

Emergency Budget VAT Increase

Cash is King

In the Government's Emergency Budget on 22 June 2010 it was announced that the standard rate of VAT will increase from 17.5% to 20%. This will take effect from 4 January 2011 and it could have a significant impact on cash flow for a number of consultants.

A supplier of services, such as a consultant, becomes liable to pay VAT at the '*tax point*'. This is generally when the services have been performed, although there are provisions for the tax point to be earlier if the services are lengthy. There is some leeway – if a VAT invoice is issued within fourteen days of the date the services have been performed, that becomes the tax point. However, if a VAT invoice is issued or payment is received before the services have been performed, that becomes the tax point, thus catching advance payments or interim invoices.

HMRC require VAT accounts to be settled not less than quarterly.

Most consultants will issue interim invoices and a final invoice after they have provided services. Where the client is late in paying there is a very real possibility that a consultant will have to pay the VAT on his invoices to HMRC when it has not received the corresponding payment from its own client. This cash flow problem will be exacerbated by the increase in VAT announced in the Government's Emergency Budget.

There are some steps consultants can take to reduce this exposure.

Cash accounting system

Consultants with a turnover of less than £1.35 million excluding VAT can take advantage of the cash accounting scheme, providing they satisfy certain conditions which are described at <http://www.hmrc.gov.uk/vat/start/schemes/cash.htm>. Under this scheme a consultant will account for VAT when payment is received and can continue to use the scheme until its turnover reaches £1.6 million.

Bad Debt Relief

The cash flow problems caused by the VAT regime can also be mitigated with internal accounting procedures in relation to bad debt. HMRC say that where a debt is over six months old it can be written off as a bad debt in a company's accounts, whereupon the VAT paid can be recovered from HMRC, subject to the satisfaction of certain conditions. HMRC offer guidance at <http://www.hmrc.gov.uk/vat/managing/reclaiming/bad-debts.htm>. This does not mean the debt itself is written off, however, as far as the client is concerned.

Contractual protection

In contracts that are currently being negotiated, consultants should include terms that allow them to terminate or suspend if there is non-payment so that the VAT liability is kept as low as possible. They could also consider whether there is sufficient incentive for the client to pay on time. For example, they could insist that the interest rate on unpaid fees is the amount under the Late Payment Act provisions, ie 8% above the reference rate, and that the interest becomes payable once the account is overdue. Threats to charge interest can sometimes be enough to obtain payment. The right to suspend the licence to use the consultant's drawings and documents in the event of non-payment could also be included as a further incentive.

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Clarity as to what is to be paid when is also helpful, and making sure the client is aware of and has agreed any additional payments can also help in getting prompt payment.

Internal procedures

Consultants should check their company policies provide for monitoring unpaid invoices and pursuing unpaid invoices at the earliest opportunity.

Credit Checks

Credit checks should be conducted on all potential clients before agreeing to work for them. This should be coupled with a policy clarifying what constitutes acceptable financial standing and what safeguards are required when working with clients who lack such standing, for example payments on account.

Please contact James Hutchinson or Stephen Milne at Beale and Company Solicitors LLP for further information on this subject.

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