Summer holiday boost

Indirect Tax



01 August 2020

Neil Warren answers some practical questions about the reduced 5% VAT rate that will apply to many supplies made by the tourist and hospitality industry until 12 January next year

Key Points

What is the issue?

The temporary 5% rate of VAT will apply to many supplies made in the tourist and hospitality industry but not all of them. The article explains how to ensure the

correct rate is charged in each of the three diff erent trading categories.

What does it mean for me?

Care will be needed with some issues, such as how to deal with payments made when 20% VAT applied but where the actual supply takes place during the window of the temporary VAT reduction. If any mixed supplies are being made, it is also important to consider where output tax must be apportioned.

What can I take away?

The flat rate scheme percentages have been reduced for three categories affected by the rate reduction. In some cases, it might be worth advising clients to leave the scheme. The article also considers why no anti - forestalling legislation was introduced, which means that the 5% rate could be extended to next year’s holiday bookings in some cases.

When asking what supplies will be subject to 5% VAT between 15 July 2020 and 12 January 2021, it is logical to divide the changes into three different categories:

- **food and drink sales:** affecting pubs, cafes, restaurants, members clubs, fast food take-aways;
- **overnight accommodation:** hotels and similar establishments, caravan parks, camp sites, holiday cottages; and
- **admission fees to tourist attractions:** shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions, similar cultural events and facilities.

With regard to food and drink sales, the reduced rate will apply to all food and drink sold on the premises of a business, with the exception of alcohol which continues to be subject to 20% VAT. For take-away sales, the reduced rate will apply to hot food and hot drinks, again excluding hot alcoholic drinks such as mulled wine. All other take-away sales will be subject to the same VAT rate as now. See Box 1.

Image

BOX 1: VAT ON FOOD AND DRINK

John goes into his local pub and buys a cheese roll, a packet of crisps, a pint of beer, a cup of coffee and a hot pizza. All sales will qualify for 5% VAT apart from the beer, which is excluded as an alcohol drink.

He orders the same food and drink the following day but from his local take-away café. The coffee and pizza will qualify for the 5% rate of VAT as hot take-away food and drink but the beer will be subject to 20% VAT. The VAT liability of the crisps (20%) and cheese roll (zero-rated) remain unchanged because they are not hot food.

Should a business reduce its prices to pass on the VAT savings or keep prices the same and increase its profits?

It is up to business owners to make a commercial decision. Many businesses price their goods on a VAT inclusive basis and account for output tax of 1/6 on their gross sales. The reduction to 5% VAT means that the relevant fraction will be 1/21. There is no problem if a business keeps its prices the same and increases its profits. For example, it would probably involve a lot of work for a business having to reduce the price of a cup of coffee from £3.60 to £3.15 to pass on the VAT saving to customers.

How will a business deal with sales that are subject to different rates of VAT, say a 'pie and pint' offer in a pub?

The first challenge is to consider whether there is one main supply, with the other supplies being incidental. If this is the case, then the VAT charge wholly depends on the liability of the main supply. So, for example, a vodka drink with a splash of coke added is a single supply of an alcoholic drink – the coke is ignored.

The second challenge is to consider the perception of customers: what do they expect to receive when they part with their cash? In the case of a 'pie and pint' offer, they clearly expect both food and drink. This is a mixed supply and output tax must be apportioned on any fair and reasonable basis, so that 5% VAT is paid on the pie and 20% on the beer.

A problem with holiday bookings is where advance payments were made when the 20% VAT rate applied but the actual stay takes place in the period when the 5% rate is relevant. What is the situation here?

If a sales invoice is raised or payment received in advance of a booking, this creates an 'actual tax point' and the VAT payable depends on the rate in force when the payment was made or invoice issued to the customer; i.e. 20% VAT up to 14 July.

However, there is a concession in the legislation that the whole of the charge for a supply can be based on the 'basic tax point'; i.e. when the goods or services are supplied to a customer. This concession is at the discretion of the supplier – it cannot be demanded by the customer. See Box 2, which shows two different situations.

Image

BOX 2: ADVANCE PAYMENTS FOR TWO HOTELS

Marie paid an advance deposit of £500 plus £100 VAT to Posh Hotel in January 2020 for her hotel stay in August. She will pay the balance of £1,000 plus VAT when she arrives. Posh Hotel can just charge 5% VAT on the £1,000 balance and not adjust the 20% VAT charge on the deposit. However, it could issue a credit note to Marie for £75 so that she benefits from the 5% VAT rate on all of her booking fee. All credit notes must be issued to customers within 45 days of the VAT rate change (see VAT Notice 700 paras 30.7.4 to 30.9.2 and specifically para 30.7.5).

Bob is sole trader of a seaside guest house and never issues invoices to his customers. He prices his services on a VAT inclusive basis and takes a non-refundable deposit of £50 per customer when the booking is made. Let us assume a guest paid a deposit in January and the balance of £400 when they arrive in August for their stay. Bob's output tax liability is:

£450 x 1/21 = £21.43

with the basic tax point option of accounting for VAT. He has already paid output tax of £8.33 on the deposit back in January (20% VAT), so will include the balance of £13.10 on the return that includes August.

The difference is important. If a business has issued an invoice and added VAT, then any VAT reduction must be passed back to the customer by issuing a credit note. The supplier cannot pocket the VAT saving.

Many advisers were surprised that there was no anti-forestalling legislation to prevent the 5% rate being applied to sales invoices raised or payments received for next year's bookings. Why did this happen?

The changes were legislated on 14 July by the VAT (Reduced Rate) (Hospitality and Tourism) (Coronavirus) Order SI 2020/728. This legislation introduced new groups 14 to 16 to VATA 1994 Sch 7A; i.e. the reduced rate schedule. And you are right: there was no anti-forestalling legislation, which was a surprise to many advisers.

Anti-forestalling legislation would prevent advance payments and invoicing on or before 12 January 2021 benefiting from the 5% rate if the actual supply took place after this date.

I asked HMRC the reason and a spokesperson said: 'The new temporary reduced rate of VAT for tourism and hospitality was introduced to help businesses in these

sectors that 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 six months in which the relief is in operation being covered by it. Allowing businesses to obtain the relief on bookings which are pre-paid during the six 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.'

What are the practical challenges with admission fees to tourist attractions?

The good news is that the legislation is very specific about which venues will qualify for the 5% rate on admission fees, as listed at the beginning of this article.

However, the extension of the reduced rate to 'similar cultural events and facilities' creates a grey area, which is open to interpretation. HMRC guidance includes the example of a botanical garden qualifying for the reduced rate within this definition. I visited a seaside a few weeks ago and paid an admission fee to go on the pier. I feel very confident that this fee qualifies for the reduced rate as a tourist attraction.

There is an important sentence in the HMRC guidance: 'It is the responsibility of each taxpayer to demonstrate that its supplies are eligible for the temporary reduced rate.' In cases of doubt, however, HMRC has confirmed that customers 'should contact the VAT enquiries helpline on 0300 200 3700 who will be able to provide further support'.

Finally, one omission from the 5% list and confirmed as an exclusion in the guidance is admission to sporting events.

Where can I find more information about the rate reduction?

HMRC issued Revenue and Customs Brief 10/2020 on 9 July 2020, which includes links to specific guidance under the 'more information' section. Three public notices have been updated and are a particularly useful source of information.

Finally, what is the situation with the flat rate scheme?

HMRC has amended the flat rate percentages for three categories affected by the rate reduction.

The revised rates are as follows:

- catering services, including restaurants and takeaways: 12.5% to 4.5%;
- hotel or accommodation: 10.5% to 0%; and
- pubs: 6.5% to 1%.

In some cases, it might be financially worthwhile for a business to leave the scheme, particularly if it has a lot of sales that are subject to 5% VAT. However, once a business leaves it cannot rejoin for 12 months. So, the VAT saving made by leaving now might be lost when we are back to 20% in January and it cannot rejoin until July 2021 (see VAT Notice 733 s 12).