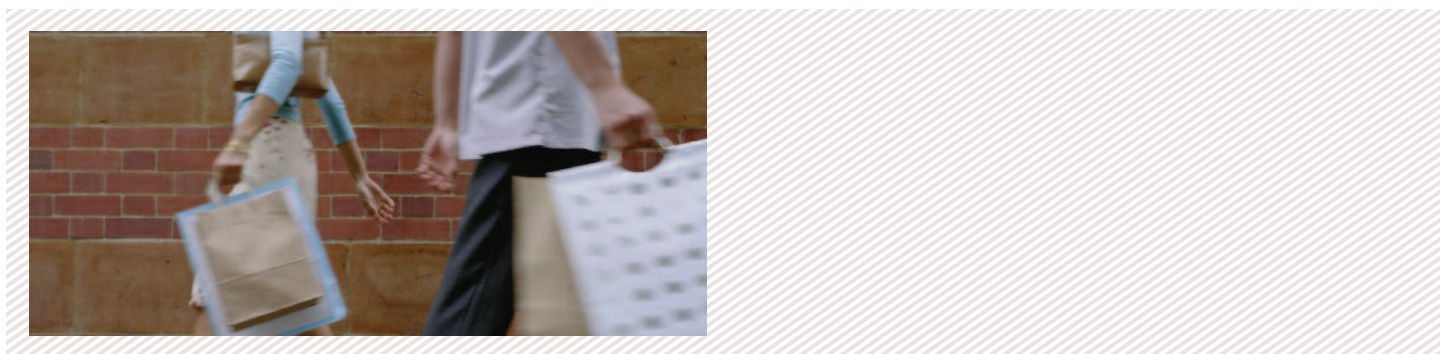


RETAIL AND WHOLESALE
VAT RETURNS TO 17.5 PER CENT
WHAT DOES IT REALLY MEAN?





▶ 1 JANUARY 2010 – VAT BACK TO 17.5 PER CENT – WHAT DOES IT REALLY MEAN?

ON 1 DECEMBER 2008, THE GOVERNMENT CUT THE STANDARD RATE OF VAT TO 15 PER CENT AS PART OF ITS PACKAGE TO STIMULATE THE ECONOMY. IN PRACTICE, THE REDUCTION WAS TARGETED AT THE RETAIL CONSUMER, TO GET THEM BACK INTO THE HIGH STREET AND READY TO SPEND AND THE GOVERNMENT WAS RELYING ON THE RETAIL SECTOR TO PASS ON THE SAVING TO STIMULATE THAT SPENDING FOR THE GREATER GOOD OF THE ECONOMY.

It was always part of the plan that the rate cut was temporary and would revert to 17.5 per cent on 1 January 2010, so the spectre of the rate rise has been with us all along.



THE RETAIL ENVIRONMENT

Few retailers would claim that the past year has been easy; consumers are concerned about their own finances and there has been a marked shift from retail spending to using 'discretionary' funds to clear costly debts and to put aside some savings. Has the VAT rate reduction helped keep consumer spending at least a little more buoyant?

It was interesting to note that, at the time of the rate reduction, many stores were already engaged in some pretty brutal discounting to get pre-Christmas customers through the door – 30 per cent discounts were far from uncommon: did a 2.5 per cent VAT rate reduction look attractive in a sea of retail discounting?

Commentators, both economic and political, have made various claims for and against but there is some evidence in favour of a modest feel-good effect for the consumer of paying less tax.

RETAILERS BEAR THE COST

Whilst the cut was intended to stimulate the economy, the engine driving that stimulus, the retailer, was faced with the appalling prospect of emergency systems changes to ensure that stock control and point of sale systems accommodated the new rate.

There were concerns over ticketing and consumer protection law in that the ticket price was different to the till price and much credit must go to the sector for its pragmatism in dealing with these issues at incredibly short notice. The price of this work and pragmatism to the sector? Estimated at £90m.

POST-REDUCTION BLUES

So what has happened up to now? The consumer seems to have settled into a VAT rut. The price of goods is what it is, regardless of the VAT rate and will either take it or leave it. Those businesses which have the most attractive offering in price and quality have remained more competitive.

This creates a problem for the sector. There is an expectation that, regardless of levels of profit for retailers, if they want the custom they must remain competitive on price. The result is that any hike in VAT might not affect the price at the till but does reduce margins by 2.5 per cent.

This might not seem a lot in the context of a single transaction but an aggregate 2.5 per cent loss of margin is bad news, particularly when taken in the context of keen discounting.

TIMING IS EVERYTHING

Is it possible for the Government to have picked a worse time for a VAT rate increase – during a holiday period when systems personnel and IT support providers might well be unavailable and on the cusp of the traditional sales season?

Ok this isn't great news but it does offer some opportunity for creative pre-Christmas pricing and 'buy now to beat the VAT increase' promotions.

As a direct comparison, Germany raised its VAT rate by 3 per cent on 1 January 2007. Notably, retail sales in December 2006 were just over 1 per cent above forecast; retail sales slumped during January 2007 and only very gradually crept back to forecast by mid-2007. Whilst the VAT hike was not the only factor, it was influential.

Note that the German rate rise and economic knock-on took place in a far better economic climate than the present, so it's not unreasonable to expect the UK's post rate rise slump to be more acute than that felt in Germany, unless prices at the till remain attractive to the jittery consumer.

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FOR YOU, THIS IS NOT JUST ABOUT TAX...

It's about cashflow... VAT works in mysterious ways for retailers. The Government will always tell you that it's simple; you collect the tax from the customer and pay it to the Treasury – the customer is the taxpayer.

This is, of course, hopelessly simplistic. Your VAT payments come round in huge quarterly – or monthly – chunks and make cashflow management difficult. The rate rise will mean those chunks are 2.5 per cent larger at a time when gross income may actually be static or declining due to discounting or reduction in consumer spending. As a result, many businesses will struggle to make their VAT payments and HMRC is not a forgiving creditor.

It's about pricing... as set out above, pricing will need to be managed to ensure that consumer expectation is managed as well as ensuring that you remain competitive.

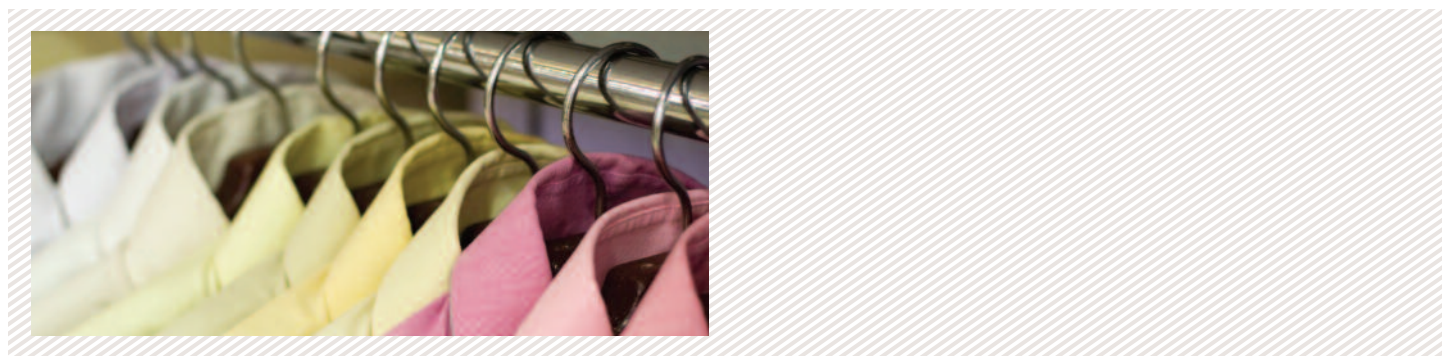
It's about compliance... Point of Sale and accounting systems will need to be updated to accommodate the change. It is absolutely critical that businesses begin to plan to deal with systems updates right now.

There's also the issue of shop-floor stock bearing old ticketing. From a customer perception point of view, it's much easier to let them know that the till price is less than the ticket price due to a VAT rate reduction; will customers accept the converse on a rate rise? This could flow into consumer protection issues with 'misleading pricing'. Can Trading Standards be expected to take a practical and even-handed approach?

It's about the future... There will be a General Election by 3 June 2010 and, although the parties are terribly coy about their tax plans – BDO has already commented on this in 'Breaking the Silence', there seems to be a tacit acceptance that tax increases are necessary.

A 1 per cent VAT rate increase is considered to generate about £5bn of additional revenue and the UK's 17.5 per cent standard rate is still one of the lowest in Europe, which ranges up to 25 per cent in Denmark and Sweden, so there's plenty of precedent for a 20 per cent plus VAT rate. Would a future Government consider abandoning some of the current zero-rates on a wide range of foodstuffs, books and children's clothing and introduce a reduced rate of 5 per cent – the lowest which EU law allows? Any shift from the zero-rate to a positive rate of VAT would have a disproportionately greater effect on those with lowest incomes. Would the Government feel obligated to compensate low income families for the regressive effects of these VAT increases through benefits increases?

However you regard it, VAT is a fact of life and you, the retailer, are at the sharp end. It is at the retail stage that a vast amount of the sticking VAT rests and how you manage VAT will not only determine the success of your business but the future health of the economy. So, no pressure then...!



FOR THE GREATER GOOD OF THE ECONOMY

FOR RETAIL BUSINESSES, VAT HAS A HORRIBLE INEVITABILITY; THOSE MONTHLY OR QUARTERLY PAYMENTS CREEP UP AND ROB YOU OF YOUR CASH FLOW AND THE UNWANTED CONSEQUENCE OF A GOOD PERIOD OF TRADING IS A BIGGER VAT BILL!

Whilst this is all true, we think it's time to start looking a bit harder at your VAT position. It's also true that the inevitability of VAT has tended to mask the fact that, with active management, it's possible to reduce your VAT bill.

CAN YOU CONFIDENTLY ANSWER 'YES' TO EACH OF THESE QUESTIONS?

- Am I accounting for VAT only on income which is VATable?
- Have I identified all zero-rating opportunities?
- Am I certain of what actually goes into my VATable takings?
- Have I removed all non-VATable items from my takings?
- Am I taking credit for the VAT I incur at the earliest opportunity?

If you can't answer 'yes' to every question, it may be the time to pick up the phone to one of our VAT specialists to see if we can help you make a difference to the amount of VAT you pay.

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HOW WE CAN HELP YOU

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