Partial exemption – supplies from non-UK establishments

Brief 22 (2015): changes to VAT regulations following Judgment in the case of Le Credit Lyonnais (C-388/11)

HMRC has released Brief 22/15 which sets out the revisions to the UK partial exemption regulations following the ECJ decision in Credit Lyonnais (C-388/11). Originally the amendments should have taken effect from 1 August 2015 but implementation was deferred as a result of consultation responses. The scope of the changes was narrowed as a result of concerns expressed that the proposals went too far. A revised version was released for a further limited and short consultation in October and as a result of comments received the draft regulations were amended again.

Essentially, the changes in their final form are:

1) Businesses using the standard method cannot take account of supplies made from non UK establishments when calculating their residual recovery rate. (Amendment to Regulation 101)

2) Each sector of a sectorised special method must reflect the use to which VAT-bearing costs are put in the business and in that sector, the structure of the business and the type of activity undertaken by that sector. (Amendment to Regulation 102). A requirement for each sector to keep separate business accounts has now gone following the responses to the October consultation. This is a welcome change as that proposed condition had given rise to concern especially as it was not clear what HMRC meant by that phrase in this context.

3) The value of supplies made from non-UK establishments can only be taken account of in a sectorised method. Credit Lyonnais confirmed that sector cannot simply be based on a geographic location.

4) Regulation 103 will also be amended to mirror the changes to Regulation 102.

These changes have effect in relation to:

• any standard method longer period beginning on or after 1 January 2016, (Regulation 101)

• any special method approved or directed on or after 1 January 2016 (Regulation 102) and, for Regulation 103,

• any VAT period beginning on or after 1 January 2016

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Comment

These changes will affect businesses on the standard method that make supplies from non UK establishments. The UK recovery rate will be applied to all residual UK costs used to make such supplies as the separate use based provision under Regulation 101 will be removed. The standard method override will be triggered If the standard method and a calculation that fairly reflects use give answers that are sufficiently different (a £50k difference, or £25k for group undertakings) to bring the override into play. Alternatively, if the difference is material a special method may be required even if the override is not triggered. It is that latter comment that has the potential to cause difficulty as the meaning of material in this context is a) clearly different from the meaning of substantial in the override provisions, b) is not defined, and c) has to be looked at on a case by case basis based on the circumstances of the individual business.

Businesses on sectorised special methods will also be affected. Sufficient records to demonstrate allocation of costs to, and use by, sectors will need to be kept. HMRC says, however, that it does not expect many businesses to be affected as most businesses that make supplies from overseas establishments already use a special method that is compliant with the new legislation.

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