is completed); or payment is received; or an invoice is issued – whichever is the earliest. The rules are modified in certain situations, including when there is a change in the standard rate of VAT.

For any sales of standard-rated goods or services that take place on or after 4 January 2011 businesses should charge VAT at the new rate of 20%. This means that businesses currently calculating their VAT using the VAT inclusive fraction of 7/47 should use the new fraction of 1/6 from 4 January 2011.

However, the old rate of 17.5% should be used if a business has:

- provided goods or services more than 14 days before the issue of a VAT invoice (eg. a business which issues a VAT invoice on 4 January 2011 for goods or services provided before 21 December 2010); or
- received payment before 4 January 2011.

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 4 January 2011 should be subject to 20% VAT. This means that the annual invoice 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 It should specifically refer to and cancel that part of the old invoice which has been superseded.

Implications for retailers

Electronic tills, especially those set up to provide VAT information, will need to be adjusted.

Other issues

Business purchases

In most cases it is up to the supplier to ensure that the VAT is correct on any invoice that they issue, and the customer will then use it to claim back the VAT charged in the normal way. After 4 January 2011 most input tax claims will be for the amount shown on the invoice.

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.

VAT returns

For the majority of businesses the period of their VAT return will span 4 January 2011 and particular care will have to be taken to allocate supplies and purchases to the correct accounting period and to use the correct rate.

Cash accounting

Although the cash accounting scheme allows businesses to account for VAT at the point that payment is received, it does not affect the amount of VAT due and receipts after 4 January 2011 should be correctly identified as supplies made at either the 17.5% or 20% rate. Therefore, care needs to be taken.

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 will apply for most but not all categories of business. Note that the flat rate percentages will not simply be increased by 2.5%!

Fuel scale charges

E-mail: help@clarkhowes.com

There will be no change to the fuel scale charges which will have applied since 1 May 2010 but the VAT element will be recalculated.

Accounting software

Most accounting software packages have a facility to change the rate of VAT or create an additional rate of VAT, but if you would like any advice on adjusting your accounting package please contact us.

Further help and advice

The good news is that HMRC have stated that they will adopt a 'light touch' in relation to errors or mistakes in the first VAT return after the change, which arise as a result of the change. If you do make a mistake this 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).

If you have any concerns about the VAT reduction or would like any further information on any of the matters raised here, please contact us.