



# VATwatch

Braim VAT Consultancy's Updating Service

ISSUE 82

24 NOVEMBER 2008

## PRE-BUDGET REPORT SPECIAL

**This issue focuses on the headline news concerning the change to the standard rate of VAT. Any additional VAT measures contained in the pre-Budget Report will be covered in a subsequent issue.**

### TEMPORARY CUT IN THE STANDARD RATE OF VAT

The Chancellor today announced that the standard rate of VAT is being reduced from 17.5% to 15% with effect from 1 December 2008 for a 13-month period following which the rate will increase back up to 17.5% on 1 January 2010. Clearly this change will have an impact on every taxpayer who makes standard rated supplies. In particular, they must decide whether the old or new rate must be applied to their sales in the immediate future. Standard rated supplies made up to and including 30 November 2008 will be subject to VAT at 17.5%, those made on or after 1 December 2008 will be subject to VAT at 15%.

Which rate must be applied to a sale is determined by applying the tax point rules - as it is these that dictate when a sale is deemed to be made. So, the normal position is that sales made on a date when the old rate applies must be subjected to the old rate and sales made on a date when the new rate applies must be subjected to the new rate. However, the position becomes rather more complicated due to there being further special change of rate rules that can be applied if a taxpayer wishes (and it is totally at the taxpayer's discretion whether they choose to apply them at all and, if they do, whether they apply them to all affected sales or just to ones of their choosing).

### Normal tax point rules

There are two types of tax point – a basic tax point and an actual tax point.

A basic tax point is created:

- For a supply of goods – when the goods are made available (eg delivered) to a customer;
- For a supply of a one-off service – when the physical performance of the service has been completed;
- For a supply of continuous-type services (i.e. services in the construction sector where, under the contract, periodic stage payments are payable plus services that are supplied over a period and the payment for those services is determined or is payable periodically or from time to time. Typical examples of such services include the hire of goods, rental of land/property, membership subscriptions of clubs, most supplies made by accountants to their ongoing clients, security services etc) – these supplies do not have any basic tax point and so are deemed to be made only when an actual tax point is created.

An actual tax point is created (which overrides the basic tax point so that the basic tax point can then be ignored) where:

1. Before the basic tax point either a VAT invoice is issued or a payment is received; or

2. A VAT invoice is issued no later than 14 days after the basic tax point.

Here are some examples to illustrate the rules.

**Example 1:** A wholesaler delivers goods to a retailer on day 1. The wholesaler issues a VAT invoice on day 10 and the retailer pays for the goods on day 40. The basic tax point occurs on day 1. However, this can be ignored as an actual tax point is created on day 10 and so the sale is deemed to occur on day 10 (and the VAT rate applicable on day 10 must be charged/accounted for).

**Example 2:** A wholesaler delivers goods to a retailer on day 1. The wholesaler issues a VAT invoice on day 20 and the retailer pays for the goods on day 40. The basic tax point occurs on day 1. An actual tax point is created on day 20 when the VAT invoice is issued. However, this is more than 14 days after the basic tax point and so the sale is deemed to occur on day 1 (and the VAT rate applicable on day 1 must be charged/accounted for).

**Example 3:** A membership club grants a person membership of the club for the year 1 January to 31 December. The subscription is payable at the start of the year. No VAT invoice is issued. The supply made by the club is a continuous supply of services and so doesn't have a basic tax point. The club must treat its supply as made when the actual tax point occurs i.e. when the subscription is received (and so the VAT rate applicable on that day must be charged/accounted for).

By applying these normal tax point rules a taxpayer can therefore work out which rate needs to be applied to sales that span the change in rate. **This means for example, that a taxpayer can legitimately charge the new lower standard rate on any sale with a basic tax point no more than 14 days before 1 December 2008 provided they do not issue a VAT invoice until 1 December 2008.**

### Special "change of VAT rate" rules

There are some further special rules that can be applied to create a VAT saving where there is a reduction in the rate of VAT.

Where a basic tax point occurs after the change of rate but an actual tax point has been created by the issue of a VAT invoice or receipt of payment before the change of rate then, under the special rules, the basic tax point can be treated as the date on which the sale is made thereby allowing the lower rate to be applied to the sale. *\*(please read the correction at the end of this document)*

**Example:** A supplier arranges to sell goods on 10 December but requires the customer to pay in advance so they issue a VAT invoice on 30 November seeking payment. An actual tax point is created by issuing the invoice on 30 November and so the old 17.5% rate must be charged on the invoice. However, under the special rules, the basic tax point of 10 December can be treated as the date of the sale and so the lower rate can be applied to it as long as the supplier issues a credit note within 14 days of the date the rate changes.

A similar scenario can be applied to a supply of continuous services. Where a continuous supply spans a change in rate a supplier can, if they wish, apply the new lower rate to that part of the supply made after the change of rate even though an actual tax point was created (by issuing a VAT invoice or receiving payment) before the change of rate. Applying this to **Example 3** above would mean that the club could reduce the VAT payable on the subscription by applying the lower rate to one twelfth of the annual subscription (NB review this in case rate change is not 1/12/08).

As can be seen from the above, by applying either the normal tax point rules or the special change or rate rules, a taxpayer may be able to account for the new lower rate on some sales. Such

legitimate use of the rules can therefore produce a saving though obviously it is only worthwhile doing so if the customer is unable to reclaim some or all of the VAT (as fully taxable VAT-registered businesses can reclaim whatever amount of VAT is charged).

**Some other points to note about the change in rate:**

- **The new VAT fraction** to be used to calculate VAT within a VAT-inclusive value at the new lower rate is 3/23. Eg vat-inclusive sale value is £100. VAT within it =  $£100 \times 3/23 = £13.04$ .
- **Claiming input tax:** Where a purchase invoice shows a VAT value it is that value that is reclaimable. Where the invoice only shows a VAT-inclusive value the reclaimable VAT is calculated by using the VAT fraction appropriate to the tax point date shown on the invoice.
- **Retailers using a retail scheme:** If the change in rate occurs part way through a VAT period the period must be split into two parts and separate retail scheme calculations applied to each part using the old/new VAT fractions.
- **Cash accounting scheme users:** The cash accounting scheme does not determine when a sale is made - it simply determines when the VAT on the sale has to be paid to HMRC. Therefore cash accounting scheme users need to apply the normal tax point or special change of rate rules like everyone else to determine when a sale is made and so what rate applies to it.
- **Flat rate scheme users:** The change in rate will affect the rate of VAT actually charged to customers but it should not alter the flat rate percentage to be applied to a sale – so if a 10% flat rate applies to a sale of £100 plus 15% VAT the amount of flat rate payable is  $£115 \times 10\%$ .
- **Credit notes:** Where a credit note is issued after the change of rate in respect of a sale that attracted the old 17.5% rate, the credit note should also have the old 17.5% rate applied to it.
- **Second hand margin scheme users:** Where the basic tax point occurs after the change in rate but VAT has been accounted for at the old higher rate (due to payment having been received before the change of rate), the new lower rate VAT can be accounted for on the sale.

Please note that VATwatch is not intended to be a comprehensive guide to every development in VAT. It should not be used as a substitute for specific advice in individual circumstances. Braim VAT Consultancy cannot accept any liability for any action/inaction as a result of any reliance on VATwatch's contents.

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Please read also the next pages which contain a correction and a couple of other points of interest.



# VATwatch

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ISSUE 83

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**PRE-BUDGET REPORT SPECIAL**

**PART 2**

This issue includes a couple of corrections to the comments in issue 82 and provides additional commentary on the pre- Budget Report.

## **CORRECTIONS TO COMMENTS IN ISSUE 82 REGARDING THE TEMPORARY CUT IN THE STANDARD RATE OF VAT**

### **Special "change of VAT rate" rules**

Where a basic tax point occurs after the change of rate but an actual tax point has been created by the issue of a VAT invoice or receipt of payment before the change of rate then, under the special rules, the basic tax point can be treated as the date on which the sale is made thereby allowing the lower rate to be applied to the sale.

In issue 82, I stated that if the lower rate is applied to the sale then if a VAT invoice had been issued showing the 17.5% rate a credit note needed to be issued within 14 days of 1 December to correct the VAT chargeable. HMRC have announced that, due to a change to be made to secondary legislation, the time limit for issuing the credit note is being extended to 45 days. Of course, if no VAT invoice was originally issued (eg because the customer was not VAT-registered) then no credit note needs to be issued.

### **OTHER POINTS**

- **Continuous supplies of services** (such as for the leasing of equipment): Suppliers often issue a VAT invoice showing the payment/tax point dates for a period of up to a year and the VAT payable on each date. Such invoices are no longer valid for any tax points shown on/after 1 December and must be cancelled with a revised invoice showing the lower VAT rate being issued.
- **Annual accounting and payment on account schemes:** HMRC have stated that the amounts of the payments on account that have to be made will not be changed.
- **Errors made arising from the change of rate:** HMRC have stated that they will apply a "light touch" in respect of errors arising from the change of rate made on the first return rendered following 1 December. Corrective action (i.e. the issuing of an assessment) will not be taken unless there is good reason to suppose there would be an overall loss of tax. This suggests that errors relating to sales to other VAT-registered businesses might go unchallenged.
- **Payment of VAT liabilities:** HMRC have introduced a new business support service to help businesses worried about paying their VAT (and other tax and NI) liabilities. The telephone number is 0845 302 1435 and is open 8am to 8pm weekdays and 8am to 4pm on weekends. HMRC have stated that their staff will discuss each business' circumstances

and will consider agreeing to spread payments over a longer period and “in most cases” should be able to give a decision “in about 10 minutes”. If deferring payments is agreed then late payment surcharges will not be applied though interest will be charged where the law allows it to be.

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