VAT: Partial exemption special methods

Indirect Tax



19 February 2024

CIOT attended a focus group with HMRC to discuss partial exemption special methods and some of the more common difficulties.

The CIOT previously engaged with HMRC on VAT partial exemption special methods (PESMs) when the PESM application form was digitalised via G-form (see earlier article tinyurl.com/9jewwa57). A PESM is the methodology by which a business with both VAT exempt and taxable income can recover input VAT on a fair and reasonable basis where the standard method is not suitable. For a fuller description of the basics of partial exemption, standard and special methods, see February 2022 *Tax Adviser*, 'Partial exemption in VAT registered businesses' (tinyurl.com/yc523zwh).

The CIOT were invited to attend a recent HMRC focus group meeting with other VAT specialists from practice to discuss various aspects of PESMs. HMRC reported at the focus group that since the digitisation of the application process had been launched,

this had much improved the monitoring of live applications (approximately 700 to 1,000 per year) by the allocated PESM caseworker. This included timeline adherence as the application passes through the different stages of review and engagement by other teams. The digitised process also highlights when cases are becoming long term, so they can come under scrutiny sooner.

Common sticking points

Attendees raised several examples of times when finalising a PESM proved to be difficult. For example, for a sectorised PESM, only one sector out of a larger number could end up in dispute. In some more extreme examples, up to five resubmissions were required to bring the case to full agreement. HMRC said that ‘use’ is the key factor in any PESM request and it is important to provide the evidence that supports the fair and reasonable declaration (see para 6.2 of VAT notice 706 (tinyurl.com/yc8a6jt9)).

Another example discussed was possible simplifications in circumstances where a company joins an existing VAT group. This results in having to resubmit the whole PESM for approval, as the ‘fair and reasonable’ declaration must cover the whole group. A PESM is therefore required each time a new company is added to the business. This was seen as particularly burdensome in cases where the added company had no impact on the PESM.

Discussing the PESM

There was broad agreement from attendees that, where the application requires it, advisers would like early conversations with HMRC caseworkers to discuss perceived issues with the PESM application. Generally, the costs incurred by clients for this engagement are less than having to enter into repeated correspondence with HMRC. Although this position was less favoured by HMRC in the past, they have started to recognise the value of early conversations, particularly in complex cases where it is far easier to understand the fact pattern in live discussion than by letter. HMRC did highlight that it is crucial to present background information for a meeting in advance (for example, a week or so before the meeting) to allow officers to review the data and prepare questions. There was little use presenting data on the day of the meeting when the team had had no time to review it.

Rejected applications

Several stakeholders highlighted that they had received rejection letters on a PESM application, and it was frustrating to not understand the reasons why the rejection read: '*it is not fair and reasonable*'.

HMRC agreed that the reason(s) for rejection should be included in this correspondence and that this had addressed internally. They expect all current PESM rejection letters to include explanatory points and welcomed feedback should it be found that this information was not supplied. The CIOT had flagged this in our earlier meeting (see article linked above).

If CIOT or ATT members have received such limited information in recent PESM rejection letters, please let us know at technical@ciot.org.uk and we can provide these details to the PESM team.

Please note, at the time of the workshop, the *Hippodrome Casino Ltd* [2024] UKUT 27 (TCC) case transcript was not in the public domain so was not discussed.

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