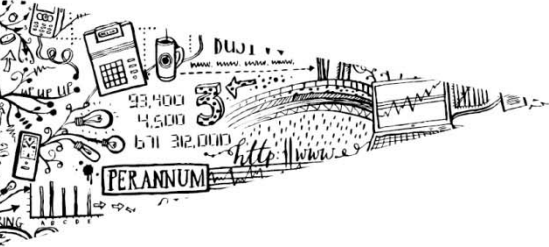


VAT alert Ireland

Issue 04/11



Proposed 2% VAT increase

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The Minister for Finance has announced that he will propose to the Cabinet, via the Budget on 6 December, a 2% increase in the standard rate of VAT. Whilst the Minister has remained silent on the effective date of this increase ('the changeover date') it is expected that it could be as early as January 2012.

In this alert we have highlighted some of the invoicing and system change issues which may arise on foot of this measure.

Taxpayers accounting for VAT on the invoice basis

Supply completed

Invoice to VAT registered customers

A person who is accounting for VAT on the invoice basis must charge VAT at the rate which is in force at the time the invoice is issued, or is required to issue, to other VAT registered persons.

On completion of a supply to VAT registered customers an invoice must issue no later than the 15th of the following month. Thus, assuming the VAT rate is increased in January 2012, if a supply is completed in December 2011 there are two options:

- Issue an invoice in December 2011 with VAT at the standard rate of 21% or
- Issue an invoice on or after 1 January 2012 with VAT at the increased standard rate of 23%.

In summary, all VAT invoices issued business to business on or after the date of increase should show VAT at 23% unless the invoice should have issued before this date. This is the case even if the goods or services were supplied before the changeover date.

Non VAT registered customers

The VAT legislation does not require the issue of a VAT invoice to unregistered customers. A liability arising in respect of supplies by a VAT registered trader to an unregistered person is normally related to the date of supply and not to the date of issue of the invoice, if one is issued.

Goods or services which are actually supplied to unregistered persons prior to the date of a change in VAT rates are taxable at the rate in force when they are supplied, notwithstanding that they may be invoiced on or after the changeover date.

Contracts with interval payments

The date an invoice issues in respect of a contract with a fixed interval payment spanning the changeover date will determine the VAT rate. By way of example, if payment for a lease of office furniture for the period 1 November - 28 February is received before the changeover date VAT at 21% will apply if the invoice issues before this date.

If, however, the invoice issues after the changeover date 23% VAT will be charged regardless of the fact that payment was received when the lower rate was in place.

Payments in advance

Where payments are received (including deposits) from VAT registered businesses before the changeover date in respect of goods or services not supplied until on or after that date they are subject to VAT at the rate effective at the time the invoice relating to the payment is issued or should have been issued (i.e. by 15th day of the month following the month in which the payment was made), whichever is the earlier.

Monies received from unregistered persons are subject to VAT by reference to the rate in force at the time of payment and not the date of supply.

Budget account sales, credit sales, hire purchase sales and other credit sales

These sales are chargeable to VAT as follows:

- at the rate in force at the time of the sales, in the case of sales to unregistered persons, or
- at the rate in force at the time of issue of the invoice or the time the invoice ought to have been issued, if earlier, in the case of sales to VAT registered customers.

Credit notes

A credit note issued to a VAT registered trader in respect of a supply of goods or services, which contains a VAT adjustment, must show VAT at the rate applicable when the original invoice was issued. As a result a credit note which issues after the changeover date in respect of an invoice which issued prior to this date will state 21% VAT.

Taxpayers accounting for VAT on the cash receipts basis

Non VAT registered customers

A person who accounts for VAT on the cash receipts basis must account for VAT at the rate in force at the time of supply. Accordingly, taxpayers operating on this basis are liable for VAT at the rate applicable at the time the goods or services are supplied and **not** at the rate applicable when payment is received.

VAT registered customers

A person who accounts for VAT on the cash receipts basis will be required to charge VAT to its VAT registered customers at the rate in force on the date of the supply regardless of when the invoice issues.

Systems Changes

Businesses will have to adopt their systems to ensure that VAT is charged at the correct rate from the changeover date, which may not be straightforward in all cases.

The immediate issues for businesses will revolve around the systems changes necessary to cope with the increase which will include:

- ▶ *Output VAT codes or rates* - The most sophisticated systems will permit the ongoing use of a single tax code with both existing and historical rates of VAT. However, for many systems this is likely to cause problems if historical VAT account adjustments are required or if pre-rate change reports need to be run in preparation for a Revenue audit.
- ▶ For this reason, it is usually advisable to create a new VAT code or rate within the system rather than simply change the existing standard rate. This will allow for clear audit trails and processing of credit notes after the changeover date that relate to supplies at the different rates.
- ▶ *Input VAT codes or rates* - At the very least, a new VAT code or rate needs to be created within the system for standard rated purchases, since, depending on the tax points, some purchases will need to be posted after the changeover date with the old VAT rate. In addition it is possible that multiple new input VAT codes will be required in order to cover acquisitions, import VAT, reverse charge services, domestic reverse charge purchases.
- ▶ *Output VAT determination logic* - Creating a new standard rate "accounts receivable" (AR) tax code of 23% will likely require a VAT logic configuration change. As an example, within SAP new condition records will be required in order to allocate the new standard rate to domestic transactions. Similar changes will be required in other accounting systems.
- ▶ *Input VAT determination logic* - Where the input tax accounting/recoverability decision is made manually, guidance will be required for "accounts payable" (AP) personnel to ensure that they are familiar with the new rate or tax code changes. However, where the input tax recoverability decision is automated based on a default, these purchase defaults will need to be amended. This potentially could require changes to tens of thousands of vendor records.
- ▶ *Invoicing requirements* - For a valid VAT invoice it is a requirement for each description of goods or services being supplied to indicate the VAT percentage that has been charged. In addition to changing the standard rate of VAT in the system, changes may be required to invoice templates or programs
- ▶ *Expense systems* - VAT recovery on standard rated expense claims is usually calculated on a VAT inclusive basis. Where this calculation routine has recovered VAT based on 21/121 of the standard rated expense cost, this must now be changed to 23/123.

- ▶ *Electronic Data Interchange (EDI)* - It is important to consider the impact of the VAT rate change on any EDI invoicing processes in place for both sales and purchases. In particular, where incoming EDI invoices are automatically processed and posted to the GL without manual intervention the import routine will need to be altered to ensure VAT is captured accurately at the new rate.
- ▶ *Retailer Systems* - Many retailers operate Electronic Point Of Sale (EPOS) systems, which calculate VAT based on the gross selling price. Changing the rate in the EPOS system alone will not result in adjustments to the price on the shelf, but will simply decrease the profit margin. In order to adjust the price on the shelf, it is likely that the product SKU data will need to be amended for all standard rated products. For the larger retailers, this could involve the re-pricing of thousands of items.

What other operational considerations are there?

It is important to also consider the operational implications to a business of the VAT rate change. For example:

- ▶ *IT capacity* - At year end many businesses freeze the system to prevent changes at a critical time of year for both sales and financial reporting. As such the change request and approval process may be problematic and should begin immediately.
- ▶ *In-house reporting tools* - Any in-house reporting tools that are used to assist in the recording and reporting of VAT such as a tax code selection tool and/or VAT account reconciliation tool will need to be changed to reflect the reduction in VAT rate.
- ▶ *Revision of customer documentation* - If a business intends to pass the increased VAT charge onto its customers it may be necessary to revise price lists, web-site information, publications or even quotes or contracts that have been issued in advance of a supply taking place after the VAT rate change.
- ▶ *Amendments to existing contracts* - Existing contracts which have been entered into at one VAT rate but where the contract has not been fulfilled may require adjustments to the corresponding VAT invoices and accounting procedures to ensure the increased VAT rate is accounted for correctly. For example, if a contract to supply goods is signed on 5 December 2011 and the contract is not completed until after the changeover date then the agreed price of the contract will have to be adjusted if the supplier does not wish to absorb the 2% VAT increase.
- ▶ *Imports* - Many businesses avail of a VAT deferment account to facilitate payment of VAT due on the importation of goods into Ireland. Consideration should be given to whether the 2% VAT rate increase will necessitate increasing the deferment guarantee amount. This consideration could be particularly important for those businesses importing goods just in time for the Christmas season or January sales.

Opportunities

The VAT rate increase provides the opportunity for businesses to consider bringing forward a billing deadline to avail of the 21% VAT rate. This is particularly relevant to businesses supplying standard-rated goods or services to non-VAT registered customers and to VAT-registered customers with limited VAT recovery, e.g. banks, insurance companies, hospital, schools etc.

For example, in the event that the VAT rate is increased with effect from 1 January 2012, businesses that issue their bills or fee notes on the 1st of every month may wish to consider raising and issuing fee notes or invoices on 30 December to avail of the 21% VAT rate rather than the 23% rate.

Given that the new VAT rate will, most likely, become effective in a number of weeks businesses should prioritise a review of the implications. Should you require any further information in this regard please do not hesitate to contact us.

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