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## **VAT – CHANGE OF THE STANDARD RATE TO 20 PER CENT: ANTI-FORESTALLING LEGISLATION**

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Guidance note

Version 2: December 2010

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## VAT: ANTI-FORESTALLING LEGISLATION

### 1 Introduction

On 22 June 2010 the Chancellor announced an increase in the standard rate of VAT to 20 per cent to take effect from 4 January 2011.

This note gives guidance on the VAT anti-forestalling legislation which will be introduced as part of Finance (No. 2) Act 2010. The legislation is designed to restrict the extent to which a forestalling benefit can be obtained by the 17.5 per cent rate of VAT continuing to apply to certain supplies of goods or services provided on or after 4 January 2011 when the standard rate changes to 20 per cent.

The scope of the legislation is such that it is likely to affect very few businesses.

The legislation will affect you if you receive a payment or issue a VAT invoice **before** 4 January 2011 for goods or services that you are to provide **on or after that date** and one of the following conditions is met:

- **you supply the goods or services directly or indirectly to a connected person (such as another business controlled by you); or**
- **you provide or arrange funding of your customer's payment; or**
- **you issue a VAT invoice to your customer that does not have to be paid in full within six months; or**
- **the payment or VAT invoice is in excess of £100,000 (including any other supplies made as part of the same scheme or arrangements), and this is not normal commercial practice.**

The legislation may also affect you if, **before 4 January 2011**, you supply rights or options to receive goods and services from you **on or after that date**, free of charge or at a discount.

Even then, the legislation will not affect you if the recipient of your supply ("the customer") can recover the VAT on that supply in full.

If your business does not enter into arrangements of the type described above, and is not involved in any scheme to obtain a forestalling benefit for any person, you should be completely unaffected by the legislation and need read no further.

Even for those businesses that do enter into such arrangements there may be other conditions that have to be met before the legislation has effect. Detailed guidance is provided below.

## **1.1 Background and date from which legislation has effect**

In his 2010 Emergency Budget the Chancellor announced an increase in the standard rate of VAT from 17.5 per cent to 20 per cent. The Exchequer Secretary to the Treasury made a Written Ministerial Statement on 22 June 2010 announcing that anti-forestalling legislation would be introduced to prevent artificial avoidance seeking to exploit the change in the VAT rate to 20 per cent.

The legislation applies to transactions taking place on or after 22 June 2010. However, no extra tax will become due under this legislation until 4 January 2011.

The legislation only applies to standard-rated supplies, not to zero-rated, exempt or reduced rate supplies.

## DETAILED GUIDANCE

### 2 Forestalling

VAT forestalling works by manipulating the “tax point” rules which govern the date that VAT becomes due. The “basic tax point” for sales of goods occurs when the goods are provided and for services when the service has been completed. However, the basic tax point is overridden if an “actual tax point” is created. An actual tax point occurs when a business either issues a VAT invoice or receives payment.

Forestalling happens when an actual tax point is created before a rate rise but the basic tax point takes place after. The effect is that VAT is paid at the rate in force before the rise on goods and services to be consumed after it.

### 3 Pre-invoicing or pre-payment for goods or services

The legislation introduces **a supplementary charge to VAT** which will apply to transactions that span the date of the VAT rate change. That is, where a VAT invoice is issued and/or prepayment received before 4 January 2011 (creating an actual tax point) but the basic tax point when goods or services are to be provided is on or after that date. (See section 9 for more detail on the basic tax point for certain goods and services.)

Where applicable, VAT of 17.5 per cent is due on the date of issue of the VAT invoice or receipt of payment but a supplementary charge of 2.5 per cent will become due on 4 January 2011.

The supplementary charge will only apply where **the customer cannot recover VAT in full on the supply** (see section 5) and at least **one** of the following conditions is met:

- the supplier and the customer are connected with each other at any time between the date that the invoice is issued, or payment received, and 4 January 2011; or
- the supplier or a person connected to the supplier finances a prepayment by the customer (see section 7); or
- the supplier raises a VAT invoice where payment is not due in full within six months of the invoice date; or
- the consideration for the supply and any related supply of goods or services (see section 8) amounts to more than £100,000. However, the supplementary charge will not apply where the supplier can show that the pre-payment is made or advance VAT invoice raised between unconnected parties in accordance with **normal commercial practice** when **no VAT rate increase is expected** (see section 12).

See section 6 for the definition of “connected persons” and a special rule about series of supplies.

#### **4 Grants of rights or options**

The legislation also applies to the supply of the grant of a right where before 4 January 2011 the customer is sold the right to receive goods and services, either free or at a discount, on or after that date. In such cases VAT of 17.5 per cent is due as normal on the grant of the right and the supplementary charge of 2.5 per cent becomes due on the date that the right is first exercised on or after 4 January 2011.

A right for this purpose includes an option or an interest deriving from a right or option.

The supplementary charge will apply where **the customer cannot recover VAT in full on the grant** (see section 5) and at least **one** of the following conditions is met:

- the grantor and the customer are connected with each other at any time between the date of the supply of the grant of the right and 4 January 2011 or, if later, the date the grant is exercised; or
- the supplier, or a person connected with the supplier, finances the customer’s payment for the grant of the right (see section 7); or
- the consideration for the grant of the right and any related supply of goods or services (see section 8) amounts to more than £100,000. However, the supplementary charge will not apply where the supplier can show that the grant is made between unconnected parties in accordance with **normal commercial practice** when **no VAT rate increase is expected** (see section 12).

See section 6 for the definition of “connected persons” and a special rule about series of supplies.

#### **5 VAT status of customer**

The supplementary charge will only be due where the customer cannot fully recover the VAT incurred on the supply. This does not mean that all supplies to partly exempt businesses, for example, will be liable to a supplementary charge if they meet one of the conditions in the paragraphs above. Provided the customer is entitled to recover VAT in full on that particular transaction the supplementary charge will not be due.

Suppliers may wish to seek assurance from a customer that the VAT on the supply will be fully recoverable, to ascertain whether the supplementary charge should apply. For example:-

- an existing customer, who normally pays in arrears, offers to pay an amount exceeding £100,000 in advance before 4 January 2011 for goods or services to be provided on or after that date; or
- a new customer attempts to do the same.

In such circumstances the supplier should seek some evidence from the customer that they can fully recover the VAT incurred (unless the supply is one of the exceptions listed in section 11).

## **6 Connected Persons**

Section 1122 of the Corporation Tax Act 2010 applies for the purpose of establishing whether businesses are connected for the purpose of the anti-forestalling legislation.

Individuals are connected to spouses or civil partners, certain relatives, persons with whom they are in partnership, and companies they control (on their own or in conjunction with other persons). Companies are connected to other companies under the same control. Trustees are connected with trust settlors (if individuals) and close companies controlled by the trust.

For example, all the companies in a corporate group will normally be connected to each other.

### **6.1 Series of supplies**

The anti-forestalling legislation prevents a connected supplier and customer avoiding the charge by inserting a co-operative unconnected person into the supply chain between them.

It does this by extending the connected party test to cover the situation where there is a series of supplies of the same, or substantially the same, goods or services - for example, company A supplies company B which, in turn, supplies company C. In these circumstances, if any supplier in the series (say A in the example) is connected to the customer (C), the supplementary charge will apply to the eventual supply to the customer (C).

## **7 Finance provided by a supplier**

The legislation sets out the circumstances in which a supplier or a person connected with the supplier is treated as financing the payment for a supply of goods or services or the grant of a right to receive goods or services.

A payment is financed by a person if, directly or indirectly, the person:-

- provides funds to enable the customer to make the whole or part of the payment (whether the funds are provided before or after the payment is made); or
- arranges for someone else to provide such funds; or
- provides or arranges funds to discharge someone else's funding of the customer.

“Providing funds” has a wide definition: it can include making loans, providing guarantees or security for loans, subscribing for shares or other securities, or other transfers of assets or value which make funds available to the customer.

“Directly or indirectly” means that the fund flow does not have to be direct from supplier to customer, but can take a more indirect route.

For example, a supplier provides finance if they receive a prepayment from a customer and loan part of it back to the customer or someone within the customer's corporate group.

## **8 Related supplies**

A supply of goods or services or a grant of a right is related to another such supply or grant where they are both made as part of the same scheme, whether or not the same supplier and customer are involved.

“Scheme” includes any arrangements, transaction or series of transactions. This covers the situation where a supplier (or business associated with the supplier) makes a series of supplies to the same customer (or business associated with the customer) each of which is below the £100,000 limit but which in aggregate exceed it.

## **9 Listed Supplies**

The legislation makes special provision for what are referred to as “listed” supplies. These are supplies which ordinarily do not have a basic tax point (for example continuous supplies of services) or, in the case of services, the basic tax point is preceded by periodic billing or payment. It is therefore necessary to create an alternative basis on which to apply the supplementary charge.

This applies to the following supplies for which the consideration is payable periodically or from time to time:

- a supply of services,

- a supply arising from the grant of a major interest in land (basically rentals under a long lease – see paragraph 11.1 below for a special rule about lease premiums),
- a supply of water other than
  - distilled water, deionised water or water of similar purity, or
  - bottled water,
- a supply of
  - coal gas, water gas, producer gases or similar gases, or
  - petroleum gases, or other gaseous hydrocarbons, in a gaseous state,
- a supply of power, heat, refrigeration or ventilation, and
- a supply of goods together with services in the course of the construction, alteration, demolition, repair or maintenance of a building or civil engineering work.

The anti-forestalling legislation provides that, for the purposes of listed supplies, the basic time of supply occurs at the end of the period to which an invoice or payment relates. Therefore, if a payment is received, or a VAT invoice is issued, before 4 January 2011 for a listed supply, covering a period ending on or after that date, the supplementary charge will be due if the other requirements in section 3 above are met.

However, this rule is modified if the period covered by the VAT invoice or payment includes more than one billing period. In that case, the end of the billing period becomes the basic time of supply for the goods or services provided in that billing period. In such cases, the consideration for the listed supply (i.e. the payment or VAT invoice amount) must be apportioned, on a just and reasonable basis, between the billing periods concerned. This ensures that no supplementary charge arises in respect of goods or services provided in billing periods which end before 4 January 2011.

## **10 Cross-border supplies of goods and services**

The anti-forestalling legislation can apply to cross-border supplies of services where the UK customer must account for UK VAT under the reverse charge procedure. The UK customer must similarly account for any supplementary charges due in respect of such supplies. As with a domestic supply, no supplementary charge will be due if the UK customer can deduct all the VAT due under a reverse charge as input tax.

The anti-forestalling legislation does not apply to imports of goods into the UK or goods received from another EU Member State that are subject to acquisition VAT. Similarly, it does not apply to exports of goods from the EU or dispatches of goods to another EU Member State that are zero-rated.

## 11 Exceptions

### 11.1 Premium paid for a lease of land

The supplementary charge will not apply to a payment or VAT invoice for a premium under a lease granted before 4 January 2011, where the lease extends beyond that date. This is because, in relation to the premium, the basic tax point is the date the lease is granted, rather than when the lease ends.

This does not apply to rentals under the lease, but then the next exception may apply.

### 11.2 Leasing of Assets

There is no supplementary charge on prepayment or advance invoicing of rentals or hire charges for leasing of any assets, if the prepayment or VAT invoice is for a period of not more than a year and is in accordance with **normal commercial practice** when **no VAT rate increase is expected** (see section 12).

### 11.3 Hire Purchase, Conditional Sale and Credit Sale Agreements

In some cases HP, conditional sale and credit sale agreements contain all of the details necessary to constitute VAT invoices. In a minority of transactions the documentation constituting the VAT invoice is given to the customer in advance of the delivery of the goods, for example on signing of the agreement. As a result the supplier's VAT accounting system accounts for VAT at that earlier time, at the rate in force at the time.

Consequently, in some cases an order may be taken and invoiced before 4 January 2011 with delivery taking place on or after that day. This is most likely where there may be a significant delay between the signing of the agreement and eventual delivery of the goods (for example cars). Such a transaction is potentially liable to the supplementary charge because the invoice would not be payable in full within six months (see section 3, third bullet).

However, the supplementary charge will not apply if all the following conditions are met:

- it is the supplier's **normal commercial practice** (see paragraph 11.1.3) for the invoice to form part of the agreement and for it to be issued in advance of the supply of the goods;
- the goods are intended and expected to be delivered or made available to the customer within six months of the date of the invoice; and,
- none of the other conditions set out in section 3 applies to the transaction.

## 12 Normal commercial practice

In certain circumstances the supplementary charge will not apply to transactions that would otherwise be affected if the supplier can demonstrate that the transactions are in accordance with **normal commercial practice** when **no VAT rate increase is expected**. This section explains what is meant by normal commercial practice.

### 12.1 Normal commercial practice within a particular business

Any business that issues VAT invoices or receives pre-payments for

- goods or services in excess of £100,000 or
- covering a period of up to a year in respect of the leasing of assets

will not have to account for the supplementary charge if it can demonstrate that such transactions form part of its normal commercial practice and were not entered into in order to avoid the effect of the rate rise (and the transactions are not caught by the other conditions which do not have a normal commercial practice exception – e.g. supplies to connected parties).

So, if a business has a number of customers that have previously paid in advance for goods or services, it will not have to account for the supplementary charge if those customers pay before 4 January 2011 for goods or services to be provided after that date, and the periods covered by the advance payments are similar to previous advance payments.

On the other hand, the fact that pre-payments ordinarily occur as part of its normal commercial activities is not in itself sufficient for all pre-payments to be considered as outside the scope of the legislation. If a long-standing business customer that normally paid in arrears approached the company to accept a pre-payment in excess of £100,000 before 4 January 2011 for services to be provided on or after that date, then it would be prudent for the supplier to check whether the customer can recover the VAT in full on the supply. If that is not the case, the supplementary charge will apply. This is because the transaction does not meet the normal commercial practice test in this instance and the pre-payment is made expecting a VAT rate increase. Similarly it would not be possible for a business to suggest that its partly exempt customers make such pre-payments without the supplementary charge potentially applying.

In summary, any company that pre-invoices or receives pre-payments as part of its normal business transactions will not be affected by the anti-forestalling legislation unless it issues a VAT invoice to, or receives a pre-payment from a customer who does not ordinarily pre-pay, and the consideration (including any related supplies – see section 8) is in excess of £100,000, or the transactions are

caught by other conditions which do not have a normal commercial practice exception.

## **12.2 Normal commercial practice within a business sector**

The situations described in paragraph 12.1 apply in cases where there is a continuing business relationship between supplier and customer. However, there are some business sectors where pre-payments may be the norm but transactions are more in the nature of a 'one-off'.

For example, in the construction industry a one-off client might pre-pay a construction company before the works start, to allow the constructor to purchase specialist parts or equipment. If the client could not recover all of the VAT charged on the construction costs such a pre-payment would, on the face of it, be caught by the legislation if it exceeded £100,000. However, provided the construction company can show that the pre-payment was in accordance with the industry norms, HMRC will accept that it is normal commercial practice, even though the company may not have dealt with that client previously and cannot point to previous examples of pre-payments between them.

Similarly a property development company may enter into an option to purchase land from an individual landowner where the value of the option exceeds £100,000 and where the land will be provided free or at a discount on or after 4 January 2011. Again it is not essential for the property company to have entered into similar transactions with that same individual in order for this to be normal commercial practice. However, it will need to point to similar transactions it has made in the past, or the fact that such transactions are normal within the sector, to show that it was not carried out in order to avoid the effect of the change in the standard rate to 20 per cent.

Also businesses which have only recently started trading may not have an established normal commercial practice of their own, and so may have to look at normal commercial practice in their sector to establish if particular pre-payments are covered.

## **12.3 Normal commercial practice and hire purchase, conditional sale and credit sale agreements**

In this context "normal commercial practice" will almost always refer to the supplier's normal practice when no VAT rate increase is expected – it is therefore not possible for a company to change its current practice to bring itself within the scope of the exception.

## **12.4 Normal commercial practice and special purpose vehicles**

Transactions by special purpose vehicles set up as part of forestalling arrangements are not in accordance with normal commercial practice, since the transactions would not have occurred at all if no increase in the VAT rate had been expected.

## **13 Accounting for the supplementary charge**

### **13.1 Person liable to account for the supplementary charge**

The supplier of goods or services (or the grantor of a right to receive goods or services) is liable to account for the supplementary charge. Where the supplier or grantor is a member of a VAT group, the representative member of that group is liable to account for it.

However, if the customer is liable to account for VAT on the supply under the reverse charge procedure, then the customer must also account for any supplementary charge. See section 10 above.

### **13.2 Calculation and payment of the supplementary charge**

#### **13.2.1 Pre-payments and advance VAT invoices**

The supplementary charge is 2.5 per cent of the pre-payment amount or the amount shown on the advance VAT invoice. Payment of the supplementary charge is due on 4 January 2011 and must be declared as part of the output VAT in the VAT return covering that date (unless the business has deregistered by then – see paragraph 12.3 below).

#### **13.2.2 Grants of rights (including options)**

The supplementary charge is 2.5 per cent of the consideration for the grant of the right. However, where, under the terms of a grant of a right, some goods or services are supplied before 4 January 2011 and some are supplied on or after that date, the consideration should be apportioned on a just and reasonable basis to ascertain the amount that is properly subject to the supplementary charge.

The apportionment calculation is as follows:

$$\frac{\text{Consideration attributable to supplies whose basic tax point is on or after 4/1/11}}{\text{Total consideration for the grant of the right}}$$

Payment of the supplementary charge is due on the date that the right is first exercised on or after 4 January 2011, and must be declared as part of the output VAT in the VAT return covering that date (unless the business has deregistered

by then – see paragraph 13.3 below). This ensures that no charge arises if the right is never exercised.

### **13.3 Deregistered businesses**

Where a person is required to account for a supplementary charge but deregisters for VAT before the supplementary charge becomes payable, they are required to account for it in the final return.

If they do not do so and HMRC assesses for the supplementary charge, any interest will run from the date when the supplementary charge is due rather than the date when the final return is due.

### **13.4 Invoicing**

When a supplementary charge becomes due the supplier must usually issue a further VAT invoice to account for it (unless the original invoice showed VAT at 20 per cent). Such an invoice must be issued to the customer within 45 days of the supplementary charge becoming due. It should be headed “**Supplementary charge invoice**” and should contain the following details:

- an identifying number and date of issue,
- the amount of the supplementary charge,
- the name, address and registration number of the supplier,
- the name and address of the customer, and
- the identifying number and date of issue of the original VAT invoice.

### **13.5 Supplementary charge and input tax credit**

The supplementary charge is VAT and business customers can treat it as input tax as normal. However, as the supplementary charge will only apply when the customer cannot fully recover the VAT it incurs on the supply, it follows that not all of the charge will be recoverable.

### **13.6 Adjustment of contracts**

If a contract is made for the supply of goods or services before the rate change, the legislation requires the consideration to be increased to take account of the amount of any supplementary charge, unless the contract provides otherwise.

## **14 Further information**

If you have a query for which you have been unable to find the answer within this guidance please contact our VAT helpline on Tel 0845 010 9000 (Tel 0044 2920 501 261 for International Enquiries).

The VAT helpline is available from 8.00 am to 8.00 pm, Monday to Friday (GMT).

If you have hearing difficulties, please ring the Textphone service on Tel 0845 000 0200.