



**HM Revenue
& Customs**

VAT Input Tax Toolkit

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Introduction

Tax agents and advisers play an important role in helping their clients to get their tax returns correct. This toolkit is aimed at helping and supporting tax agents and advisers in completing VAT Returns on behalf of their clients, although it may also be of use to anyone who is completing a VAT Return. It may also be of use to tax agents and advisers who do not complete their client's VAT Return but wish to use it as a source of reference when advising their client on VAT matters or for reviewing their client's VAT declarations at the year end.

This version of the toolkit was published in July 2014. The risks in this toolkit have been reviewed and updated where necessary. Its use is entirely voluntary.

The content of this toolkit is based on our view of how tax law should be applied. Its application to specific cases will depend on the law at the relevant time and on the precise facts.

This toolkit is not a comprehensive statement of all input tax risks that may arise nor does it provide for all circumstances that a business may encounter. Areas of input tax that it does not address include:

- second-hand schemes - see **VAT margin schemes for second-hand goods, art, antiques etc**
- the Tour Operators Margin Scheme - see **Public Notice 709/5 Tour Operators Margin Scheme**
- agency arrangements - see section 22 (Supplies made through or by agents: general rules) of **Public Notice 700 The VAT Guide**
- pension schemes - see **Public Notice 700/17 Funded pension schemes**

This toolkit includes information on the following:

- preventing the application of the Lennartz approach to purchases of land, buildings, aircraft, ships, boats and other vessels made on or after 1 January 2011
- extending the Capital Goods Scheme (CGS) to certain purchases of aircraft, ships, boats and other vessels made on or after 1 January 2011
- extending the CGS to require input tax adjustments to reflect changes in the level of non-business use, including private use, of assets purchased on or after 1 January 2011
- a number of technical changes in the operation of the CGS
- extending the requirement to make 'payback' and 'clawback' adjustments when input tax is claimed or restricted on the basis of intended levels of business use, and that intention changes before use occurs
- the treatment of input tax incurred in the course of entertaining overseas customers
- the introduction of formalised special methods to apportion VAT incurred for business and non-business purposes and, where businesses are required to carry out partial exemption calculations, special methods incorporating both business/non-business and partial exemption calculations

For further information on using this toolkit and reasonable care under our penalty system see **Toolkits to help reduce errors - essential information.**

For guidance on matters not dealt with in this toolkit you should refer to our full guidance:

VAT Input Tax (VIT)

Reclaiming VAT on purchases made before registration or after deregistration

A business may generally reclaim VAT incurred on goods it has purchased no more than four years before the date of registration. The goods must, however, be for its taxable business purposes and remain on hand at the date of registration. A business may also generally reclaim VAT incurred on services it has purchased for its taxable business purposes during the six months before VAT registration. VAT cannot be claimed on goods and services purchased before registration which relate to exempt supplies or non-business activities.

For further information and details of record-keeping requirements see [Purchases made before VAT registration: reclaiming the VAT](#).

Once a VAT registration has been cancelled there are limited circumstances in which input tax can still be claimed. Input tax can be claimed on goods and services supplied to the business while it was registered for VAT. It can also be claimed on services (such as legal or accountancy advice) which relate solely to the activities of the business while it was VAT registered. VAT cannot be claimed on goods purchased after deregistration.

For more information see [Reclaiming VAT after you cancel your registration](#).

Flat Rate Scheme

A business using the Flat Rate Scheme (FRS) should not generally claim input tax on its VAT Returns. Input tax may however be claimed on individual purchases of capital expenditure goods with a VAT inclusive cost of £2,000 or more. Input tax cannot be claimed on goods purchased for resale or to be leased, let or hired. Input tax cannot be claimed on expenditure which relates to work performed on a capital item, for example the refurbishment or extension of premises. A business which has newly registered for VAT may also claim VAT on stock and assets on hand at the time of registration subject to the normal rules for such claims. If a business using the FRS is required to account for acquisition tax on the purchase of goods from a supplier elsewhere in the European Union (EU) this cannot be claimed as input tax unless it relates to the purchase of capital expenditure goods costing £2,000 or more including the related VAT.

For more information see [Flat Rate Scheme for VAT](#).

Giving HMRC feedback on toolkits

HMRC would like to hear about your experience of using the toolkits to help develop and prioritise future changes and improvements. HMRC is also interested in your views of any recent interactions you may have had with the department.

[Send HMRC your feedback](#)

Areas of risk within VAT input tax

The main areas of risk within VAT input tax broadly fall into the following categories:

Record keeping

Good record keeping is essential, as poorly kept records can mean that the VAT Return is prepared on the basis of inaccurate or incomplete information. Where a business operates from more than one location it is also important that procedures are in place to ensure that all relevant accounting information needed for completing the return is reported to the person that prepares it in time for inclusion on the return.

For further information on record keeping see [Record keeping fact sheet](#).

Even when records are well kept, mistakes, duplications and omissions may occur, resulting in input tax being claimed too early, too late or in the incorrect amount. If a computer package is used to calculate VAT Return values, care should be taken to ensure that correct date ranges are set and that all relevant transactions within the period date range are included.

The requirement to add back input tax if the related expenditure remains unpaid six months after the date of the supply or the due date for payment (whichever is the later) is also often overlooked.

Private and non-business use

In many businesses personal and business finances can be closely linked and input tax may be claimed incorrectly on expenditure which is partly or wholly for private or non-business purposes. 'Business purpose' can be a complex area in relation to input tax.

For further guidance see [VAT Input Tax VIT10200](#), [VIT10400](#), [VIT10600](#) and [VAT Business/Non-Business \(VBNB\)](#).

When expenditure has a mixed business and private/non-business purpose the related VAT should generally be apportioned and only the business element claimed. Under the Lennartz approach when a business purchases an asset, or services resulting in the construction of a new asset, which has mixed business and private use (but generally not mixed business and non-business use other than private use), the VAT may be claimed in full at the time of purchase but output tax must subsequently be declared to reflect private use. From 1 January 2011 the Lennartz approach cannot be adopted for purchases of land, buildings, aircraft, ships, boats and other vessels - see [Q8](#).

When goods on which a business has claimed input tax in full (such as an item of stock) are subsequently put to private or non-business use, there is generally a deemed supply for VAT purposes and output tax is normally due on the cost of the supply. The deemed supply is one of goods if the change of use is permanent and of services if temporary. There are, however, separate rules for land, buildings, civil engineering works, computers, aircraft, boats and other vessels which are purchased on or after 1 January 2011 and are subject to the [Capital Goods Scheme](#). For more information see [Notice 706/2 Capital Goods Scheme, September 2013 edition](#).

Partial exemption

When a business has expenditure which relates wholly or partly to existing or intended exempt supplies, it becomes partly exempt and can only claim the related input tax if it is below the prescribed de minimis limit. For a list of exempt supplies which are commonly made see [Q9](#). The partial exemption standard method determines how much input tax can be claimed unless an individual special method has been approved by HMRC. Many businesses do not recognise that they are partly exempt or carry out partial exemption calculations incorrectly, for example by using an unapproved special method or by omitting to carry out a longer period calculation.

If certain assets (computers or land/building works over specified values) have been purchased for use in the business, those assets are subject to adjustments under the CGS to reflect changes in the degree of taxable use relative to exempt use. The need to consider CGS adjustments is often overlooked.

From 1 January 2011 the CGS has been extended to include purchases of aircraft, ships, boats and other vessels over a specified value. For any items subject to the CGS where the input tax is incurred on or after 1 January 2011, the CGS adjustment must also include any change in the level of non-business or private use.

Business entertainment

Input tax is often claimed in error on the provision of business entertainment. This includes, for example, the provision of hospitality or entrance to theatres, concerts and sporting events, and similar expenditure. Input tax cannot be claimed on business entertainment provided to anyone other than employees or overseas customers. While input tax may be recovered on the business entertainment of overseas customers, in many cases an equivalent output tax charge will arise.

Entertainment costs analysed to expense headings such as advertising or marketing are often overlooked and the related VAT claimed in error.

Cars and motoring expenses

Input tax errors frequently occur in relation to the purchase or lease of cars and to motoring expenses in general. Input tax cannot be claimed on the purchase of most cars while the recovery of VAT incurred in leasing a car which is available for private use should generally be restricted to 50 per cent. If a business supplies fuel for cars, an output tax scale charge is generally due for each car unless records are maintained to demonstrate that fuel has only been provided for business journeys. Input tax claimed in respect of business mileage payments must be restricted to the fuel element of the mileage rate and be supported by original fuel purchase invoices.

International transactions

There are distinct mechanisms for the payment and recovery of VAT on goods purchased from suppliers outside the EU (imports) and inside the EU (acquisitions). If these are not applied correctly input tax error can result.

The purchase of many services from overseas suppliers requires the UK recipient to account for both output tax and input tax on the supply (the reverse charge), applying any appropriate restrictions to input tax recovery - this requirement is often overlooked or incorrectly performed.

Using links within the document

[Blue underlined text](#) are links within this document.

Green bold text are hyperlinks to external documents on the internet (access to the internet is necessary to view these).

We have a range of services for people with disabilities, including guidance in Braille, audio and large print. Most of our forms are also available in large print. Please contact any of our helplines if you need these services.

HMRC services for customers with particular needs

Client Name:

Period Ended:

Checklist for VAT input tax

Record keeping

- | | | Yes | No | N/A |
|---|--|--------------------------|--------------------------|--------------------------|
| 1 | Have input tax records been reviewed for posting errors ?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 | Is satisfactory evidence held to support input tax claims?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 | Have the records been reviewed to ensure that input tax has been claimed at the correct time ?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4 | Has input tax claimed on expenditure which remains unpaid after six months been added back?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Private and non-business use

- | | | | | |
|---|---|--------------------------|--------------------------|--------------------------|
| 5 | Has input tax been restricted appropriately on expenditure for private purposes ?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 | Has input tax been restricted appropriately in respect of non-business, other than private, activities ?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 | Has VAT incurred on expenditure with mixed business and private/non-business use been correctly adjusted?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8 | Have Lennartz output tax adjustments been made if required?
<input type="text"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Yes No N/A

Partial exemption

9 Have [partial exemption](#) calculations been carried out correctly if required?

Capital Goods Scheme

10 Have [Capital Goods Scheme](#) adjustments been carried out correctly if required?

Business entertainment

11 Has the recovery of input tax on [business entertainment](#) been restricted?

Cars and motoring expenses

12 If a [car](#) has been purchased has input tax recovery been restricted appropriately?

13 Has input tax been restricted on the [lease or long-term rental](#) of cars available for private use?

14 Has input tax been claimed correctly on the purchase of [fuel for cars](#)?

15 Has input tax been correctly adjusted in respect of [vehicles other than cars](#) which are available for private or non-business use?

16 Has input tax been claimed correctly on [business mileage](#) payments to employees?

International transactions

	Yes	No	N/A
17 Has input tax been claimed correctly on goods imported from outside the European Union ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="text"/>			
18 Has acquisition tax on goods acquired from a supplier in another European Union member state been declared correctly?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="text"/>			
19 Has input tax been accounted for correctly on services received from overseas suppliers ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="text"/>			

Explanation and mitigation of risks

Record keeping

1. Have input tax records been reviewed for posting errors?

Risk

Many input tax errors are the result of misposting or misunderstanding when transactions are first entered in the records. See [explanation](#) below for a list of common errors.

Mitigation

A general review of input tax postings prior to submission of the VAT Return will often identify and eliminate many common errors.

Comparing the tax and net summary totals may also highlight any significant mispostings. Compare the calculated input tax to the amount claimed on the last return or on the return for the same period last year and consider whether any significant variations are consistent with your understanding of the business and its development.

Explanation

Common errors include:

- duplicated claims - particularly where requests for payment or pro-forma invoices have been received
- manual, arithmetical and consolidation errors
- input tax incorrectly calculated on VAT inclusive amounts
- VAT and net values transposed
- input tax incorrectly calculated for VAT reduced-rate purchases or transactions subject to a settlement discount
- input tax claimed on purchases which do not carry VAT (such as stamps, train/air/bus tickets, some tolls)
- input tax claimed on costs incurred outside the UK (for example conference/business trip accommodation and meals) - see below
- Insurance Premium Tax (IPT) claimed as input tax
- VAT Return and assessment payments claimed as input tax
- purchase credit notes incorrectly posted
- self-billed sales invoices on which output tax is due posted as purchase invoices
- input tax claimed on costs proper to a third party - for further information see [Supply and consideration VATSC9000](#)

Some computer accounting packages have integral VAT audit functions which can assist in identifying potential errors before a return is submitted.

While VAT incurred in other European Union (EU) states cannot be claimed as input tax, it may be recoverable from the relevant national authority.

For further information see [UK businesses visiting other EU countries - getting VAT refunds](#).

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2. Is satisfactory evidence held to support input tax claims?

Risk

Input tax claims must normally be supported by VAT invoices. If VAT invoices are not obtained, input tax may be claimed incorrectly in respect of purchases from unregistered suppliers or for supplies which do not carry VAT. Purchases from new or infrequent suppliers are more likely to be unsatisfactorily evidenced.

Mitigation

Ensure input tax claims are supported by VAT invoices or less detailed or modified VAT invoices. For information on VAT invoices see [explanation](#) below.

Where input tax is claimed on the payment made against a supplier's statement, the supporting invoices should be reconciled to the statement.

When a supplier has issued a pro-forma invoice or a request for payment, check that a VAT invoice has been obtained to support the input tax claimed.

Explanation

A VAT invoice must be issued when a registered person makes a standard or reduced-rated supply to another registered person. In the case of retail sales the supplier may issue a less detailed VAT invoice (if the value of the individual supply is less than £250) or a modified VAT invoice.

For further information on VAT invoices see **VAT invoices: what they must show**.

Exceptions to the requirement for a VAT invoice in the business's name are:

- invoices issued to employees for road fuel, subsistence, small tools and site costs purchased for business purposes (although alternative evidence - such as the employee's invoice and proof of reimbursement by the business - should be retained)
- telephone calls made from public or private telephones, purchases through coin-operated machines, car park charges (not on-street meters which are not subject to VAT), some commercial tolls, where the expenditure on each item is £25 or less including VAT

For further guidance see **VAT Input Tax VIT31200**.

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3. Have the records been reviewed to ensure that input tax has been claimed at the correct time?

Risk

Input tax should normally be claimed on the VAT Return relevant to the tax point (time of supply) shown on the supplier's invoice. In certain circumstances input tax may be claimed on a later return, for example when awaiting the invoice from a supplier, but input tax must not be claimed on an earlier return. Timing errors often occur in respect of high value purchases made shortly after the end of a tax period or when goods are purchased on hire or lease purchase terms.

Mitigation

Ensure input tax is claimed correctly against the tax point on the supporting VAT invoice. In particular, consider expenditure towards the end of the tax period and ensure that input tax is claimed at the correct time. Where goods have been purchased on hire purchase or lease purchase, check that the correct tax point is used by reference to the relevant finance agreement.

Explanation

Input tax must be claimed on a VAT Return within four years of the due date for the return period in which the supplier's tax point falls.

If the Cash Accounting Scheme is being used, the point at which input tax may be claimed is the date of payment.

When purchase invoices and credit notes proper to an earlier VAT Return period are posted late to a computerised accounting system care needs to be taken to ensure that all relevant transactions are included. A reconciliation of the calculated VAT Return values to the nominal ledger VAT control or input tax control account should highlight such omissions.

When a business reclaims input tax following a change in the tax rate, it must claim it at the rate charged by the supplier.

For further guidance see [VAT Input Tax VIT30000](#).

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4. Has input tax claimed on expenditure which remains unpaid after six months been added back?

Risk

Input tax claimed on expenditure which remains unpaid six months after the relevant date must be repaid. The relevant date is the date of the supply or, if later, the due date for payment.

Mitigation

Review aged creditors listing and purchase ledger accounts for any unpaid expenditure over six months old upon which input tax has been previously claimed. Ensure input tax is added back appropriately. If the invoice is subsequently paid input tax can then be claimed.

For further guidance see [Notice 700/18 Relief from VAT on bad debts](#).

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Private and non-business use

5. Has input tax been restricted appropriately on expenditure for private purposes?

Risk

For many businesses private and business finances can be closely linked. While a business may pay a range of bills and expenses for the private purposes of its directors, proprietors and partners, the related VAT cannot be claimed. For common types of private expenditure see [explanation](#) below. Such expenditure may not be identified, for example on expense claims, and the related VAT claimed in error.

Mitigation

Review input tax records, including expense claims, for private expenditure and ensure that the related VAT is not claimed.

There are separate rules for motoring expenses - see [Q12-Q16](#) below.

For expenditure with a mixed purpose see [Q7](#) below.

For further guidance see [VAT Input Tax VIT10200](#).

Explanation

Common examples of private expenditure include:

- domestic accommodation, household bills such as repairs and maintenance, groceries, furniture, domestic heat, light and telephone, pets - although if such expenses have an element of business use an apportionment may be appropriate - see [Q7](#)
- personal clothing (other than uniforms or necessary protective clothing)
- private hotel stays and taxi trips
- hobbies, sports and leisure activities
- legal and taxation advice which is not for the purposes of the business - for more information on taxation advice see **VAT Input Tax VIT13600** and **VIT13700**
- meals and drinks (other than meals taken for business purposes when away from the normal place of work - excluding business entertainment)

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6. Has input tax been restricted appropriately in respect of non-business, other than private, activities?

Risk

Most commercial activities clearly represent 'business' for VAT purposes and the VAT incurred on related expenditure can be reclaimed subject to the partial exemption rules and specified exclusions. Other activities, particularly in the grant funded and voluntary sectors, do not constitute 'business' for VAT purposes and the VAT on related costs cannot be claimed. Most hobby activities are not 'business' for VAT purposes even though low value and/or infrequent supplies may be made.

Mitigation

Consider the full range of activities undertaken to identify any which are non-business. Review input tax records to identify non-business activities and eliminate incorrect input tax claims.

Explanation

If a service is provided free of charge or is funded largely by grants or donations, it may not constitute a business activity for VAT purposes. A business may have a range of activities each of which must be considered individually. For example a charity may have both business activities (such as the sale of donated goods) and non-business activities (such as the provision of free of charge welfare support and advice).

VAT incurred on expenditure which relates wholly to a non-business activity cannot be claimed. VAT on expenditure with mixed business and non-business use should be apportioned and the business element only claimed - see [Q7](#) below.

For further guidance on deciding whether an activity constitutes business for VAT purposes see **VAT Business/Non-Business (VBNB)**.

There are special rules for Local Authorities and similar bodies. For further information see **Public Notice 749 Local Authorities and similar bodies**.

For further guidance see **VAT Input Tax VIT20000**.

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7. Has VAT incurred on expenditure with mixed business and private/non-business use been correctly adjusted?

Risk

Unless the Lennartz approach is adopted (under which input tax on certain expenditure is recovered in full at the time of purchase and output tax adjustments are made subsequently to reflect private use - see [Q8](#)) VAT incurred on expenditure which has mixed business and private/non-business use should be apportioned appropriately and only the business element claimed.

Mitigation

Review input tax records for expenditure with mixed business and private and/or non-business use. If the Lennartz approach is not adopted, establish the extent of actual or intended business use and ensure only the business or intended business element is claimed.

For ongoing costs (such as heating/ lighting/telephone) the basis of apportionment should be reviewed to ensure that the apportionment remains fair and reasonable.

Explanation

The law does not specify a method of apportionment for costs incurred with mixed business and private and/or non-business use - the only requirement is that the result is fair and reasonable.

From 1 January 2011 HMRC can approve a business/non-business method of apportionment, not including private use, when requested by the business. For more information see section 7 of [Notice 706 Partial Exemption \(February 2014 edition\)](#).

If the Lennartz approach is not adopted or not available, an apportionment should be made on the basis of use or intended use. An apportionment can be based on factors such as:

- income streams
- use
- employee time
- floor space within a building

Any apportionment method employed for ongoing costs should be reviewed regularly to ensure that it continues to produce a fair result. A record should be kept of how the basis for apportionment has been established.

When acquiring an asset for mixed business and private/non-business purposes a business may make a choice to exclude all or part of that asset from the business's assets, by holding it privately or as a non-business asset. For more information about the VAT treatment of an asset or part of an asset excluded from the business's assets see [Public Notice 706/2 Capital Goods Scheme](#).

When goods on which a business has claimed input tax are subsequently put to private use, there may be a deemed supply for VAT purposes and output tax is due on the cost of the supply. Where goods are transferred out of the business so they are no longer treated as business assets there is a supply of goods.

For further information see [Private use of goods or services, self-supply and VAT](#).

For further guidance see [VAT Input Tax VIT20000](#).

For capital expenditure on land, buildings, civil engineering works, computers, aircraft, boats and other vessels made on or after 1 January 2011 an adjustment mechanism to take into account changes in use of these assets has been introduced by adapting the Capital Goods Scheme to include changes in private/non-business use (see [Q10](#)).

Additionally, from 1 January 2011 when input tax is claimed or restricted on the basis of intended business, non-business or private use and that intention changes before actual use occurs, the original input tax treatment must be revisited and adjusted. Such adjustments are known as 'clawback' and 'payback'. For more information see Q12 of the **VAT Partial Exemption Toolkit**.

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8. Have Lennartz output tax adjustments been made if required?

Risk

Under the Lennartz approach, when a business incurs VAT on the purchase of an asset, or on services resulting in the construction of a new asset, which has mixed business and private use, input tax is recovered in full at the time of purchase. However, output tax adjustments are required over the life of the asset to reflect the full cost of any private use.

For the purposes of a Lennartz calculation the life of an asset is ten years for land and buildings purchased before 1 January 2011 and five years for other assets.

With effect from 1 January 2011 the Lennartz approach is not available for purchases of land, buildings, aircraft, ships, boats and other vessels.

Mitigation

Ensure that the Lennartz approach is not adopted in respect of ineligible items. Identify any assets on which Lennartz output tax calculations are required. Ensure the necessary output tax adjustments are made, keeping a record of their calculation.

Explanation

If VAT is incurred on the purchase of an asset, or on services which result in the construction of a new asset, and the asset is used for mixed business and private purposes, the Lennartz approach may be adopted and input tax recovered in full at the time of purchase. However output tax reflecting the full cost of the private use must be declared over the life of the asset.

The full cost of private use is determined with reference to the taxable VAT-bearing costs of the asset (excluding VAT) spread over the specified economic life. There is no prescribed method for determining the extent to which goods are put to private use but whichever method is used must be fair and reasonable and demonstrably reflect actual levels of use. The level of private use may change and must be monitored from period to period over the asset's specified economic life.

A decision to adopt the Lennartz approach must be made at the time of purchase and cannot be revisited at a later date. Eligibility to use the Lennartz approach is subject to certain conditions.

With effect from 22 January 2010 use of the Lennartz approach was restricted to goods and services having mixed business and private use. Since that date the Lennartz approach has generally no longer been available for assets having mixed business and non-business use.

Businesses which have adopted the Lennartz approach in respect of non-business use other than private use prior to this change may choose one of two options:

- to continue to make Lennartz output tax adjustments over the specified economic life of the asset
- to unravel the whole Lennartz calculation and adjust both input tax and output tax

For further information see **VAT Input Tax VIT25510**, **VIT25540** and **VIT25550**.

From 1 January 2011 the Lennartz approach is not available for the purchase of land, buildings, aircraft, boats and other vessels having mixed business and private use. Any VAT incurred on such assets must be apportioned to reflect the level of business use (see [Q7](#)) and if these are capital items adjustments must be made over the economic life of the asset under the Capital Goods Scheme (see [Q10](#)). Where the Lennartz approach has been adopted in respect of such assets purchased **before** 1 January 2011, the business must continue to use that approach in respect of that asset. Any VAT incurred on or after this date is recoverable only to the extent that the asset is used to make taxable supplies.

For further information see [VAT Input Tax VIT25510](#).

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Partial exemption

9. Have partial exemption calculations been carried out if required?

Risk

A business may not recognise that it is partly exempt. For example many businesses whose core business activity is taxable may also receive exempt property income or commissions (insurance/finance/lottery) making them partly exempt. When exempt supplies are made or intended, the business is partly exempt and the recovery of related input tax may need to be restricted.

Mitigation

Review the activities of the business, including those which are secondary or incidental, to identify existing or intended exempt supplies. It is important to differentiate between exempt supplies and zero-rated supplies (which carry no VAT but are taxable).

Input tax incurred in relation to exempt supplies may only be claimed if it is below de minimis levels - see [explanation](#) below. The partial exemption calculation specifies how exempt input tax must be quantified and how much input tax may be claimed.

Any required adjustments for private or non-business use must normally be carried out before the partial exemption calculation. However, with effect from 1 January 2011 a business may apply for a special method (known as a 'combined method') which combines its business/ non-business calculation (other than any adjustments for private use) with its partial exemption calculation.

Ensure that partial exemption calculations are carried out in accordance with the standard method or an approved special method. Confirm that a longer period adjustment is carried out at the appropriate time.

For further guidance on the standard method, longer period adjustments and other issues see [Partial exemption PE1000](#) and [Public Notice 706 Partial exemption](#).

Section 4 of Public Notice 706 includes a worked example of a standard method calculation.

Explanation

Exempt supplies are set out in Schedule 9 to the VAT Act 1994 and include:

- many land transactions (including rents) - but generally not when an option to tax has been exercised in respect of the property in question - see **Public Notice 742 Land and property**
- insurance
- betting, gaming and lotteries
- finance
- education
- health and welfare
- some sports activities - see **Public Notice 701/45 Sport**
- some charity fund-raising events - see **How VAT applies to fundraising events**
- cultural services subscriptions to some membership organisations - see **Public Notice 701/5 Clubs and Associations**

The basis for apportioning non-attributable input tax between exempt and taxable supplies is specified in the partial exemption standard method which must be followed unless a partial exemption special method has been approved.

Exempt input tax is the total VAT incurred on expenditure to be used exclusively in making exempt supplies plus a proportion of VAT incurred on costs which cannot be wholly attributed to either taxable or exempt supplies (including general overheads). Input tax incurred in relation to the making of exempt supplies may only be claimed if it is below a de minimis limit (not more than £625 per month on average during the period or longer period, normally the tax year, and not more than 50 per cent of total input tax in the relevant period). Simplified de minimis tests for smaller businesses have been introduced from 1 April 2010 - see **Public Notice 706 Partial exemption**. If the use of a 'combined method' is approved, the normal de minimis limit does not apply and no exempt input tax can be claimed.

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10. Have Capital Goods Scheme adjustments been carried out if required?

Risk

For most goods and services the proportion of VAT that may be claimed is determined at the time of purchase and confirmed by the relevant longer period partial exemption calculation. However, certain land and computer assets are subject to the Capital Goods Scheme (CGS) and the extent of taxable use must be monitored over a specified period. With effect from 1 January 2011 the CGS has been extended to include capital expenditure on aircraft, boats and other vessels with a VAT-exclusive cost of £50,000 or more.

An input tax adjustment may be required to reflect any changes in the extent of taxable use or the liability of any disposal during that adjustment period. For assets subject to the CGS where the capital expenditure was incurred on or after 1 January 2011, adjustments are also required to reflect changes in the extent of business and non-business/private use.

Mitigation

Identify assets which are subject to CGS adjustments. Ensure appropriate CGS adjustments are made.

Explanation

Assets subject to the CGS are referred to as 'capital items'. Only items used as capital assets of the business are subject to the CGS - items for resale are excluded.

The CGS applies to capital expenditure on land, buildings, civil engineering works and refurbishments where the VAT exclusive standard or reduced-rated costs are £250,000 or more. It also applies to any computer with a VAT exclusive cost of £50,000 or more. 'Computer' means a single item of equipment rather than a complete network - computer software and computerised equipment are not included.

With effect from 1 January 2011 the CGS has been extended to apply to capital expenditure on aircraft, ships, boats and other vessels with a VAT exclusive cost of £50,000 or more. As well as VAT incurred in the purchase of such items, the CGS also includes VAT incurred in the course of their manufacture, refurbishment, fitting out or alteration.

Prior to 1 January 2011, only VAT on business-related expenditure (that is input tax) fell within the CGS. With effect from 1 January 2011, all of the VAT on an asset (that is input tax and non-business, including private, VAT) falls within the CGS.

The period over which CGS adjustments are required is called the 'adjustment period'. This is split into a number of intervals (normally years) which are aligned with the business's partial exemption year. The adjustment period for land, buildings and civil engineering works is normally ten intervals, while for other CGS items it is normally five intervals. With effect from 1 January 2011, however, the number of intervals may vary if the business's interest in an asset is more than one year less than the standard CGS adjustment period. For more information see [Public Notice 706/2 Capital Goods Scheme](#).

A business does not have to be partly exempt or have non-business activities when it acquires an asset for the CGS to apply. For example a fully taxable business may be required to make a CGS adjustment if a CGS building used for wholly taxable purposes is the subject of an exempt sale or lease during the specified adjustment period.

For more information see [VAT Partial Exemption Toolkit](#).

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Business entertainment

11. Has the recovery of input tax on business entertainment been restricted?

Risk

Input tax cannot be claimed on the provision of entertainment to anyone other than an employee or an overseas customer. The provision of food and drink, theatre or concert tickets, accommodation, entry to sporting events and facilities, or the use of capital assets such as yachts and aircraft for the purpose of entertaining, are all classed as business entertainment for VAT purposes.

Sponsorship arrangements can also include elements of business entertainment and apportionment of the input tax may be required.

Where input tax is incurred in relation to the entertainment of an overseas customer it may be claimed but an equivalent output tax charge may arise. There are two tests that should be considered to establish whether a charge to output tax arises - the necessity test and the strict business purpose test - for more information on business entertainment and overseas customers see [Revenue & Customs Brief 44/10](#).

Mitigation

Identify all entertainment costs and ensure input tax is not recovered or is apportioned appropriately. Consider analysing headings such as marketing or advertising which may include business entertainment. If input tax is claimed on the business entertainment of overseas customers, consider whether an equivalent output tax charge arises.

Explanation

The recovery of input tax on the provision of entertainment for employees is generally allowed. For entertainment purposes employees include directors and partners but not former employees, job applicants and shareholders. However, when entertainment is provided solely for directors or partners of a business, the expenditure is not for business purposes and the related VAT cannot be claimed. 'Perks' which are provided to specific individuals within a business are generally subject to an output tax charge.

When an employee, director, proprietor or partner acts as host to non-employees, the business entertainment rules apply and the related VAT should not be claimed. If employees and non-employees are entertained (for example at a Christmas party attended by employees and employees' guests) the VAT should be apportioned and only the proportion relating to staff entertainment claimed.

VAT incurred on actual subsistence costs reimbursed to employees, and to subcontractors treated as employees, may be claimed if incurred for business purposes. Input tax cannot be claimed on flat rate subsistence allowances.

For further guidance see [VAT Input Tax VIT40000](#) and [Public Notice 700/65 Business entertainment](#).

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Cars and motoring expenses

12. If a car has been purchased has input tax recovery been restricted appropriately?

Risk

Input tax can only be claimed on the purchase of a car when one of the following applies:

- it is a stock in trade car of a manufacturer or a dealer
- it is intended to be used primarily as a taxi, a driving instruction car or for self-drive hire
- it is to be used exclusively for business purposes and will not be available for anyone's private use, which normally includes home to work journeys

This restriction applies to purchases of new cars and of second-hand cars on which VAT has been charged.

Input tax may be claimed on the purchase of a pool car that is kept at business premises, used only for business journeys and not taken home overnight by employees. In a limited range of circumstances input tax may be claimed on a pool car taken home overnight where to do so is necessary for the purposes of the business.

If a car on which input tax has been claimed is subsequently put to a different use which would not permit input tax recovery (for example a pool car is made available for private use), a 'self supply' occurs and output tax must be declared on the current value of the car at the time of change of use.

For more guidance on availability for private use see [VAT Input Tax VIT52700](#) and [VIT54800](#)

Mitigation

Identify any cars purchased in the period. Ensure input tax is only claimed on those cars meeting the conditions noted above. The restriction of input tax includes delivery charges and fitted accessories.

Explanation

A car is any motor vehicle of a kind normally used on public roads which has three or more wheels and meets one of the following conditions:

- it is constructed or adapted mainly for carrying passengers
- it has to the rear of the driver's seat roofed accommodation which is fitted with side windows or which is constructed or adapted for the fitting of side windows

Vehicles capable of accommodating only one person or capable of carrying twelve or more people (including the driver) are not cars. Vehicles of not less than three tonnes unladen weight or with a payload of more than one tonne are also not cars.

For further information see **What is a car, commercial vehicle or motor home for VAT?**

For further guidance see **VAT Input Tax VIT50000 Motoring Expenses** and section 3 of **Public Notice 700/64 Motoring expenses**.

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13. Has input tax been restricted appropriately on the lease or long-term rental of cars available for private use?

Risk

The recovery of VAT incurred on the lease or long-term daily rental of a car available for private use (other than a taxi or for driving instruction) should normally be restricted to 50 per cent.

Mitigation

Check input tax claimed against car leasing invoices and confirm that input tax has been restricted appropriately.

Explanation

Input tax on leased cars must normally be restricted by 50 per cent unless the car is to be used exclusively for business purposes and will not be available for anyone's private use. For guidance on availability for private use see **VAT Input Tax VIT52700** and **VIT54800**

If a car is purchased under a finance agreement (such as on hire-purchase or lease-purchase terms) which envisages the transfer of ownership, the transaction is treated as a purchase for VAT purposes - see [Q12](#).

If a business rents a self-drive hire car to replace a company car available for private use, the 50 per cent restriction applies from the first day of hire. If a self-drive hire car is otherwise rented for no more than ten days for specific business purposes, the 50 per cent restriction does not apply.

Where a second-hand margin scheme car is leased, the 50 per cent restriction does not apply. Invoices issued by car leasing companies should indicate whether the 50 per cent input tax restriction applies to an individual car. Separately invoiced maintenance charges which are an optional addition to the basic lease agreement are not subject to the 50 per cent input tax restriction and may be claimed as long as the car is used for business purposes.

For further guidance see **VAT Input Tax VIT53300** and section 4 of **Public Notice 700/64 Motoring expenses**.

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14. Has input tax been claimed correctly on the purchase of fuel for cars?

Risk

If a business purchases fuel for cars one of four options must be adopted for each car in respect of the VAT incurred:

- claim all of the VAT because the car is used exclusively for business journeys
- claim all of the VAT and apply an output tax fuel scale charge based on the car's CO2 emissions to reflect private use
- maintain detailed records to separate business mileage from private mileage and demonstrate that fuel has only been provided for business journeys
- claim no VAT on **any** road fuel purchased for **any** vehicles (both cars and commercial vehicles)

Mitigation

Identify cars for which fuel has been supplied and input tax claimed. Ensure output tax scale charges are declared for each car unless business mileage records are maintained to separate business from private journeys or the car is used exclusively for business journeys. Confirm that current scale charges rates have been used. If maintained, review adequacy of business mileage records.

Explanation

If input tax is recovered on the purchase of fuel for cars, the business must either prepare and retain adequate mileage records to demonstrate that fuel has only been provided for business journeys or declare the appropriate output tax fuel scale charge for each car. The inclusion of sporadic fuel purchase invoices without supporting mileage records is not acceptable.

If total mileage is very low and the business opts to recover no input tax on any fuel and not declare the appropriate scale charge, this option relates to **all** road fuel purchased by the business for both cars and commercial vehicles.

Generally all VAT incurred on vehicle repairs and maintenance can be claimed as long as there is some business use of the vehicle and the business pays for the work.

For further guidance see **VAT Input Tax VIT54500**, **VIT55400** and **VIT55700** and sections 8 and 9 of **Public Notice 700/64 Motoring expenses**.

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15. Has input tax been correctly adjusted in respect of vehicles other than cars which are available for private or non-business use?

Risk

Normal input tax rules apply to vehicles such as motorcycles, motor homes, vans and double cab pick-ups with a payload of more than one tonne which are available for private use. Unless the Lennartz approach is adopted, the VAT on the initial purchase should be apportioned and only the business element claimed. For more information on the Lennartz approach see [Q8](#). Double cab pick-ups with a payload of less than one tonne are classified as cars for VAT purposes - see [Q12](#).

Mitigation

Identify the extent of business use of vehicles other than cars. Ensure the input tax claimed is restricted to the business element.

Explanation

If fuel is purchased for vehicles other than cars, the amount of VAT reclaimed should be restricted by apportionment to the business element. Alternatively, all input tax may be claimed and output tax scale charges declared as for cars if preferred. If there is no business use of such a vehicle, no related VAT can be claimed.

Private use of a vehicle other than a car which is on a small and irregular scale and is incidental to its main business use may be ignored.

For further guidance see [VAT Input Tax VIT50000 Motoring Expenses](#).

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16. Has input tax been claimed correctly on business mileage payments to employees?

Risk

If mileage allowances are paid to employees for business journeys and input tax is claimed, the claims must be restricted to the fuel element of the mileage rate. Claims must be supported by original fuel purchase invoices.

Mitigation

Ensure that any input tax claimed for business mileage allowances is restricted to the fuel element.

For guidance on an appropriate fuel element see [Company cars - advisory fuel rates](#). Alternatively equivalent guidelines issued by organisations such as the AA or the RAC may be used.

Ensure that all claims are supported by original invoices.

For further guidance see section 8.7 of [Public Notice 700/64 Motoring expenses](#).

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International Transactions

17. Has input tax been claimed correctly on goods imported from outside the European Union?

Risk

Input tax on goods imported from outside the European Union (EU) can be claimed where a C79 certificate or acceptable alternative evidence is held. However, input tax is often claimed when the evidence is unsatisfactory or the claim is duplicated.

Mitigation

Ensure a C79 certificate or alternative evidence that HMRC have agreed to accept is held to support input tax claimed on the import of goods. Review cash book/shipping agents' invoices to ensure duplications are avoided and that customs duty is not claimed as input tax. Ensure input tax is not claimed on imports such as cars and items to be used for business entertainment.

Explanation

When standard or reduced rate goods are imported from outside the EU, VAT is charged at the time of importation. A monthly C79 certificate listing import VAT paid is normally sent to the declared importer and in most circumstances this certificate is the evidence required before input tax can be claimed. For more information on C79 certificates and details of imports which do not appear on a C79, and of acceptable alternative evidence for input tax purposes, see section 8 of [Public Notice 702 Imports](#).

The VAT itemised on the C79 is subject to the normal input tax rules. Any customs duty paid along with import VAT cannot be claimed.

Duplications often occur when claims are made against both the C79 certificate and the actual payment of the VAT either against a disbursement invoice raised by a shipping or forwarding agent or deferred payment.

For further guidance see [Public Notice 702 Imports](#).

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18. Has acquisition tax on goods acquired from a supplier in another European Union member state been declared correctly?

Risk

If goods are acquired free of VAT from a supplier in another European Union (EU) Member State through the provision of a UK VAT registration number, acquisition tax at the rate appropriate to the goods, if standard or reduced in the UK, must be declared in box 2 of the VAT Return. The net value should also be declared in box 9.

The acquisition tax declared may be claimed as input tax subject to the normal rules. For example, the purchase of a car free of VAT from a supplier in another Member State may result in the requirement to account for acquisition tax in box 2 of the return with no corresponding input tax claim in box 4 if the car is available for private use.

Mitigation

Review purchase records for evidence of goods acquired from suppliers in other EU states. Ensure that both acquisition tax and input tax have been correctly declared/claimed. Confirm that the value of acquisitions has been included correctly in box 9 of the VAT Return.

Computerised accounting systems will often carry out necessary acquisition tax calculations and post appropriate values to the VAT Return report. If so, it is important that the correct codes are set and that the appropriate VAT rate (standard, reduced or zero) is used to reflect the liability of the goods if supplied in the UK.

For further guidance see [VAT Single Market VATSM3300](#) and sections 7 and 8 of [Public Notice 725 The single market](#).

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19. Has input tax been accounted for correctly on services received from overseas suppliers?

Risk

If a business purchases a range of services from an overseas supplier it may be required to account for output tax on that supply under the 'reverse charge mechanism'. This VAT, subject to the normal rules, may be recovered as input tax. This calculation is often overlooked or performed incorrectly.

Mitigation

Review purchase records for evidence of the purchase of services from an overseas supplier. Ensure reverse charge calculations are correctly carried out and the input tax recovery is restricted if appropriate.

Explanation

The general rule regarding the place of supply of services changed on 1 January 2010 so that a business purchasing services from an overseas supplier is required to account for tax on those services under the reverse charge mechanism.

Under the reverse charge mechanism output tax must be declared in box 1 of the VAT Return. This VAT, subject to the normal rules, may be recovered as input tax in box 4.

There is a range of exceptions to this general place of supply rule which may remove the requirement to carry out the reverse charge. These exceptions currently include services relating to land, the hiring of the means of transport, supplies involving admission to events and exhibitions, restaurant and catering services and some transport services. It is therefore important to establish exactly what services have been performed to identify the correct treatment rather than relying wholly on the invoice wording.

For further guidance and details of the changes see **VAT Place of supply of services** and **Public Notice 741A Place of supply of services**.

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