

The reversion of the standard rate of VAT to 17.5% may give professional service firms a New Year headache

The standard rate of VAT will revert back to 17.5% on 1 January 2010. When there is a change in the VAT rate or a VAT liability, the output tax is chargeable by reference to the normal rules. However for professional service firms, that may not be straightforward. There are also special provisions and anti-forestalling legislation to consider.

This factsheet summarises how the supplies by professional service firms should be treated. However, it does **not** cover supplies made under Legal Aid contracts or certificates.

Single or continuous supply?

The time that output VAT has to be accounted for (referred to as the 'tax point'), and therefore the rate that has to be applied, depends upon whether you are making a 'single' or 'continuous' supply.

HM Revenue & Customs (HMRC) consider that the majority of the services provided by professional service firms are single one-off supplies, albeit sometimes performed over a long period. So for example, although litigation may take a number of years to conclude, it is generally a single matter even if interim bills are raised.

A continuous supply is generally regarded as being provided over an extended period, where payment is received from time to time. Examples from HMRC of the continuous supplies made by professional service firms include trustee services, retained adviser arrangements, and certain contracts with insurers for dealing with continuous claims cases.

Single supplies - normal tax point rules

For single supplies, the tax point will typically arise when a matter is completed. This is referred to as the 'basic' tax point. However, that date will be overridden when a VAT invoice is issued or payment is received before that date, or a VAT invoice issued within 14 days of it. Where the basic tax point is overridden, VAT must be accounted for by reference to the date of the invoice or receipt of payment.

For Law firms, the Law Society and HMRC have agreed to a further overriding tax point for legal services. This applies where fees are not agreed at the time a matter is completed, and it extends the 14 day invoicing rule to three months. If a VAT invoice is not raised within three months, then you revert back to the date that the matter was completed.

There are also two important issues regarding payment. A payment received after a 'basic' tax point does not create an overriding tax point. Secondly, the receipt of money into a client account does not constitute payment for these purposes - a tax point will only occur when the payment is received into an office account.

For 'basic' tax point purposes, a matter is generally considered to be concluded when all of the work except for the invoicing has been completed. For contentious matters, this may be delayed until the settlement of costs has been agreed between the parties. However, the review of bills by the Law Society should not delay a tax point.

Single supplies - special provisions

In the event of a VAT rate change, you can choose to apply the normal tax point rules and account for VAT at the rate in force at the time. However, there are special provisions which allow you some flexibility where supplies span the rate change. These provisions are optional, can be applied selectively, and you do not need to inform HMRC if you use them. For single supplies, the provisions cover three scenarios:

Matter completed on or before 31 December 2009, but VAT invoice raised on or after 1 January 2010 and within 14 days of completion (or 3 months where fees not agreed)

Under the normal rules, the 17.5% rate would apply. However, you can choose to apply the 15% rate (assuming that no payment is received on or before 31 December 2009). The 15% rate might be appropriate if your client cannot reclaim some or all of the VAT that you will charge.

If you issue a VAT invoice showing 17.5% but then wish to use the 15% rate instead, you must issue a credit note for the 2.5% within 45 days of the rate change (so 14 February 2010).

NB: If the invoice is raised more than 14 days/3 months after completion, the tax point reverts to the 'basic' date under the normal rules.

Matter completed on or after 1 January 2010, but VAT invoice raised or payment received on or before 31 December 2009

Under the normal rules, the 15% rate would apply. However, you can choose to apply the 17.5% rate.

Please also note the anti-forestalling provisions which are referred to below and which apply to certain pre-payments or advance invoicing. Matter commenced on or before 31 December 2009, but not completed until on or after 1 January 2010, and VAT invoice raised or payment received on or before 31 December 2009.

Under the normal rules, the 15% rate would apply to the whole supply. However, you can choose to apportion the service and apply the 15% rate to the value supplied in the period to 31 December 2009 and 17.5% rate to the remainder.

VAT invoice raised and payment received on or after 1 January 2010

Under the normal rules, the 17.5% rate would apply to the whole supply. However, you can choose to apportion the service and apply the 15% rate to the value supplied on or before 31 December 2009, and 17.5% to the remainder.

Continuous supplies - normal tax point rules

For continuous supplies of services, a tax point occurs when a VAT invoice is issued or payment is received, whichever happens earlier. The actual performance of the service is not taken into account in determining the tax point.

Continuous supplies - special provisions

Where a continuous supply spans a VAT rate change, the special provisions allow you to consider when those services are actually performed and to apply the relevant VAT rate. Once again, these special provisions are optional, can be applied selectively and you do not need to inform HMRC.

For example, you provide retained legal advisory services for the period 1 December 2009 to 28 February 2010. The special provisions cover two scenarios:

Earliest of VAT invoice issued or payment received is on or before 31 December 2009

Under the normal rules, the 15% rate would apply to the whole supply. However, you can choose to apportion the service and apply the 15% rate to the value supplied on or before 31 December 2009 and 17.5% to the remainder.

Earliest of VAT invoice issued or payment received is on or after 1 January 2010

Under the normal rules, the rate of 17.5% would apply to the whole supply. However, as in the above case you can choose to apportion the service and apply the 15% rate to the value supplied on or before 31 December 2009 and 17.5% to the remainder.

Disbursements

Where expenditure is incurred as agent, it may qualify to be treated as a disbursement for VAT purposes.

Provided that the strict conditions for such treatment are met, the recharge to the client is outside the scope of VAT. Where the conditions are not met, the recharge forms part of the firm's professional costs and should be charged at the same rate of VAT as the underlying supply.

Anti-forestalling legislation

Anti-forestalling legislation has been introduced to prevent businesses from taking advantage of the temporary 15% rate in certain circumstances. It applies by levying an additional 2.5% charge on the supplier where VAT invoices are raised or payments are received on or before 31 December 2009, for supplies made on or after 1 January 2010, and one of the following conditions is met:

- you supply the goods or services to a connected person (such as another business controlled by you); or
- you provide/arrange funding of your client's payment; or
- you issue a VAT invoice to your client that does not have to be paid in full within six months; or
- the payment or VAT invoice is in excess of £100,000, and this is not normal commercial practice.

The legislation may also affect you if, before 1 January 2010, you supply rights or options to receive goods or services on or after that date, free of charge or at a discount.

The anti-forestalling provisions will not apply in any case where your client can recover the VAT that you charge in full.

What should you do?

You should be taking steps now to ensure that the transition to the new VAT rate is as smooth as possible, including:

- ensuring that your accounting and billing systems can cope - remember that you may be issuing invoices with 15% after 1 January 2010, and with 17.5% before;
- giving clear guidance to the appropriate people, from billing teams to fee earners, as to which rate should apply;
- identifying circumstances or clients where you may wish to use the special rules; and
- identifying risks arising from the anti-forestalling legislation.

Who should I contact for assistance?

Grant Thornton has a national VAT practice with specialists in each of our offices throughout the UK. If you would like further information on this subject, or any other aspect of VAT, please contact your local Grant Thornton Professional Practices or VAT contact.