Pre-registration VAT: assets held when first registered

Indirect Tax

04 December 2015

CIOT address issues raised by members

We have been asked to consider the application of the rules regarding ‘pre-registration VAT’ on assets held when a business is first registered. The relevant UK law is found in VAT Regulations 1995, reg 111.

Evidence from members and others suggests that, until recently, HMRC did not require apportionment of the VAT incurred on any assets to reflect the fact that it had been used before registration, and so some of the VAT was attributable to what were, in effect, exempt supplies in EU law. Full recovery of VAT was permitted. We understand, however, that HMRC have sought to apportion such VAT that is being claimed. Case law (*Denise Jerzynek* [2004] UKVAT V18767) suggests that, for reasons of simplification, HM Customs & Excise, as they were then, did not require apportionment. However, it should be noted that the case did not consider the obligation to interpret UK legislation in accordance with relevant EU law.

We saw two issues:

- First, if it was indeed the case that HMRC did not require apportionment in the past, it would appear to be unfair to now require taxpayers who had made decisions based on the ability to recover the VAT to now be required to apportion the VAT incurred.
- Second, although we accept that UK law must be interpreted in accordance with EU law and it may be possible to interpret the reference in article 111 to pre-registration VAT being ‘treated as input tax’ so as to require apportionment, the legislation is not entirely clear. In any event the issue of simplification raised in *Jerzynek* needs to be considered.

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Accordingly, we are suggesting to HMRC that they should:

- Amend the legislation rather than seek to interpret it differently from how they have previously. The legislation should make it clear that, if an asset is used before and after registration, an apportionment must be carried out to determine the extent to which the VAT is attributable to taxable activity after registration.
- Provide adequate transition provisions to ensure that small businesses that have worked on the basis that the VAT would be recoverable are not prejudiced.

Finally, although we were asked questions only about VAT on goods, we pointed out that the six-month rule for services could result in VAT properly deductible under EU rules not being recoverable so we suggested that any legislative amendments should deal with that too.