

# VAT rate cut to 15%

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As widely predicted the Chancellor announced a cut of 2.5% in the standard rate of VAT from 17.5% to 15% effective from 1 December 2008.

The measure is designed to stimulate consumer spending. Whether this has the desired effect is debatable. What is certain is that, with less than a week before the effective date of the new rate, many businesses will find the changes required administratively difficult.

For retailers, they will need to decide if they will pass on the rate cut to customers. This may prove troublesome particularly where prices have already been set and published.

For most businesses that issue invoices to their customers they will need to consider the various accounting implications that come with a VAT rate change - something that has not happened for over 17 years.

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One of the main considerations resulting from the announced rate change is when to apply the old rate and when to apply the new rate. For example, invoices issued before 1 December will be liable to 17.5%. Invoices issued after the rate change should be issued with the new 15% rate unless the goods or services were supplied before 1 December and more than 14 days before the invoice is issued or where payment for the supply was received before 1 December.

However, there are special provisions which allow businesses to credit invoices issued before 1 December at 17.5% (and to ignore the payment date) where the goods or services are actually supplied after 1 December. Special rules also apply for services that span the rate change allowing business to adjust for supplies pre and post the rate change and tax them according to when the service was actually supplied.

Most of these provisions are optional and therefore in reality a business will only want to issue credit notes and adjust the

VAT charged where its customers are not able to fully recover the VAT.

The important point to remember is where possible avoid creating a tax point before 1 December (by issuing an invoice or making a payment) where this can easily be postponed until after this date. For example, postponing the tax point for a large commercial property transaction could result in significant savings in VAT (as well as stamp duty land tax - SDLT) for some businesses.

Overall the additional administrative burden for many businesses should not be underestimated. This is perhaps best illustrated by the publication of HMRC's guidance covering the implications of the rate change which runs into some 44 pages.

Finally, it should be remembered that the cut is only intended to be temporary. We can look forward to an increase in the rate and all that this brings on 1 January 2010.

# Some practical implications of the VAT rate change

## 1. Special Rate Change Provisions

Following the announcement of a cut in the standard rate of VAT from 17.5% to 15% with effect from 1 December 2008, HMRC have confirmed that the special rate change provisions can be applied selectively (i.e. to individual supplies) and more importantly these can be adopted without notifying them in advance. This means that if invoices have been issued or a payment has been made before 1 December in respect of goods or services that are not supplied until after 1 December, the VAT rate of 15% can still be applied (provided a credit note is issued within 45 days of the rate change and a refund made where appropriate). These measures are optional and in reality will only be required where the recipient of the supply is unable to recover VAT in full.

## 2. Supplies of goods and services - invoiced after 1 December

Normally, invoices issued after 1 December for a supply of goods and services will be invoiced at 15%, except where the goods have been supplied or the service completed before 1 December and more than 14 days before the invoice date. For example, if you raised the invoice on 1 December but supplied the goods before 18 November then the 17.5% rate would still apply. If you have supplied the goods between 18 and 30 November and received no payment, it is again worth considering delaying the invoice until 1 December but by no more than 14 days from the date the goods were physically supplied.

## 3. Supplies of services carried out over a period of time - invoiced after 1 December

Where no prepayment is made or invoice is issued before 1 December, VAT can be applied at 15% to services, even where part of an ongoing supply of services is performed before 1 December. Therefore, you should consider delaying the issue of invoices to customers who are not able to recover VAT in full until 1 December.

## 4. Continuous supplies of services – invoiced in advance

Where tax invoices at 17.5% have been issued with various tax points applying to regular payments that will be made up to one year in advance (e.g. leasing supplies etc) they become invalid on 1 December. They must be replaced with new invoices with the 15% rate applying to any tax points after this date.

## 5. Credit Notes

Credit notes raised to correct a genuine reduction in the value of a supply must be issued at the same rate as the original supply. Therefore, credit notes relating to invoices that were issued before 1 December will apply the 17.5% rate even if issued after this date.

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**IMPORTANT NOTE:** You cannot issue a credit note to cancel an invoice raised at 17.5%, where the goods have been supplied or the service has been wholly performed before 1 December, to simply re-issue it at 15% after the rate change. There must be a genuine reduction in the value of the supply for the credit note to be valid (unless the reason for the credit note falls within the special rates change provisions set out in 'Special Rate Change Provisions').

## 6. The VAT fraction

To calculate the amount of VAT on a tax inclusive value apply the fraction  $\frac{3}{23}$

## 7. Cash Accounting Scheme

Anyone using the cash accounting scheme will need to identify when the supply was made. Even though VAT is not declared until after payment is received the scheme does not affect the tax points. Supplies made before the rate change may still have to be accounted for at the 17.5% rate, even where payment is received and VAT is declared after this date.

## 8. Flat Rate Scheme

Most (but not all) of the flat rate percentages have been reduced to take account of the reduction in the VAT rate and should be used from 1 December.

## 9. Scale Charges for Private Motoring

The scale charges have been reduced accordingly and the new rates should be applied from 1 December.

## 10. Leasehold property transactions

Where rental periods span the rate change, the special rate change provisions can be applied to apportion the rent pre 1 December at 17.5% VAT and post 1 December at 15%. This is optional and would only be necessary where the tenant is not able to recover all of its VAT.

## 11. Freehold property transactions

Assuming no advance payments have been made, the tax point is the date of completion. Therefore delaying completion until on or after 1 December will reduce the VAT payable. Even for businesses able to fully recover VAT there will be a saving in the amount of SDLT as this is applied to the VAT inclusive purchase price.

## 12. Acquisitions from other EU Member States

The tax point is the 15th day of the month following the month in which the goods are dispatched or, if earlier, the date the supplier issues their invoice. Acquisitions taking place after 1 December will be subject to 15% VAT.

The above points are only a summary of some of the VAT implications that result from a change in the VAT rate. They are intended for guidance only and specific advice should be sought for individual transactions.