

VAT

Partial Exemption

Introduction of Simplified De-Minimis Tests



Background

HM Revenue & Customs has announced the introduction of simplified partial exemption de minimis tests. These will enable businesses to work out whether or not they can treat themselves as fully able to recover input VAT without having to perform a full partial exemption calculation.

The Existing De Minimis Test

The New De Minimis Tests

The New Simplified Tests

The Annual Test

Background

Businesses that earn income that is exempt from VAT as well as income that is subject to VAT must perform partial exemption calculations so as to restrict the amount of VAT recovered on costs.

Small businesses that incur very little input VAT in respect of the exempt activity have been able to treat themselves as fully able to recover VAT provided that they meet what is known as the 'de minimis test'.

The Existing De Minimis Test

The existing de minimis test will remain in place and there will be no change to the de minimis limits:

Input VAT relating to the exempt activity amounting to:

- less than £625 per month on average; and
- Not more than 50% of total input VAT.
- is fully recoverable.

However, in order to work out whether a business passes this test it must first perform a full partial exemption calculation.

The New De Minimis Tests

To reduce the burdens on business HMRC is introducing new versions of the test that can be done without the need to perform a full partial exemption calculation. These new versions of the test fall into two categories:

- Two new simplified tests; and
- One new annual test.

The new simplified tests can be used for VAT periods starting on or after 1 April 2010.

The new annual test can be used for VAT partial exemption years starting on or after 1 April 2010.

Use of the new tests is optional so businesses can carry on using the traditional de minimis test or can use one of the new ones. Permission from HMRC is not required.

The New Simplified Tests

There are two versions of the simplified test:

1. A business that has total input VAT of less than £625 per month on average and has exempt income of not more than 50% of total income can treat itself as de minimis.

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2. A business that has exempt income of not more than 50% of total income and whose total input VAT after deducting input VAT that directly relates to (i.e. will be used exclusively for) its non exempt business activities is less than £625 per month on average can treat itself as de minimis.

These tests can be used in place of the traditional de minimis test every quarter and again when performing the annual partial exemption de minimis check at the end of the partial exemption year.

Note 1: Total input VAT in this context excludes input VAT that is specifically blocked from recovery such as VAT incurred on business entertainment.

Note 2: Total income includes the following:

1. Supplies of goods or services in the UK subject to VAT at 0%, 5%, or 17.5%;
2. Supplies made outside the UK that would be subject to VAT at 0%, 5%, or 17.5% if made in the UK; and
3. Exempt supplies.

The Annual Test

A business that was de minimis in its previous partial exemption year can, instead of applying quarterly de minimis tests, treat itself as de minimis for the whole of the following partial exemption year.

To use this treatment the business must have reasonable grounds for believing that its total input VAT for the current partial exemption year will not exceed £1,000,000.

A business that uses the annual test must still perform a partial exemption de minimis check at the end of the partial exemption year using either the traditional de minimis test or one of the new simplified tests.

If the test reveals that the business was in fact partly exempt it will be required to perform a full partial exemption calculation and repay the over-claimed input VAT.

The business will also be obliged to check its de minimis position every quarter thereafter using either the traditional or one of the new simplified de minimis tests. Quarterly checks will continue to be required until the business has been de minimis for a full partial exemption year.

Specific advice should be obtained before taking action, or refraining from taking action, on any of the subjects covered.

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