

## Background

In his 2008 Pre-Budget Report the Chancellor announced a temporary reduction in the standard rate of VAT from 17.5 per cent to 15 per cent.

In two written statements of 25 November 2008 and 31 March 2009 the Financial Secretary to the Treasury set out the scope of anti-forestalling legislation that the government intended to introduce to prevent artificial avoidance seeking to exploit the change in VAT rate. The FST made clear that the legislation was not intended to affect genuine commercial transactions and that a draft would be exposed for comment.

The draft legislation has been published today on the HM Revenue & Customs (HMRC) website.

The legislation counters forestalling by introducing a 'supplementary charge to VAT' to apply where an actual tax point (the date a VAT invoice is issued or prepayment received) occurs before the rate rise but the basic tax point (the provision of goods or services) is to take place afterwards. In such cases VAT of 15 per cent is due on the date of issue of the invoice or receipt of payment but a supplementary charge of 2.5 per cent becomes due on the date that the rate reverts to 17.5 per cent.

The measure is restricted in its scope to avoid affecting normal commercial transactions or transactions between suppliers and fully taxable businesses which can recover the VAT they incur. Hence the supplementary charge can only apply where the customer cannot recover all of the VAT that it incurs and one of the following conditions is met:

- the supplier and the customer are connected with each other
- the payment is financed by the supplier (or somebody connected to them)
- the supplier raises a VAT invoice where payment is not due until at least six months from the date of the invoice

Similar provisions prevent the use of the grant of rights or similar options as an avoidance mechanism and cover cases where before the rate rise the customer is sold the right to receive goods and services after the rate rise either free or at a discount.

The supplementary charge becomes due on the date that the option is first exercised after the rate rise where:

- the grantor and the customer are connected with each other
- the payment is financed by the supplier (or somebody connected to them)

The draft goes beyond the scope of the FST's original statement in one significant area by applying the supplementary charge to situations where a prepayment or pre-invoice in excess of £100,000 is made before the rate change for goods and services, or for the right to receive goods and services, on or after the date that the standard rate returns to 17.5 per cent.

One area where substantial prepayments can reflect commercial reality is in relation to property leases. Where a premium is payable the legislation recognises this by setting the basic time of supply as the date that the lease is granted, therefore avoiding the need to apportion premium payments between the lease period occurring before the VAT rate change and that occurring after it.

A further exception is made in relation to the leasing of assets. The legislation provides that, where a prepayment or invoice relates to an asset lease for a period of up to a year and that accords with normal commercial practice, the supplementary charge will not apply.

Should you have any comments on the scope of the legislation and, in particular, any examples of where it could have an impact on genuine commercial transactions HMRC would be pleased to hear from you. We are particularly interested in any examples where pre-payments in excess of £100,000 reflect normal commercial practice other than those currently provided for in the draft. If such examples are identified the draft legislation may be amended to incorporate further exceptions to the application of the supplementary charge. For this reason it would be useful if you would provide us with practical rather than hypothetical examples of such transactions to allow those exceptions to be properly targeted.

Responses should be made by 10 April 2009 and sent by post to:

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Or by [email](#)