



Legal Update

Winter 2010

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The New Year and VAT changes – implications for Solicitors

VAT Rate changes

Following the emergency budget in June 2010 the standard rate of VAT will increase from 17.5% to 20% on 4 January 2011, the first business day after the New Year and just over a year since the last increase. The new VAT fraction will be 1/6.

Businesses that issue VAT invoices

In simple terms you must use the 20% rate for all VAT invoices that you issue on or after 4 January 2011.

However there are special rules if you perform services where various tax points span the date of change and these will be most relevant for those clients who are unable to recover the output VAT on their bills such as private individuals (Wills, Trust and Probate work), charities and other non business clients. There is also anti-forestalling legislation to stop deliberate VAT avoidance.

Supplies that Span the date of change – Supplies of services

Generally, for a supply of services the VAT rate should be that at the date the bill is raised. However a concession exists where both the basic tax point and actual tax point occur after 4 January 2011, but the relevant work began before that date. The supplier may choose to

adopt the normal rules and simply charge the 20% rate on the entire invoice value, or can instead charge output VAT at the 17.5% rate on that part of the work completed before 4 January 2011, and at the 20% rate on the part completed after the rate change.

Where an invoice is raised after 4 January 2011 to a non VAT-registered customer for a period which spans the change in VAT rate the customer is likely to request that the apportionment procedure should be applied to the invoice as described above.

If you choose to do this you will have to be able to demonstrate that the apportionment is fair for example by reference to your work in progress records.

Advance Payments

So can any saving be made where your client makes an advance payment? Subject to anti-forestalling (see below) where your client has agreed to make a payment in advance and before 4 January 2011 the VAT on this payment should be accounted for at the lower rate of 17.5%. This is a good incentive for clients to pay early, however the firm will have to account for the VAT on payments received or on the issue of invoices raised early.

With regards to surplus funds under Legal Services Commission Standard Block Contracts where the advanced payments are received before 4 January 2011 the VAT should be accounted for at the 17.5% rate.

Standard Monthly Payments from the Legal Services Commission

If you receive Standard Monthly Payments (SMPs) from the Legal Services Commission for legal aid work, the VAT treatment under the agreed procedures depends on the extent to which each payment relates to completed cases. The special change of rate rules can be applied to cases in progress at 4 January 2011 which have not already been partly paid for through an earlier SMP. In other words, an SMP received after 4 January 2011 that relates to work on a case partly performed up to the date of the change, can be apportioned between that liable to 17.5% and that liable to 20%.

Anti-forestalling legislation

These rules are not likely to affect many businesses, but may affect you where the supply of goods or services is made on or after 4 January 2011, your customer cannot recover VAT on the transaction in full, and any of the following circumstances apply:

- A connected person pre-pays you for future supplies;
- You issue a VAT invoice to a connected person for future supplies;
- You facilitate funding for a customer enabling them to pay in advance for goods or services you provide;
- You issue a VAT invoice that does not require payment for at least six months
- You issue advance VAT invoices or receive a prepayment for more than £100,000 when this is not normal practice for you.

Summary and practical implications

- Invoicing your client early and receiving advance payments provides a cash flow advantage to your firm and a saving to those clients unable to recover the VAT.
- Where supplies straddle the VAT change it is possible to save clients money by charging the lower rate of 17.5% on work carried out before 4 January 2011. However, you need to ensure your accounting system is able to cope with two different VAT rates on the same invoice.
- Ensure you are prepared to amend the VAT rate on your accounting package. On most packages you should be able to amend the VAT rate but if not you will need to contact your software supplier.
- Ensure that all your purchase invoices are entered onto your accounting system at the rate of VAT shown on your invoice. Some systems only allow one VAT rate and once this has been changed to allow sales invoices to be raised you may need a manual workaround.

Further guidance

HM Revenue & Customs have issued a guide which can be obtained from their website www.hmrc.gov.uk/vat/forms-rates/rates/rate-rise-guidance.pdf

The above is a general guide only, and businesses wishing to discuss how the change should be implemented in respect of their particular circumstances should contact their normal Menzies Legal Team contact or a member of the Menzies VAT team.

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