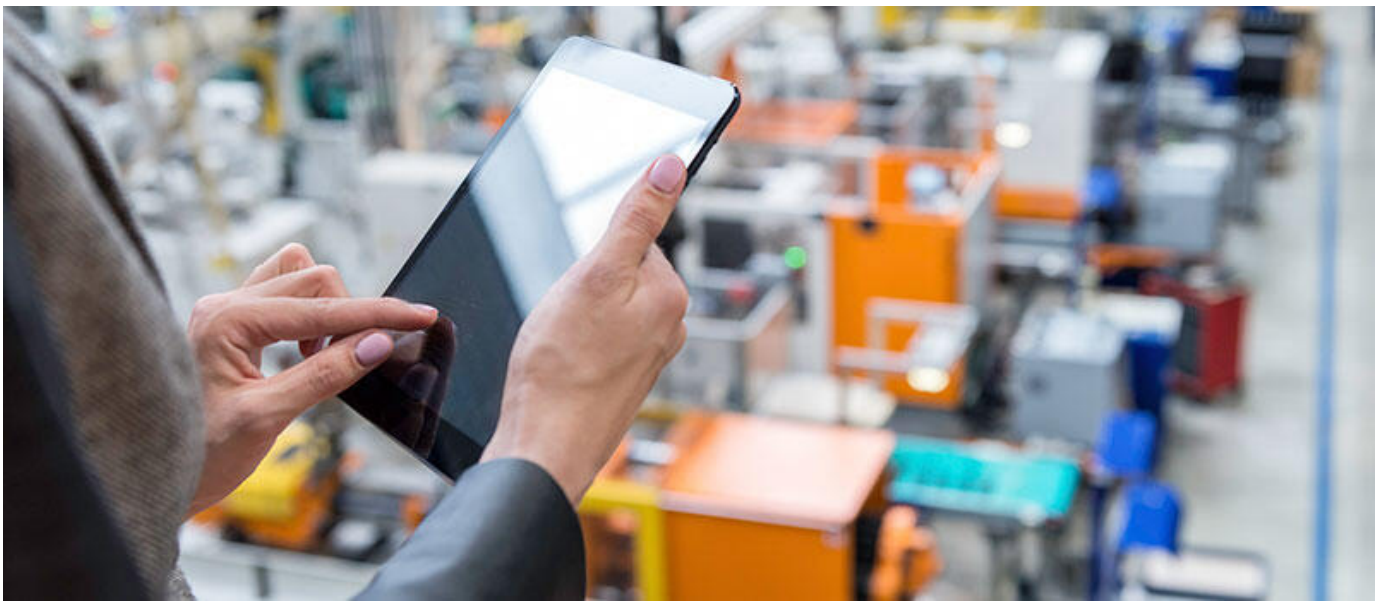
VAT: partial exemption working group: guidance project

Indirect Tax

December 2026



26 November 2026

HMRC’s VAT Partial Exemption Guidance provides guidance on attribution and the ‘direct and immediate link’ test, which assists businesses and advisers when deciding how to allocate input VAT under the partial exemption method. With case law continuing to clarify the principles for attribution, HMRC has engaged with its Partial Exemption Special Method (PESM) working group, which includes representatives from practice and CIOT, to discuss whether a list of positive indicators that would integrate outcomes from case law could provide greater clarity and certainty in the guidance.

In previous articles, the CIOT has highlighted its previous work with HMRC’s Partial Exemption team, both through the working group (tinyurl.com/ycayfwnb) to discuss difficulties in applying for and negotiating partial exemption special methods, and through individual discussions (tinyurl.com/5948bzz2) on practical tips when special method applications are rejected. At the October 2026 meeting, the topic under

consideration was attribution and the ‘direct and immediate link’ test.

Pages PE21000 and PE21500 of HMRC’s VAT Partial Exemption guidance (tinyurl.com/5x63dksu) currently set out the main principles for attribution and relevant case law. In advance of the meeting, HMRC had prepared ten draft positive indicators that set out practical scenarios where attribution of input VAT (VAT incurred on costs) is typically considered and highlighted the principal case law relevant to each indicator.

The focus group considered several key discussion topics, including the difficulties that could arise for particular outputs, how effectively the indicators might address those difficulties, the case law foundations, and suggestions for amendments, additions and deletions.

It is important to note that although it is likely there will be updates to the partial exemption VAT manual on attribution, HMRC stressed several points about the draft indicators:

- They would not constitute a new legal test. They are intended to explain existing law, not replace it.
- No fixed number of indicators would determine a particular outcome.
- Not all indicators on the list would need to be met, though contrary evidence cannot be ignored.
- They do not remove the need to examine the facts of each business.

HMRC are undertaking further work to consider and incorporate the feedback from the meeting and any subsequent submissions. As the project is still in its early stages, if you would like to send any feedback about the attribution guidance in the VAT manual, please contact us at technical@ciot.org.uk.

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