Pre-registration VAT

Indirect Tax

01 January 2017

HMRC have issued Revenue and Customs Brief 16/2016, clarifying that its policy has not changed on the deduction of VAT relating to goods and services used by a business before it registers for VAT.

Background

HMRC recently issued Revenue and Customs Brief (RCB) 16/2016 concerning the deduction of VAT incurred on goods and services bought by a business before it registers for VAT but used afterwards.

The RCB is a response to concerns raised at the Joint VAT Consultative Committee (JVCC) by the CIOT and representatives of other professional bodies that HMRC had departed from a practice that it had implemented and not withdrawn that allowed businesses that incurred VAT on goods and services prior to being registered for VAT, to recover that VAT in full if –

- In regard to goods, they were on hand at the effective date of registration (EDR);
- In regard to services, the VAT was incurred within the six months preceding registration.

We wrote to HMRC towards the end of 2015 setting out our view. In essence, we took the view that the relevant legislation (VAT Regulations 1995, reg 111) was capable of being interpreted to require an apportionment of VAT. Our letter to HMRC can be found on the CIOT website.

HMRC’s policy

HMRC’s RCB sets out its policy on VAT incurred prior to registration on –

- Services;
- Stock on hand; and
- Fixed assets.

In each case, HMRC notes that full recovery is only permitted if a business is fully taxable so that if a business is partly exempt, has non-business activities or has other reasons why it is required to restrict input tax deduction, an apportionment is required.

For fixed assets that are within the capital items scheme, Notice 706/2 provides the following guidance on VAT incurred prior to registration: ‘When you register for VAT, you deduct one complete interval from the period of adjustment (normally ten years for land and buildings) for each complete year (12 month period) that has elapsed between the date of first use of the asset (see paragraph 11.3) and the date of registration.

VAT that you incurred on the asset while you were unregistered is non-deductible and so the baseline recovery percentage for the CGS is nil.’

Thus for a capital item incurred before registration, only that VAT that is attributable to use for taxable activities after registration will be deductible. For other fixed assets, HMRC will allow full recovery subject to the apportionment noted above.

Principles of apportionment

In regard to apportionment of VAT, our letter to HMRC noted that the High Court found that where VAT incurred is referable to both supplies made prior to registration and supplies made after registration, only that VAT that can be attributed to the supplies made after registration is deductible (See *Schemepanel Trading Ltd v C & E Commrs, QB* [1996] STC 871). So it is quite clear from case law that some apportionment is required if supplies are used both before and after EDR.

However, the essence of the point raised by different representatives was that VAT incurred prior to registration, but which relates to both taxable and exempt supplies after registration, did not have to be apportioned because of a practice adopted for the sake of simplicity by HMRC, a practice that had not been withdrawn. In our letter, we noted that there certainly was evidence of the practice recalled by various persons.

HMRC’s RCB in effect does not require apportionment for pre-registration use of fixed assets where there is some pre-registration use, but for assets within the capital items scheme an apportionment is made via that scheme.

We suggested that ideally the manner in which pre-registration VAT should be dealt with should preferably be the subject of legislation clarifying what needs to be done, but in the meantime there should be a Revenue and Customs Brief to clarify the position and any related guidance should be updated. We therefore welcome the publication of the RCB and HMRC’s statement that both VAT Input Tax Manuals and VAT Notice 700: the VAT guide will be amended to ensure the policy position is clear.

The six month rule and change in use

In our letter to HMRC, we raised a further point – the validity of the six month rule in relation to services. We pointed out that the UK has not implemented the VAT deduction rules in strict conformity with the EU VAT rules. In particular, a person who is not registered for VAT is a taxable person so that in principle VAT incurred prior to registration is deductible if the supplies on which it is incurred is attributable to taxable services even if made after registration. Thus, if VAT was incurred on services for say a year prior to registration and those services related solely to supplies made after registration, the tax is in principle deductible.

We also pointed out that the change of use rules (regulations 108 and 109 as well as the capital items rules) do not fully comply with the PVD.

For different reasons therefore, we have reservations concerning HMRC’s statements in regard to services.

Transition

HMRC indicate that taxable persons, who have reduced the VAT deducted on fixed assets, or who have been subject to an assessment in respect of VAT incurred, in order to account for pre-EDR use, can apply for a refund in the normal way.

Way forward

We do not plan to take the matter further but will await publication of the amended manuals and notice, which we will review. However, if members still have concerns, we would be happy to take this further at the JVCC.