

VAT Focus

Imminent Rise in the VAT Rates?

SPEED READ A senior member of HM Customs & Excise once commented to the writer that a VAT rate increase only occurs at the start of a new Parliament. History appears to confirm this, but it also indicates that a change of governing party is necessary too. Given the current level of the UK's economic deficit and the UK VAT rate being historically below Germany's, this article postulates a post-election VAT rise even without a change of governing party, and predicts a 2.5% increase to 20% in the standard rate and a possible new reduced rate of 8%.



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1 January 2010 saw VAT rise by 2.5% to 17.5%. For some businesses, the change was a repeat of the nightmare 13 months previously when the rate went down; for others it was a difficult transition coming at the same time as they were implementing the VAT package or, for retailers, in the middle of their post-Christmas sales; whilst for yet others it was a smooth process and they must have wondered what all the fuss was about. Yet it is all about to happen again, or is it?

VAT rate changes

A decade ago I asked a very senior member of HM Customs & Excise what the department's view was on VAT rate changes and the implications. It was a good technical discussion on the compliance requirements and processes of ensuring any amendments to public notices and staff training/awareness were catered for. But the most interesting comment, which has stuck in my mind, is that this is only something worried about during the first 12 months or so of a post-election Parliament. The thinking being the electorate will have lived with a new VAT rate long enough by the time of the next election, assuming the new Government lasts for the complete term, that any VAT increase will no longer influence voting. Do the historical facts bear this out?

When VAT was introduced on 1 April 1973 by the then Conservative Government it was at a rate of 10%, making it revenue neutral when compared to purchase tax which it was replacing. Later that year there was the oil crisis, the miner's strike and the three-day week, all of which led to the February 1974 election. The result was a hung Parliament with Labour, the largest party, forming the new Government. Their first Budget, March 1974, left VAT unchanged, but extended the base. This was quickly followed by a mini-Budget in July 1974 designed to attack inflation, which reduced the VAT to 8% from the end of that month.

The autumn of 1974 saw an October general election won by Labour, quickly followed by the third 1974 Budget, which introduced a 25% VAT rate for petrol. The first full Budget of the new Parliament, April 1975, extended the 25% rate to 'luxuries' eg. white goods, jewellery and furs. Unfortunately the VAT complexity of the two rates caused numerous absurdities, particularly with mixed supplies of goods and services, which had an unintended adverse effect on employment. To partly alleviate this the April 1976 Budget reduced the luxury rate to 12.5%, whilst the standard rate remained at 8%.

The May 1979 election returned the Conservatives to power and their June Budget raised VAT to 15%, whilst at the same time unifying the luxury and standard rates. It is interesting that they did not harmonise the VAT rates at 8%, 10% or 12.5%, but went straight for an overall increase to 15% in a measure designed to switch from direct to indirect taxation. This rate was not changed following the 1983 or 1987 elections.

The next rise in the VAT rate occurred in unusual circumstances towards the end of the 1987–1992 Parliament. The introduction of the Poll Tax by the Conservatives had not only led to a change of Prime Minister in November 1990, but had also seen protest riots on the streets of London. In his first Budget in March 1991, Norman Lamont replaced Poll Tax with Council Tax, but raised VAT to 17.5% to pay for the lost Revenue.

The only other rate changes, apart from the recent 13-month reduction to 15% and restoration to 17.5%, was in the November 1993 Budget which introduced a (social) reduced rate of 8% for fuel and power for domestic and charity use from 1 April 1994. This was subsequently reduced to 5% in the first Gordon Brown Budget in 1997. The reduced rate has since been extended to a variety of social products over the last ten years, but that is not directly relevant to this discussion.

What can be concluded, if anything, from this history?

Although the number of rate increases is small, it does appear that there is a definite trend. The 1974 introduction of a 25% VAT rate on petrol, the April 1975 extension of 25% to luxuries and the 1979 VAT rise to 15% all occurred at the start of a new Parliament.

The 1993 Budget increase was the latest following a new Parliament, being 20 months after the April 1992 election, but it was the first for a new Chancellor, Kenneth Clarke, and also the first of the four annual Autumn Budgets. Although the rise only applied to domestic and charity use fuel and power (industrial use had been taxed at the standard rate since 1 July 1990) and was a means of pacifying our European partners concerned about our zero rate in the new single market, it did follow the adage of raising the rate near the beginning of a Parliament. Therefore it warrants inclusion with the 1974, 1975 and 1979 VAT rises.

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It can of course be argued that I have been selective in picking the rate changes to demonstrate a trend. However, the other changes have been ignored since they occurred for technical or unusual political reasons. The July 1974 reduction was an attempt within a hung Parliament to control inflation. The April 1975 extension of the 25% rate to luxuries caused absurd technicalities, for example an electrician's VAT on a repair of a light would be 8%, but if he fitted a new plug as well the whole lot attracted 25% VAT. This meant a rate reduction was necessary a year later.

The 1991 increase to 17.5% was the price to be paid for removing the Poll Tax. It came towards the end of the Parliament, in the hope that removal of the Poll Tax might (as proved to be the case) assist the re-election of the governing party.

Overall, it does appear that VAT increases are more likely to occur at the start of a new Parliament and with a change of governing party.

Europe

As VAT is an EU tax, any discussion on a rate rise should not totally ignore the European dimension.

An analysis of EU standard VAT rates gives an average of 20.8%, with a low of 15% and a high of 25%. Only Luxembourg and Cyprus at 15% are lower than the UK. Surprisingly Germany, which for decades has tended to have a lower rate than the UK, is now higher at 19%. Thus any increase in UK VAT should restore the UK's historically higher rate compared to Germany and also bring the UK in line with the European average.

For reduced EU VAT rates the average is 8.3% and the UK at 5% has, with others, the lowest.

NIC and VAT increase

The 2009 PBR announcement of a further 0.5% NIC increase from April 2011 (to add to the 0.5% increase in 2011 already announced) was greeted as a tax on jobs and the Conservatives have pledged to rescind the rise. A 0.5% rise in NIC raises about £2.4 billion of Revenue, which could be replaced with a 0.5% rise in VAT. The only question is whether a new Labour Government would also consider rescinding the NIC rise.

Post 2010 election Budget

Whilst we do not yet know the election date, 6 May is the current favourite; we know the possible outcomes are a victory for the Conservatives, a victory for Labour, or a hung Parliament with either a coalition or a minority Government.

History demonstrates that since 1974, a change of Government in an election has meant an immediate post-election Budget, the longest delay being 62 days from election to Budget in 1997. History also says that if a current Government wins an election, there is no immediate Budget. If Labour is re-elected, will they follow this pattern? Probably not, as the financial markets will require reassurance that plans are in hand to cut the deficit. For similar reasons, with a hung Parliament a

Budget will be needed.

Thus if the election is on 6 May, we should expect an 'emergency' Budget sometime between June and mid-July regardless of the election outcome.

VAT increase

Economically the UK has a deficit of 12.7% of GDP, not dissimilar to that of Greece albeit Greece has a smaller economy, and post the election that deficit will need to be reduced by expense cuts, tax rises or a combination of both.

Given the size of the deficit and as every 1% rise in VAT raises about £4.3 billion, a VAT rate increase is highly likely. In addition, as the proposed NIC increase is 'a tax on jobs' which could increase unemployment having an adverse affect on the economic recovery, any Conservative Government (or a hung Parliament) should reduce NIC and look to a VAT rise to replace the lost revenue. Even a re-elected Labour Government may revisit this NIC rise and similarly raise VAT. Finally we are approaching a new Parliament and as demonstrated this is always the ideal time to increase VAT.

Amount

Having considered all the factors indicating a rise, the final question is the level of increase. The EU VAT rate average is just above 20%, so a rise to this level could be 'sold' to the public as both needed to cut the deficit and to bring the UK into line with Europe. A higher rate, 21%, 22% or 22.5% will be harder for the public to accept and whilst it should not be ruled out, seems unlikely.

So far I have only commented on the standard rate of VAT, but what about the reduced VAT rate? The UK at 5% is below the EU average of 8%. It would be a simple political measure to use a 'EU average rate argument' to also raise this to 8%.

Practicalities

Should I be proved correct and a VAT rise does occur then how much warning is there likely to be? The most recent precedence, the 12 June 1979 Budget, saw VAT increased from 12.5% to 15% six days later. Thus we should not expect too much warning and of course there will be anti-forestalling legislation to cover the announcement to implementation period. Hence the time to start planning may be now, after all we have just had one rate rise, so it is probably an ideal time to check what went right or wrong this time round and plan for the next rise. Also for those unable to recover all their VAT, if it is economic to bring any purchases forward, now may be an opportune time to consider this.

Summary

In the current economic climate an increase in VAT seems inevitable. Precedence dictates that a rise happens at the start of a new Parliament, so the only question is what rate? My personal view is 20% for standard rate and possibly 8% for reduced rate. We will all know shortly if I am right. ■

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