

Temporary 5% VAT rate

(Lecture B1209 – 16.52 minutes)

Chancellor statement

The VAT reduction from 20% to 5% was announced by the Chancellor on 8 July and will cost the Exchequer an estimated £4 billion. It relates to the period between 15 July 2020 and 12 January 2021. It is intended to promote business for the tourist and hospitality industry – hotels, B&Bs, restaurants, cafes, take away fast food outlets, pubs and wine bars, caravan parks, tourist attractions that charge an admission fee, such as museums, galleries, cinemas, theatres, zoos etc.

Three categories

The best way of looking at the changes is to divide them into three different categories:

1. Food and drink sales: pubs, cafes, restaurants, members clubs, fast food take-aways;
2. Overnight accommodation: hotels and similar establishments, caravan parks, camp sites, holiday accommodation/cottages;
3. Admission fees to tourist attractions: the Chancellor's initial speech referred to "cinemas, theme parks and zoos" but the 5% rate is much wider than this.

Note – the changes have been legislated by The Value Added Tax (Reduced Rate) (Hospitality and Tourism) (Coronavirus) Order SI2020/728, which introduces new Groups 14 to 16 in Sch 7A, VATA1994 i.e. the reduced rated schedule.

Forget alcohol

The 15% VAT saving will not apply to sales of any alcoholic drinks, hot or cold. So, alcohol sales before and after 15 July are all subject to 20% VAT. This will disappoint many pub owners who mainly sell alcoholic drinks and not much food and soft drinks e.g. many real ale establishments.

The main changes are as follows:

- All on premises sales of food and drink will benefit from the 5% rate, apart from alcoholic drinks;
- Hot take away sales of food and hot take away sales of drink will also benefit from the reduced rate, unless the hot drinks contain alcohol e.g. mulled wine.

The VAT rate for take away sales of cold food and drink is unchanged.

Three rates of VAT

The end result is that many outlets must deal with three rates of VAT for the first time. See Examples 1 and 2.

The best way of dealing with the rate reduction is to look at the categories that are affected, and ignore everything else. For example, take away sales of cold rolls and sandwiches have always been zero-rated and the status quo applies here because the rate reduction does not apply to cold take-away food.

Example 1 – food and drink - on premises sales

John visits his local restaurant and enjoys the following food and drink: a pint of beer and packet of crisps; cheese roll; fish and chips; a cup of coffee. All sales will be subject to 5% VAT, apart from the beer which is specifically excluded as an alcoholic drink.

Example 2 - food and drink – take away sales

John visits his local take-away café and orders the following: a bottle of beer and packet of crisps; cheese roll; fish and chips; a cup of coffee. The beer will be subject to 20% VAT because it is alcoholic; the cheese roll will be zero-rated as cold take-away food, as has always been the case. The crisps will be subject to 20% VAT because they are not 'hot food'; however, the fish and chips and coffee will benefit from the 5% VAT rate because they are 'hot food and drink' (and not alcoholic).

Accounting changes

There is no doubt that VAT accounting issues will be easier for a business with a sophisticated till system, compared to those which require the cashier to enter, say, button 1 for standard rated sales and button 2 for zero-rated sales each time a supply is made. These tills will need a new button 3 to deal with the 5% rate. It should be straightforward to reset most till systems:

All on premises sales are reduced from 20% to 5% VAT apart from alcoholic drinks which remain at 20%;

Hot food and hot drink take-away sales are reduced from 20% to 5% VAT apart from alcoholic hot drinks such as mulled wine. All other sales are unchanged.

Overnight accommodation

The VAT reduction for overnight accommodation is more straightforward. It applies to hotels, B&Bs, similar establishments, holiday accommodation, camp sites and caravan parks.

An important issue concerns advance payments made by customers before the reduced rate took effect but where the stays are in a period when 5% VAT applies. There is good news and the issue is covered in HMRC's guidance:

<https://www.gov.uk/guidance/vat-reduced-rate-for-hospitality-holiday-accommodation-and-attractions>

Here is how it works:

The 'actual tax point' for VAT purposes is usually the invoice or payment date, whichever happens first; in this situation it is the advance payment date.

The 'basic tax point' occurs when a supply is made to the customer - the dates of the booking.

When a VAT rate reduces, the supplier has the option of using the basic tax point for the entire supply, including the earlier deposit or advance invoice. It cannot be demanded by the customer.

VAT Notice 700, para 30.7.4 to 30.9.2 gives details.

Let us consider a seaside guest house that is VAT registered but never issues invoices to customers because they never request them. Prices are calculated on a VAT inclusive basis. The hotel always takes a £50 advance non-refundable deposit from customers, with the balance payable when the guest arrives. If it received a £50 deposit in January 2020, it would have accounted for output tax of £8.33 on its VAT return based on 20% VAT. If the guest stay is in August 2020 when the temporary 5% rate applies, and the guest pays the balance of money owed, let's say £400, the guest house will account for output tax of £13.10 on the VAT return that includes August i.e. $£450 \times 1/21 = £21.43$ based on 5% VAT for the entire booking less £8.33 already paid.

Contrast this to a business that issues invoices and adds VAT to its fees. Let's say hotel owner Jim invoiced a customer and received an advanced 50% payment of £500 + £100 VAT in January for ten nights B&B and the stay will take place in August. If he wants, Jim can raise a credit note for £75 to reduce the VAT from 20% to 5% but he must refund this VAT to the customer otherwise he will be unjustly enriched. The credit note must be raised within 45 days of the VAT rate change i.e. before 28 August (VAT Notice 700, para 30.7.5). However, he could let sleeping dogs lie and just charge the 5% VAT rate on the balancing payment i.e. £500 plus £25 VAT in August. If he raises the credit note, the customer will pay £450 to settle his account rather than £525.

No anti-forestalling legislation

Another surprise was the absence of anti-forestalling legislation to prevent advance payments being made or invoices raised before 12 January but where the actual supply relates to a period after this date when we are back to 20% VAT again. I asked HMRC the reason for this decision and a spokesperson said: "The new temporary reduced rate of VAT for tourism and hospitality was introduced to help businesses in these sectors who have been severely impacted by Covid-19 and social distancing measures. As no anti-forestalling legislation was introduced to accompany this relief, normal tax point rules will apply. This will result in all supplies of affected services which are paid for, or take place, in the 6 months in which the relief is operation being covered by it. Allowing businesses to obtain the relief on bookings which are pre-paid during the 6 months but take place in the future will aid in the recovery of these sectors which should also support employment as lock down restrictions are lifted."

Tourist attractions

The list of attractions where the admission fee qualifies for the reduced rate is bigger than perhaps expected – see Tourist attractions that will benefit from the VAT cut.

There is a sentence in the HMRC guidance which I think is very important: "It is the responsibility of each taxpayer to demonstrate that its supplies are eligible for the temporary reduced rate."

Tourist attractions will benefit from the VAT cut. Admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions, similar cultural events and facilities.

Note – admission to some facilities is already exempt from VAT under the cultural exemption, mainly relevant to public bodies and not-for-profit organisations. The exemption takes priority over the 5% rate. VATA1994, Sch 9, Group 13.

Example

An admission fee to botanical gardens would be subject to 5% VAT as a cultural facility.

Example – what about piers?

I recently visited a seaside and paid a £1 entry fee to go on the pier. Will my £1 fee benefit from the VAT rate cut as a ‘tourist attraction’? The answer I feel is ‘yes.’ Our piers were mainly built in Victorian times and are a ‘must see’ venue for many visitors. And the pier’s website describes it as a “major tourist attraction that guarantees a fun-filled day for all the family.” In my view, I have justified the 5% rate as a venue offering ‘similar cultural events and facilities’.

Mixed supplies

This topic will be relevant for some supplies affected by the temporary VAT reduction.

Here are the three key principles to consider when a customer buys a bundle of goods or services that are subject to different rates of VAT:

1. Is there one main supply and the other supplies are incidental – i.e. the incidental supplies are a way of enhancing the enjoyment of the main supply rather than being an aim in their own right. If so, VAT is charged according to the rate for the main supply;
2. Consider the viewpoint of a typical customer: what does he or she expect to receive when they part with their hard-earned cash;
3. If there is a mixed supply, output tax can be apportioned in any fair and reasonable way. There is no specific method prescribed in law.

Example - spirit drink and mixer

Think of a pub selling a gin and tonic: is this a single supply of an alcoholic drink, subject to 20% VAT, or a mixed supply that also includes a 5% non-alcoholic drink? My thinking is as follows:

If a ‘splash’ of tonic is added to the gin by the barperson, this is a way of improving the taste of the drink and is therefore a single supply of an alcoholic drink, even if a bit more money is charged for the ‘splash.’

If a customer buys the gin and also a separate mixer bottle of tonic, this is a mixed supply of two different products. The customer usually adds the tonic when he returns to his seat, observing social distancing of course.

If the mixed supply outcome in the second situation was not correct, a customer could simply order the two drinks separately, which is a waste of time.

Reduce prices or increase profits?

The dilemma for any business will be whether to pass on the VAT rate cut to customers or keep prices the same and therefore increase profits. The reality is that this is an opportunity to support businesses who have suffered increased costs and lost income because of the coronavirus crisis. It will be very time consuming to alter prices and menus to reduce a cup of coffee from, say, £3.60 to £3.15 to reflect the VAT cut.

Flat rate scheme

Finally, for SMEs who use the flat rate scheme, the percentages have been reduced for those sectors where the rate cuts are relevant. The changes are as follows:

- Catering services including restaurants and takeaways 12.5% to 4.5%;
- Hotel or accommodation 10.5% to 0%;
- Pubs 6.5% to 1%.

There will be winners and losers with the new rates, the winners being those businesses with less sales subject to 5% VAT. Withdrawal from the scheme might be the best option for some users but once you leave, you cannot join again for 12 months. You must also notify HMRC in writing of your decision to leave. The new rates might make it worthwhile for some businesses to join for just the six-month period covered by the reduced rate and then leave again. To quote the old saying: "It's all about the numbers."

HMRC VAT Notice 733, section 12 gives details about leaving the scheme.

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