



VAT MEMO 2009-2010

Newsletter Issue 1

October 2009

Welcome to the first newsletter for the 2009-2010 edition of *VAT Memo*.

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The introduction of the new rules for the place of supply of services (known as the 'VAT Package') on 1 January 2010 is arguably one of the most significant changes to the VAT regime in recent years. It will mean substantial changes to the business records and processes for many businesses.

The new year will also see the reintroduction of VAT at 17.5%, and in this issue we outline some of the practical issues facing businesses on the reversion to the old rate.

We have prepared this newsletter to provide you with a comprehensive analysis of the changes in one document. We believe you will find this particular newsletter useful and informative in advising you about the reforms, and welcome any comments you may have as to how we can improve our service. We look forward to receiving your emails at flm@flmemo.co.uk.

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Disclaimer

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CROSS BORDER SERVICES FROM 1 JANUARY 2010

See VM ¶9680

The overall aim of the VAT package is to tax the supply of services in the place where they are consumed, to simplify administration and to reduce VAT fraud. The package comprises:

- changes to the place and time of supply of cross-border services;
- new reporting requirements – including the introduction of EC Sales lists for services; and
- a new system for recovering VAT incurred in other EC countries.

There is a distinction between services provided to businesses and those provided to consumers.

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Cross border services

Business to business services (“B2B”)

See VM ¶9684

From 1 January 2010, the basic rule for determining the place of supply of B2B services will change from being the place where the supplier is located to being the place **where the customer is located**. There will, however, be a number of exceptions, mainly in transport services, to this basic rule. The main changes will be implemented on 1 January 2010. For cultural, sporting, scientific and educational services, the change will be introduced on 1 January 2011.

The effect of this is to make most intra-EU services received by business customers subject to the reverse charge, whereby the customer accounts for VAT on the service in his country.

Business to consumer services (“B2C”)

See VM ¶9680

For supplies of services B2C the basic rule for the place of supply will continue to be the place **where the supplier is established**. From 1 January 2015, the place of supply of intra-EU B2C supplies of electronically supplied services, telecoms services and broadcasting will be where the customer is established, or usually resides. The European Commission is to report on the feasibility of the new B2C rules before they enter into force.

Other services

See VM ¶9744, ¶9794

The **existing exceptions** to the basic rule, such as for land-related supplies, will remain, with the exception of valuations of, and work on, moveable property, which will be taxed where the customer is located, rather than the place of performance. This will be a welcome change for businesses involved in cross-border maintenance contracts.

Time of supply

See VM ¶9700

The rules on the time the VAT is due under the reverse charge are also changing on 1 January 2010, Instead of the date of payment triggering the requirement to account for VAT, the date VAT is due will be the **earlier of**:

- the date the service is completed; or
- when payment is made.



CROSS BORDER SERVICES cont...

For **continuous supplies** the time of supply will be linked to payment periods, but where no payment is made or invoice issued in a 12-month period, a deemed tax point will occur at the end of the calendar year.

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Cross border services

EC sales lists (ESLs)

See VM ¶9810

Under the new rules from 1 January 2010 **businesses supplying services** to businesses which are liable to the new reverse charge procedures will have to submit ESLs for the first time. They will therefore need to ensure they have the customer's VAT number. If the customer is a business which is not VAT registered there is no requirement to record the transaction on the ESL, but it will still need to be recorded on VAT returns.

Businesses which supply goods to the EU are already required to submit ESLs. If they supply both goods and services the same form can be used.

The **new filing dates** require submission within 14 days, or 21 days if filing electronically.

Penalties will be imposed for failure to submit ESLs, or for late filing.

Overseas VAT reclaims

See VM ¶9845

The paper system for claims for the refund of VAT incurred in other EC countries is to be replaced by an **electronic system** via the customer's member state. The claim will then be passed to the member state where the VAT was incurred for refund. A welcome change is that the time limit for making claims will be extended by 3 months to 9 months from the end of the calendar year in which the VAT was incurred, so claims must be made by 30 September. Member states must **refund within 4 months** of receipt and interest is due if payment is late.

Impact on businesses

The main impact of the changes will be the need to ensure that **accounting systems** and procedures are in place to deal with the new requirements.

Businesses **making supplies** of services to other EU states will need to:

- review contracts (particularly 'global' contracts where local services are supplied to a client with multiple EC locations under a single contract) to determine where such services will be deemed to be received. HMRC have stated that they aim to provide further guidance on what degree of burden will fall on suppliers in determining whether a supply is being made for the benefit of one fixed establishment or for another;
- ensure they have capture details, such as customer VAT registration numbers, or have other evidence of a customer's business status;
- ensure they are clear in which jurisdiction a client is receiving a service where customers have one or more business establishments; and
- ensure they are ready to submit ESLs by 1 January 2010.

Traders **receiving supplies** of services from EC businesses will need to analyse whether they are required to account for UK VAT on such services. For some there will be changes, for example:

- up to now where a service was received for example by a charity in relation to its non-business activities, no reverse charge was required, but this will change after 1 January;
- businesses which cannot recover all their VAT may find that they suffer **additional VAT costs** because services they used to buy VAT-free from providers outside the EU, or from



CROSS BORDER SERVICES cont...

- suppliers established in jurisdictions with lower VAT rates, are now more costly because the reverse charge applies and UK VAT is due; and
- some of the old difficulties in distinguishing between services that were already subject to the reverse charge before 1 January 2010 (such as consultancy and data processing) and those that were not (such as management and administration services) will disappear, as all such services supplied B2B will be subject to the reverse charge.

News of further HMRC guidance will be reported in updates to VAT Memo as they are announced.

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Cross border services

New Edition

AVAILABLE IN OCTOBER



Tax Memo 2009-2010

- helping to solve your tax problems

Tax Memo 2009-2010 will be fully revised and updated to reflect law and practice as at the date of Royal Assent to the Finance Act 2009, and include commentary on the:

- New benchmark system for employee subsistence expenses
- Restriction of tax relief available on pension contributions made by higher earners and the special annual allowance
- Abolition of the commissioners' system for tax cases and introduction of the new tribunals
- Implementation of the new harmonised system for tax penalties
- Changes to cross-border services for VAT (from January 2010)
- New VAT partial exemption changes (effective April 2009).

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CHANGE OF VAT RATE

See VM ¶762, ¶2888

As announced in the Budget the standard rate of VAT returns to 17.5% on 1 January 2010. The **new VAT fraction** to use when a price is stated as being inclusive of VAT is 7/47.

This change affects any VAT registered business that sells or purchases goods or services that are subject to the standard rate of VAT.

Tills and accounting systems will need to be reconfigured, so that all invoices issued on or after 1 January 2010 use the new rate of VAT unless the supply was made more than 14 days beforehand, or payment was made before 1 January 2010. HMRC are to allow an “**easement**” for businesses (such as pubs and nightclubs) which will be open overnight on 31 December/1 January.

HMRC say that their officers will adopt a "light touch" approach to errors made relating to the VAT rate change in the first VAT return made after the change. This means that only errors that result in an overall loss of revenue to HMRC must be repaid, and penalties may not be imposed.

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General rules

See VM ¶760

Generally where there is a change in the VAT rate or a VAT liability, VAT is chargeable according to the **normal tax point rules** (¶755). VAT should be charged at the rate of 17.5% on any sales of standard-rated goods or services that are made on or after 1 January 2010, unless the business decides to elect to use the special change of rate provisions below.

Special change of rate provisions

See VM ¶762

Where a **continuous supply** spans a change in the tax rate or liability, traders may choose to account for tax at the old rate on the part of the supply made before the change, even though the tax point will occur after the change - for example, where a payment is received after the supply.

Conversely, traders may choose to account for tax at the new rate on the part of the supply made after the change, even though the normal tax point would have occurred earlier (for example, where a payment is received in advance of the supply).

The trader must account for tax on the basis of the value of the goods actually supplied or services actually performed, before or after the change, as appropriate. If this reduces the liability to VAT for a supply for which a VAT invoice has already been issued at a higher rate, the trader must issue a credit note (¶2925).

Traders can elect to use these rules for all affected supplies or only some of them, but an election **cannot be made** where VAT invoices are issued under a self-billing arrangement (¶2904) or when goods are sold from the assets of a business in satisfaction of a debt (¶156). The effect of the election is that, where the VAT rate goes down, VAT may be charged at the new rate on goods removed or services performed after the date of change, even though payment has been received or a VAT invoice was issued before that date.



CHANGE OF VAT RATE cont...

Supplies of services

See VM ¶764

VAT can be charged at the old rate on the part of the service completed before the date of the change in the VAT rate, and at the new rate on the part completed on or after that date. This applies as long as the supply **can be apportioned**, for example on the basis of measured work, or in accordance with the supplier's normal costing or pricing systems. Where VAT is reduced and a VAT invoice was issued or payment was received before the date of VAT change, a credit note must be provided to the customer.

Continuous supplies of goods and services

See VM ¶808

For continuous supplies of goods or services VAT is normally chargeable at **the rate applying at each tax point**. If a VAT invoice is issued in advance, giving the amounts and dates when payments are due, it will be invalid in respect of payments due after the rate change (and where payments were not received before it). A new invoice, referring to and cancelling the invalid parts of the original invoice, must be issued. Customers cannot use the original invoice to claim input tax after the change, and they must make adjustments to input tax where necessary on receipt of the new invoice.

Where a continuous supply spans a change in the VAT rate, the supplier can elect to use the special rules outlined above.

Hire purchase, conditional and credit sales

See VM ¶816, VM¶152

Under hire purchase, conditional and credit sales agreements, there is **a single supply** of goods and the normal tax point is the earliest of:

- the date of removal of the goods;
- the date of issue of the agreement (provided that the agreement is in the form of a VAT invoice); and
- the date of the issue of a separate VAT invoice.

On a change in the VAT rate, the tax point will be whichever of the above results in the lower rate of VAT being charged.

Deposits and payments in advance

See VM ¶784

Where full or part payment is made, or a VAT invoice issued, before the basic tax point (¶764), VAT will normally be due on the amount paid or invoiced at the rate in force at that date.

If there is a change in the VAT rate before the supply is actually made, VAT may be charged at the rate applicable when the supply is made and a credit note issued to amend the VAT invoice.

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CHANGE OF VAT RATE cont...

These rules **do not apply** to security deposits (e.g. to ensure the safe return of hired goods) (¶786) which are refundable or subject to forfeiture or if the deposit does not relate to a particular supply or contract (e.g. money paid into a client's account).

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Credits and contingent discounts

See VM ¶998

Where a credit note (not arising from the change in rate) is issued to adjust an original invoice, VAT should be credited at the **rate in force at the tax point of the original supply**. Where contingent discount is allowed and the original VAT charge is adjusted, VAT should be credited at the rate in force at the time of each supply qualifying for the discount.

Facilities provided by clubs, associations, etc

See VM ¶8180

Clubs, associations, etc supplying facilities in return for a member's subscription must normally account for VAT at **the rate applying when the subscription is received or a VAT invoice is issued**, whichever happens first. Where payment is made by instalments or separate invoices are issued, the procedure for continuous supply of services should be followed.



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Change of VAT rate



NEW PENALTY REGIME

See VM ¶4145

The first quarterly VAT returns due after the new penalties for inaccuracies on returns took effect on 1 April 2009 will have been submitted by now. The new regime is based on **compliance-based behaviour**, in which an “inaccuracy” on a return may fall into the following categories:

1. one which has arisen despite the taxpayer having taken “reasonable care”;
2. one which has arisen as a result of **failure to take “reasonable care”** (penalty of up to 30% of tax lost);
3. a **deliberate understatement** or overclaim (penalty of up to 70%); and
4. an **aggravated deliberate understatement/overclaim**, i.e. one where the taxpayer has concealed his actions (penalty of up to 100%).

Inaccuracies falling within category 1 will not attract a penalty; those falling into categories 2–4 attract penalties of increasing severity, based on a percentage of the tax lost. HMRC state that the definition of “reasonable care” varies according to the person, their circumstances and their abilities. In their view taking reasonable care includes:

- keeping accurate and up-to-date records to ensure returns are correct; and
- checking the correct position when there is something you don’t understand.

It is important to remember that even where an agent such as an accountant is employed to prepare returns, it is still the responsibility of the taxpayer to ensure that the return produced on his behalf is accurate.

Disclosure

See VM ¶4147

HMRC can **mitigate** the penalty according to the type of inaccuracy, the way in which the inaccuracy is disclosed to them, and the “quality” of the disclosure. However, those familiar with the previous misdeclaration VAT penalty need to be aware that the old defence of “reasonable excuse” is now replaced by the “**reasonable care**” provision above.

Correcting an error through the VAT return is not a disclosure for the purposes of the new penalty if the error concerned is due to a failure to take reasonable care.

An important point to remember is that voluntary disclosure of an error (which previously meant that the taxpayer escaped a penalty) will no longer guarantee that a penalty will not be imposed. In fact, **repeated voluntary disclosures**, especially of the same or similar errors, are likely to be seen as an indicator that reasonable care is not being taken. However, the benefit of disclosing an error to HMRC is that the risk of a penalty actually being applied should be reduced.

A new concept to VAT is that of suspended penalties, which may be subsequently applied or cancelled, depending on the behaviour of the taxpayer (¶4148).

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