

2006 Pre-Budget Report



PBRN 24

6 December 2006

VAT: PARTIAL EXEMPTION

Who is likely to be affected?

1. Businesses seeking the approval of a partial exemption special method to calculate the amount of VAT they can recover. Users of the standard method are unaffected.

General description of the measure

2. A business that makes both taxable and exempt supplies (known as a partly exempt business) must operate a partial exemption method to calculate how much VAT it can recover on its costs. Many large partly exempt businesses operate a 'tailor-made' special method that must be approved by HMRC before use.
3. The measure comprises two changes and was the subject of a recent consultation announced at Budget 2006 (see BN 49 – VAT: Partial Exemption).

Operative date

4. Following consultation, the Government intends implementing the changes with effect on and after 1 April 2007.

Current law and proposed revisions

5. Section 26(3) of the Value Added Tax Act 1994 requires HMRC to make regulations to secure a fair and reasonable recovery of VAT. To this end, regulation 102 of the VAT Regulations 1995 (SI 1995 / 2518) allows HMRC to approve a special method. A special method only provides for the recovery of VAT on costs that relate to taxable supplies made in the UK.
6. The first change (the Method Declaration) will require a business to declare 'to the best of its knowledge and belief' that its proposed special method is fair and reasonable. HMRC will have the power to set aside a method if the person signing the declaration knew or ought reasonably to have known that is not fair and reasonable. The business would then have to recalculate past returns to ensure that it only recovered a fair and

reasonable amount of VAT. This change will allow HMRC to approve special methods more quickly, and improve fairness and equity by helping to ensure that all businesses recover a fair and reasonable amount of VAT.

7. The second change (the Combined Method) will give businesses the legal right to apply for a 'combined method' that caters for the recovery of VAT on overseas supplies that confer the right of input tax deduction (for example, supplies of finance and insurance made to customers outside the European Union). This will simplify the rules for partly exempt businesses that make overseas supplies.
8. The introduction of the Method Declaration and Combined Method will require amendments to secondary legislation, in particular, regulations 99, 101, 102, 102A and 103 of the VAT Regulations 1995.

Further advice

9. If you have any questions about this change, please contact Patrick Wilson on 0207 147 0595 (patrick.wilson@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk