



HM Revenue  
& Customs

# VAT Partial Exemption and Capital Goods Scheme

## Summary of responses

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# 1. Introduction

Businesses that make both taxable and exempt supplies ('partial exemption') incur VAT on their purchases that cannot be attributed directly to either taxable or exempt supplies. A calculation must be performed to determine how much of this VAT is recoverable. There is a standard method for working that out, but if the standard method does not provide a fair and reasonable result, businesses can use a Partial Exemption Special Method (PESM). A PESH allows a bespoke calculation for a business to determine its recoverable VAT.

The Capital Goods Scheme (CGS) provides for adjustments to be made over time to the initial VAT recovery relating to purchases of certain capital items (such as buildings, computers and aircraft), recognising the longer working life such assets have. The recovery of the VAT incurred on such assets is only made once – in the year of purchase. If, during the life of the CGS, there is any change in the proportion of taxable use then businesses must make an adjustment to their recovery of VAT to take account of this.

In July 2019 the government launched a call for evidence on the simplification of the Partial Exemption (PE) and Capital Goods Scheme (CGS) regime. Announced at Spring Statement 2019, it looked at ways to improve the operation of PE and the CGS, following the findings of the 2017 Office of Tax Simplification (OTS) VAT review. The call for evidence was intended to gather evidence and views on three distinct areas:

- Simplification of the PE Special Methods (PESMs) approvals system.
- The PE de minimis test and thresholds.
- Changes to the CGS thresholds for land and property and associated alterations, extensions, annexes and refurbishments. The call for evidence also considered the administration and scope of the CGS.

This document is a summary of the 80 responses received to the call for evidence. Over half of the responses were from businesses. The majority of the rest were from trade organisations, advisors and public sector organisations.

In addition to written responses, four multi-stakeholder meetings were held with relevant stakeholders including trade associations and accountancy firms. The government is grateful to all those who took the time to respond.

Where responses were received which covered subjects outside the scope of the call for evidence, these were noted and may be considered as part of any future reviews of this area.

For the government response to the comments received to the questions in this call for evidence, please see the 'Next Steps' at the end of this document.

## 2. Responses

### Partial Exemption Special Methods (PESMs)

This section of the call for evidence focused on the process of getting an approval for a Partial Exemption Special Method (PESM) and how that could be simplified. At present where a business requires a PESH, it must submit a proposal with a signed declaration that the proposal is, in its view, fair and reasonable. This proposal will be reviewed by HMRC and, if appropriate, approval given for its use following checks on the proposed method.

#### **Question 1 "Does your business use a PESH? If so, what was your experience in getting the PESH approved?"**

Nearly all respondents had experience of using a PESH, including those responding on behalf of members or clients.

Experiences of agreeing PESHs were mixed, over half of respondents noting that the length of time it takes to agree a PESH is excessive. In addition, a third of those also described the process as either difficult, challenging, onerous or frustrating, for example because of the time taken for approval to be granted or a perceived lack of clarity about what was required. Please also see response to Q3

These views were similar to those expressed in stakeholder meetings where the main issue was highlighted as excessive time taken to agree a PESH.

#### **Question 2 "How long did the approval process take"**

There were a range of responses to this question, from less than six months to over two years. Of those responding on behalf of others, some stated that it varied depending on the complexity of the business. Overall, most respondents felt it was excessive. The same views were shared in stakeholder meetings.

#### **Question 3 "Do you find the administration involved with PESHs challenging?"**

Of those that addressed the question the majority felt that the administration involved with PESHs was challenging. Respondents stated that it depends on the complexity of the PESH, but also that HMRC's attitude could make the process challenging. The reasons given for why it was challenging varied from HMRC's lack of commercial understanding of certain sectors to respondent's lack of understanding of the process and information required and this increased the length of time spent in negotiating with HMRC.

#### **Question 4 "Would allowing businesses to apply PESHs without seeking approval improve the system? Please give reasons for your answer."**

#### **Question 5 "Would there be issues created by removing the requirement to seek approval of a PESH?"**

These questions are considered together as most respondents answered them in that way.

A range of views were expressed in response to these questions. Around half of respondents felt that enabling businesses to apply PESHs without seeking approval

could simplify and improve the system. This view was also expressed at stakeholder meetings. Some respondents felt this would end uncertainty during the existing approvals process. An example given was larger businesses are constantly changing in nature, so they cannot always agree a PESH for the whole of the business up front, and this therefore creates uncertainty for a longer period of time. Using a PESH without approval would remove this uncertainty.

Respondents also identified potential changes that they thought would help if the approvals system was removed. These included clear rules about which PESHs HMRC can challenge, if HMRC move away from approvals and require simple notification of the intended use of a PESH; a timeframe for HMRC to respond to a PESH notification; and sectoral frameworks and improved guidance.

Over half of the responses included concerns with removing the approvals process, as it could reduce business certainty, and businesses could be at risk of future assessments and penalties. Respondents stated that there could be an optional approvals process for businesses that require the legal certainty that comes with HMRC approval.

**Question 6 "Would an increased focus on the use of sectoral frameworks be of benefit, particularly if approvals were removed?"**

The majority of respondents were in favour of increased focus on sectoral frameworks. However, respondents indicated that these frameworks should be optional, flexible, and should be developed in partnership with industry experts.

This view was also expressed in stakeholder meetings, with the suggestion that these frameworks could be used as 'off the shelf PESHs', provided they were not prescriptive.

**Question 7 "Do you have other suggestions to improve or simplify the application of the PE regime?"**

There were a number of industry or business specific suggestions made by attendees at the meetings and respondents to the call for evidence. This included the ability to amend a PESH that is currently in use without having to agree the entire method again as is currently the case. Another suggestion was where PESHs comprise sectors that are all utilising turnover-based VAT recovery calculations, it would be reasonable to permit these to be applied without prior HMRC approval, as they are essentially a consolidation of multiple standard methods calculations.

**Question 8 "Do you have other suggestions on how the way in which HMRC interacts with partly exempt businesses could be improved?"**

There were a variety of responses to this question, ranging from concerns about HMRC expertise to those about how HMRC engages with businesses. Respondents suggested more training for local officers and for PE specialists to speak directly to taxpayers and be involved earlier on in the approvals process. It was also suggested that HMRC staff should develop more commercial awareness (a point also echoed at stakeholder meetings). Respondents also suggested further guidance in the form of a checklist or a template about what is required to apply for a PESH would be useful.

## PE De minimis

This section of the call for evidence focused on the PE de minimis test and how that could be simplified. Views were sought in respect of removal of the de minimis test and raising the threshold at which businesses would have to conduct a full PE calculation.

If a business meets the PE de minimis test, it enables the business to recover all input tax that relates to exempt supplies as well as their taxable supplies. Currently a business is de minimis if exempt input tax is not more than £7,500 a year (£625 a month on average) and is less than half of the business's total input tax in the relevant period.

### **Question 9 "What is your experience of carrying out the de minimis test?"**

Responses to this question were mixed. Respondents stated that the test was complex and takes considerable effort and time, however they also thought that the de minimis test is a valuable simplification for businesses. This view was expressed in stakeholder meetings, with attendees stating that the de minimis test was a good facilitation for small businesses and that it should be retained, however they also thought that the threshold should be increased.

### **Question 10 "What would the advantages and disadvantages of increasing the de minimis threshold be to business?"**

Many respondents stated that increasing the de minimis threshold would be an advantage, as it would assist smaller business with greater input tax recovery; ease the administrative burden and remove uncertainty for those on the threshold. It would also take some businesses out of the current PE requirements and encourage more voluntary registrations for those below the current VAT registration limit.

Many respondents were in favour of an increase to the de minimis threshold and most of these were in favour of an increase in line with inflation at the very least.

Some respondents identified potential disadvantages to increasing the de minimis threshold. A higher limit could create more of a 'cliff edge' for those who would no longer be able to benefit from the de minimis as they approach the threshold and could potentially disincentivise business growth. Increasing the threshold could also create more of an administrative burden for HMRC and businesses on the edge of the threshold

### **Question 11 "Are you aware of the existing simplification, and do you make use of it?"**

Only a small number of respondents were aware of the de minimis simplification, with fewer respondents making use of it.

### **Question 12 "What would be the advantages and disadvantages of removing the de minimis test?"**

Many respondents stated that the removal of the de minimis test would be a disadvantage, as it would force more smaller businesses into PE, requiring them to perform full PE calculations; increase administrative and financial burdens for businesses; and would also have an impact on not-for-profit organisations.

**Q13 "Do you have other suggestions to improve or simplify the application of the de minimis regime?"**

Some respondents suggested a change in the way that the de minimis is calculated.

**Q14 "Do you have any suggestions on how to determine what can be considered as 'insignificant' that would be different to the current de minimis tests?"**

Suggestions included a fixed percentage of turnover (less than 1% for example) or using a transaction count or number of instances.

## **Capital Goods Scheme**

This section of the call for evidence focused on the CGS and how it could be simplified. Views were sought on proposals to increase the threshold for land and property and associated alterations, extensions, annexes and refurbishments. The call for evidence also considered removal of computers from the CGS and a change in the number of intervals.

**Q 15 "What is your experience of the CGS?"**

The most common response was that the CGS is burdensome, complex, and results in minimal adjustments. Some respondents indicated that the CGS is not well known or understood.

**Q 16 "How much time and resource do you allocate to carrying out CGS calculations? Does this have an impact on your business?"**

Most respondents stated that they had to allocate a significant amount of time to carry out these calculations, which has an impact on their businesses. They also indicated that the CGS uses specialist resource to complete (in-house or external specialists), and that it takes considerable time to compute the initial calculations. Respondents noted that the high number of qualifying refurbishments/extensions was an issue.

**Q 17 "To what extent does the CGS help to prevent cases of tax avoidance and unfair competition?"**

Some respondents answered that they did not know or didn't view CGS as an anti-avoidance matter. A small number of respondents answered that CGS was an effective anti-avoidance measure, and that it helped prevent competitive advantage.

**Q 18 "What would be the advantages and disadvantages of increasing the threshold for land and property for businesses?"**

Most respondents indicated that the threshold should be increased, with mixed views on the advantages and disadvantages of doing so. The main view was that it would reduce the number of qualifying assets falling under CGS, simplifying internal record keeping and reducing the administrative burden on businesses. However, respondents also stated the disadvantages, which include some taxpayers (and HMRC) losing out from future changes in usage and the VAT resulting, if they were not under the CGS mechanism.

Many respondents did not specify a specific value for the increase, although links to indexation and inflation were suggested. Some respondents specifically stated £1 million, again with many requesting indexing going forward or regular reviews. A smaller number of respondents suggested a value of between £2.5 million and £5 million.

The stakeholder meetings included similar discussions to the above. The general view was that an initial increase would be welcome, followed by regular reviews and increases in the future. Stakeholders also wanted any increases to be based on the economic life of assets. Suggestions ranged from doubling the current threshold to raising it to £2.5 million

**Q 19 "Would there be any other issues involved with increasing the land and property threshold?"**

Respondents answered that there could be transitional issues resulting from any increase, with the primary concern being developments/refurbishments that straddled any change in threshold and how these assets would be treated going forward.

**Q 20 "If the threshold for land and property is increased, do you think we should consider having a different threshold for alterations, extensions, annexes and refurbishments, (i.e. retain the current threshold) or would this increase complexity?"**

Many respondents were of the view that any difference in thresholds would not be a simplification but would result in an increase in complexity, making the CGS harder to administer. Although other respondents supported different thresholds, they recognised that this would increase complexity.

The consensus within stakeholder meetings was that having differing thresholds would increase complexity, and therefore should not be considered.

**Q 21 "Are there other ways in which the CGS can be improved?"**

There were a number of other suggestions to improve the CGS. The most common suggestion was to have a form of de minimis for CGS. Respondents also stated that they would like better guidance on the application of CGS special methods. There were a small number of responses on the scope of the CGS, with respondents stating that yachts/aircraft should be removed from CGS altogether. Stakeholders also suggested the alignment of the CGS interval adjustments with the PE years (at present businesses account for the CGS adjustment in the subsequent VAT return to the PE annual adjustment). In addition, the proposal was made to align the CGS with normal VAT record-keeping requirements (for CGS purposes, businesses need to keep records for 10 years, whereas for normal VAT requirements they only need to keep records for six years)

**Q 22 "Do you have experience of computers being included in the CGS?"**

Of the respondents who answered this question, a very small number had experience of computers being included in the CGS.

**Q 23 "Would removing computers from the CGS be a simplification for business?"**



A majority of respondents agreed that computers should be removed from the scope of the CGS, whilst recognising it would have a limited effect on simplification.

#### **Q 24 "What do you think of the current interval length?"**

Respondents were generally of the view that the current intervals were appropriate. A few respondents suggested intervals ranging from five to 20 years.

#### **Q 25 "Would a change in the number of intervals help businesses with their administration of VAT? Why? "**

Many respondents answered that a change in the number of intervals would help businesses with their administration of VAT, specifically helping with the Transfer of Going Concern record keeping requirements. A small number of respondents stated that they were satisfied with the current methodology and its application.

### **Other suggestions**

This part of the call for evidence invited any other suggestions for improving and simplifying the PE regime and the associated CGS.

#### **Q26 "Do you have other suggestions to improve and simplify the application of the PE and CGS regime?" (excluding points already raised)**

There were various suggestions put forward in response to this question, including improved light touch principles and more frameworks, simplification of business/non-business calculations, and dispensation for clubs, charities and voluntary organisations.

Respondents would also like to understand the position of leases regarding CGS terminations. Another suggestion was an opt-in system for carrying out full PE calculations. For example, where recovery is below 15%, businesses should be able to apply a specific percentage to the total input tax without any attribution.

Other responses included a reduction of the scope for exemption; limiting the CGS to single capital purchases over £1 million; a single VAT adjustment for CGS in year 10 of the intervals (or two five-year adjustments); simplification of rules before incorporating any changes into Making Tax Digital; and improved HMRC guidance.

#### **Q27 "Do you have any experience of the operation of PE and the CGS in other countries?"**

Respondents gave the following examples of PE/CGS regimes (or equivalent) in other countries:

- Germany has no formal PESH approval process, however options for use of proxies within methods are limited.
- In Ireland VAT groups operate a sectorised method based on concessionary treatment of fund managers, allowing a review but not requiring PESH approval.
- Australia has a very high de minimis threshold £250k and a multi-tiered system of input tax recovery.
- Canada has a special refund scheme for the not-for-profit sector.
- Singapore publishes recovery percentages for sectors yearly.
- Some EU Member States either have a single residual pot or provide sector flat recovery rates

Respondents stated that the schemes in other jurisdictions are generally simpler but less flexible, and that thresholds are reviewed and updated more frequently than in the UK.

The general view was that the UK has a very flexible regime. Respondents stated that this flexible approach is appreciated and should be retained, but that this can sometimes lead to protracted approvals. Respondents also noted that the UK has a very low exemption threshold in comparison to other countries, which means more businesses fall under PE rules.

**29 "Do you have any other comments?"**

There were no discernible recurring themes in response to this question. However, a few participants restated the need for better guidance.

## 3. Next steps

### Changes to Internal Processes

Having evaluated these responses, an internal review was carried out to assess the process for applying for a PESH and how this can be simplified. HMRC will make the following changes shortly to simplify the current system:

- **Centralised application point**

There will be a centralised application point for PESH applications set up shortly. This means that all PESHs will go to the same HMRC team in the first instance and they can be recorded promptly. This will provide clarity for taxpayers as to the correct place to submit their PESH application. Additionally, this will reduce the time taken for HMRC to begin reviewing a PESH application.

- **Clearer application process**

In order to apply for a PESH, there will be an accompanying application form to complete. The form will guide applicants through the steps of applying and make it clear what information is required. This will minimise the need for ongoing information requests from HMRC and should reduce the time needed for HMRC to process an application. A PESH will only be processed once all the information required has been provided.

- **Sectoral Frameworks**

The review of all current frameworks is ongoing, with some now completed. An internal review to identify the need for new frameworks is also being carried out and we intend to engage with relevant stakeholders in taking this forward. HMRC are also in the process of reviewing and updating our existing PE and CGS guidance.

### Further stakeholder engagement

The government is grateful for the informative responses to this call for evidence. These responses have illustrated a range of views and concerns, including specific changes which could be made to simplify the PE regime and the associated CGS.

The changes to internal processes outlined above are intended as a first step to address the concerns expressed about the current PE regime. HMRC will be engaging with stakeholders in due course to evaluate the impact of those changes and the extent to which they have simplified the process for business. As part of that engagement, HMRC will also keep under review the need and potential for further changes.

In terms of the de minimis and CGS, HMRC will also engage further with stakeholders to better understand the impact of any potential threshold and process changes which could be made in the future.

# Annexe A: List of organisations and stakeholders who responded to the call for evidence

The respondents to this call for evidence were:

ABI
Aria Resorts
Ashfield Park Homes
Aviva
AXA
BDO
BHHPA
British Property Federation
Brickhill Park
BUFDG
Burke Enterprises Ltd
Buzzacott LLP
Coswawes Park
CBRE LTD
Charity Tax Group
CIOT -ATT
Clock Caravan Park
Creek Caravan Park
Deloittes
DWP Tax centre of excellence
EY
England Golf
FLA
FODO
Gainsborough Park
Haulfryn
Helle Valley Holiday Park
Helford Sailing Club
Hoo Ness Sailing Club

Hurley Riverside Park
ICAS
ICAEW Tax Faculty
ILAG
Investment Association
IUA
KPMG
Lang & Horgan LTD
LIIBA
Lloyds Banking
Markel Tax
NCHA
Netleys
NFU
Oaklands Grange Caravan Park
Orchards park
PCSW LTD
Pettycur Bay
Pioneer Caravans
Places for People Group
Public bodies group and charities
PWC
Quiet site
Resiparks.co.uk
Royal Mail
Royal Northern & Clyde Sailing Club
Royal Solent Yacht club
Royal Yachting Association
Salterspetfood
Scotchwell Park
Sport & Recreation Alliance
Strood Yacht Club
Tenby Sailing Club
Thames Motor Yacht Club

Tomlinson's Leisure Park
Tudor Sailing Club
UK Finance
VAT in Industry Group
VAT Practitioners Group
West Kirby Sailing Club
West Lancashire Yacht Club
Woodhouse Farm Caravan Park
Woodside Caravan Park
X-VAT Ltd
YFM Equity