Revenue and Customs Brief 8 (2020): Change to partial exemption VAT treatment

Indirect Tax

30 July 2020

HMRC have published the long-awaited Revenue and Customs Brief 8 (2020): Change to partial exemption VAT (https://tinyurl.com/ya2clbw8), which sets out its policy changes for businesses that supply goods by way of hire purchase agreements, and have a suggested apportionment method for input VAT incurred on overheads. This RCB follows the CJEU judgment in Volkswagen Financial Services (UK) Ltd (Case C-153/ 17) (https://tinyurl.com/ycf3jp3j).

Background: The Volkswagen Financial Services (UK) Ltd case

When a consumer wanted to purchase a VW vehicle from a Volkswagen dealer on finance arrangements, the dealer would supply the vehicle to Volkswagen Financial Services (UK) Ltd (VWFS) plus VAT; and in turn, VWFS supplied both the vehicle and financial credit services to the consumer. VWFS's view was that its partial exemption special method should be based on the transaction count; as individual supplies of a standard rated vehicle and VAT exempt credit were made to each consumer, the VAT recovery rate on overheads would work out at 50%.

After ongoing litigation in the UK, the Supreme Court referred questions to the CJEU in 2018. The Advocate General (AG) opined that the VAT liability of supplies of hire purchase agreements in the UK was not correct and should be treated as a single taxable supply of a vehicle, the value of which also should include the value of the credit supplied. Although the VAT incurred on overheads would become recoverable, this would be exceeded by the increased output VAT due on the supply of the vehicle.

HMRC’s position was that as VWFS sold the vehicles at cost as part of the sales agreement, this taxable supply should not affect the apportionment calculation for the input VAT recovery on overhead costs, which they deemed to relate wholly to the VAT exempt supply of credit and arrangement services and hence all irrecoverable.

The CJEU did not follow the AG’s opinion and instead held that VWFS’s overhead costs were a component of the overall supply of goods under a hire purchase agreement and that there is a right to recover input VAT on overheads even where they had been set against the exempt element for costing purposes. Further, one cannot exclude the value of the goods in a values-based partial exemption apportionment method.

What changes?

The RCB proposes a method which, inter alia, takes the credit amount of the asset value as the numerator. The credit amount of the asset value, plus the credit amount, plus the finance charges, plus any arrangement fees are the denominator. This will result in a recovery percentage below 50% (the result originally sought by VWFS) but still significant – the example in the RCB produces a recovery rate of 46.69%.

The suggested partial exemption method that is in the brief is not compulsory, so businesses with existing partial exemption special methods can continue to use them if desired. Otherwise, businesses can contact HMRC if they would prefer their existing method.

As this case has been ongoing for several years, many businesses will have already lodged protective claims with HMRC and they should now be progressing with the publication of this brief. HMRC are also inviting businesses to contact them at wmbcassetfinanceteam@hmrc.gov.uk in the following circumstances where the taxpayer has:

- recovered no overhead VAT on hire purchase supplies;
- submitted error correction claims for overhead VAT on hire purchase supplies;
- requested revisions to their partial exemption methods; and
- submitted proposals for a new partial exemption method.