



# VATS

## THE WAY TO DO IT

**Anna Saprykina on surviving the rise in VAT**

January is generally one of the quietest months for many businesses – the Christmas and New Year fuss is over and many people are away or recovering from the festivities. This year however has started with a new concern for most businesses: the rise in the VAT rate from 17.5% to 20% – the highest it has ever been in the UK. This marks the third change in VAT in two years, so for many businesses this is familiar territory, but the rules governing a change of rate still cause confusion.



Anna Saprykina, has a Diploma in Financial Management from ACCA and is the author of the business workshops 'From Beautician to Entrepreneur'. After many years of experience in analysing businesses and industries during her career in finance, Anna became a business owner herself and is a founder of London-based Body Silk Consulting, providing business training for the young entrepreneurs with a focus on the beauty and aesthetic industry.

### WHERE DOES IT COME FROM?

Value added tax or VAT was first introduced in France by French economist Maurice Laure – the joint director of the French tax authority – who initiated the concept of VAT, which came into effect on April 10, 1954. VAT was initially introduced for large businesses of France, and then employed for all business sectors of the country.

Value added tax, also known as goods and services tax, proves to be beneficial for the government. Through implementation of this tax system, government can raise revenues invisibly, where the tax is not shown on the bill paid by the buyer. VAT is different from sales tax in various aspects. While sales tax is to be paid on the total value of the goods and services, VAT is levied on every exchange of the product, so that consumers do not have to carry the total cost of tax. However, VAT is generally not applied on export goods to avoid double taxation on the final product. But if VAT is charged on export goods, the tax amount is usually refunded to the tax payer. In other words, VAT is an indirect tax, which is imposed on goods and services at each stage of production, starting from raw materials to final product. VAT is levied on the value additions at different stages of production. VAT is widely applied in the European countries, including the UK.

### HOW BIG IS THE IMPACT?

Realistically, a 20% increase means that products once costing £117.50 will now cost £120. So, it is not that much of a rise when you put it in terms like that. Even still, there's always the possibility that businesses are trending their prices up by a few percentage points to cover their expenses, and that could lead to an even higher increase.

Now, whether or not you decide to absorb the increase as a negative or mark up your prices to adjust well, that's solely up to you as a business owner. On one hand, adjusting slightly so you don't lose out over time might be a smart move. Then again, if your competitors aren't adjusting and are offering lower prices, you could find that business is going elsewhere. Like most things in business, you will have to do a little bit of research here and find out how the market is trending. Depending on what you're selling, speaking in practical terms, absorbing the rise at your end wouldn't be the end of the world so long as you're still selling your treatments and products at a decent rate.

Of course, some businesses are VAT registered and some aren't. Some will have no option but to absorb more than others. Unregistered companies might be able to find a small advantage by raising the rates for

their treatments and products slightly. Again, though, it depends on the competition and the overall flow of the market. In the beauty industry, the trend these days is that the beauty treatments will remain at the same price range given the competition and the current ability of the clients to spend money (again - depends on the location, clientele, whether the business has been around for a long time or not, and so on), but the prices for the cosmetic products and supplies

will be likely to go up as many suppliers have increased their prices already. The most important aspect of the VAT rise is that your business - especially your website and the price list - needs to be able to adjust the prices on time. Most salons are going to have some type of software system that does this for them through the e-payment system they are using. Even still, you should check to make sure the rates are adjusted.

## HOW TO MINIMISE THE NEGATIVE EFFECT OF THIS VAT RISE FOR YOUR CLINIC/SALON?

Here's some helpful information from the last VAT changes, to help your salon adjust your cash strategy.

### APPLYING THE NEW VAT RATE

There are special rules for deposits received before January 4, for 'continuous supplies' and invoices covering one year. Don't get caught out by anti-forestalling legislation, which is in place to prevent prolonged use of the 17.5% rate in respect of goods/services to be supplied on or after January 4 2011.

Assuming the goods or services in question do not fall foul of the anti-forestalling legislation, the following rules can be applied for sales of goods or services that span the VAT rate change:

### RULES FOR VAT ON SERVICES

For services started before January 4, but finished after this date the work up to January 3 can be invoiced at the 17.5% VAT rate. The work completed on or after January 4 should be invoiced at 20%. HMRC may require a business to demonstrate that the apportionment of services between the VAT rates is fair.

Services where the work is completed before January 3 but invoiced on or after January 4 can be billed at the 17.5% rate. HMRC may require evidence that the work was completed prior to January 4

If the services are to be completed on or after January 4, but a VAT invoice is issued for the work prior to January 4, the invoice can reflect the 17.5% VAT rate - but make sure you check that this is not caught by the anti-forestalling rules.

### RULES FOR VAT ON GOODS

Where goods are delivered before January 4 2011 but invoiced and/or paid for on or after this date, the supplier can choose to use the 17.5% VAT rate. This is not compulsory, and the 20% rate can be used at the time of invoicing.

Where goods are invoiced or paid for before January 4 2011, but delivered on or after this date, the supplier can choose to use the 17.5% rate.

Where goods are invoiced before January 4 2011 but delivered and paid for on or after January 4 2011, the supplier can choose to apply the 17.5% rate to the invoice.

Should businesses absorb the rise or pass it on to customers? The general view in the marketplace is that this VAT rate rise will have to be passed on to consumers. Margins are already tight, and it will be hard for them to absorb any additional costs.

Many suppliers were considering slowly putting up prices towards the end of 2010, so there was not such a noticeable difference when the VAT rate rose. You may have noticed that for larger items (e.g. a piece of equipment, such as an IPL or laser), the New Year has seen offers such as 'we are holding the VAT rate down' to encourage people to buy in the post-New Years sales.

### WHAT ARE THE IMPLICATIONS FOR THE ADMIN AND BOOK KEEPING?

Salon owners need to understand the rules while issuing and receiving invoices. For invoices received, if the VAT rate shown on them is wrong, correct invoices should be requested from suppliers. Only the VAT amount shown on an invoice can be reclaimed, even if the rate shown is wrong.

For invoices issued, businesses still need to declare the right amount of VAT on VAT returns, even if invoices have shown the incorrect VAT amount - so, if an invoice is issued for 17.5% VAT but 20% is due, the business will have to pay over 20% to HMRC and try to recover the additional 2.5% VAT from the customer. It is essential that the invoices show the correct amount of VAT, in order to maximise the VAT to be recovered.

### WHAT CAN YOU DO TO MINIMISE THE IMPACT?

If businesses can recover VAT in full, then depending on the value of their quarterly purchases, they may actually need to do nothing other than be aware of the new rules. For businesses that cannot recover VAT in full, or those trying to mitigate cashflow costs, they should seek advice and take full advantage of the special provisions allowed during a rate change that enable the 17.5% VAT rate to be used after January 3 2011. If large purchases are expected in the run up to the rate change, consideration should be given to asking for invoices early (subject to rules relating to tax points and anti-forestalling provisions).

It is worthwhile checking out the HMRC website about any updates about the recent VAT rate increase. Overall, the increase is relatively small and should not impact your business that much. For start-ups, simply be aware that the rates have risen and act accordingly.