



PARTIAL EXEMPTION AND CAPITAL GOODS SCHEME HMRC CONSULTATION: OUR RESPONSE

1. Introduction

- 1.1 On 18 July 2019, HMRC published a consultation document calling for evidence to explore ways to improve the operation of partial exemption (PE) and the capital goods scheme (CGS).
- 1.2 As we routinely deal with these issues as a tax consultancy firm, working with accountants, businesses and other tax and finance professionals, we are keen to provide HMRC with a response to this call for evidence. Below, we respond to HMRC with our views, user experiences and suggestions for the simplification and improvement of PE and CGS.

2. Partial Exemption Special Methods (PESMs)

- 2.1 In our view, the current PESH approval process is too long, cumbersome and not fit for purpose. Typically, approval of a PESH can take at least six months, and it is commonplace for the process to take 12 to 24 months. The approval process is not fast enough to deal with changes in the business. Although the process does not need to be a real time process, the length of the process should be kept to a minimum and not cause uncertainty for taxpayers when submitting VAT returns whilst approval of a new method is pending with HMRC. Therefore, we suggest removing the current uncertainty caused by the approval process by removing the requirement to obtain approval prior to adopting a PESH. This will result in more accurate VAT returns as PESHs that are adopted can reflect changes to the business faster and reduce corrections to submitted VAT returns.
- 2.2 Currently, self-certification is required, but this is subject to an approval process, meaning the self-certification is of little value. By removing the approval process, the value of self-certification will be restored. Self-certification of the PESH would then be achieved through the declaration made by the taxpayer when they decide to use a new PESH and submit a signed VAT return using that new PESH.
- 2.3 In our view, Special Method Override Notices are often unnecessary and uncommon in practice. If there is no approval process then, in our view, these would not be required at all. If, whilst the taxpayer is considering a new method as its current method is not suitable, the business should be able to default to a use based method in the interim, which in our view would be satisfactory to both HMRC and the taxpayer.

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- 2.4 If the PESH adopted by a business is challenged by HMRC, then HMRC have the ability to assess for any VAT that HMRC considers is due, under officers' powers of assessment. Alternatively, if the business discovers errors in the use of its PESH, then the Error Correction procedures should be followed to correct that error. It should be recognised that this will create uncertainty for businesses if reasonable methods are challenged regularly by HMRC and it is proposed that HMRC allows all PESHs adopted by businesses which are reasonable, only assessing where the PESH is abusive.
- 2.5 If HMRC are assessing for inaccuracies within a business' PESH, this assessment should be supported demonstrating, using best judgement where appropriate, why the PESH used by a business was abusive. The officer should provide an opportunity for the taxpayer to respond with further information before seeking resolutions through the statutory appeal procedures.
- 2.6 In our experience, frameworks are very helpful and the use of frameworks should be encouraged and extended wherever possible, as this allows businesses greater certainty in using more accurate PE methods without engaging in lengthy and uncertain discussions with HMRC. Further frameworks for as many sectors as possible should be published and accessible through HMRC's guidance. A taxpayer should not be required to gain approval for using a framework PESH and the taxpayer should be free to adopt the framework that the taxpayer considers most appropriate. As the frameworks may not be suitable as 'no one size fits all', in our view, the taxpayer should be allowed to deviate from the framework if the taxpayer believes it is fair and reasonable to do so. The taxpayer should hold evidence to support its PESH and provide such evidence and explanation to the satisfaction of HMRC in the normal way during any compliance check by HMRC if requested.

3. De minimis

- 3.1 As the de minimis thresholds (for the standard and simplified tests) have not changed since they were initially brought in, they should be increased to a reasonable level in order to account for natural changes over the course of time arising from indexation.
- 3.2 A further simplification could be offered, perhaps for small micro-businesses under a certain threshold, eg £150,000 turnover. The partial exemption calculation could be simplified to a single calculation, applicable to each VAT period, in which all the input tax is considered as non-

attributable, and the business can simply recover the input tax according to the percentage ratio of taxable supplies over total supplies.

- 3.3 The current simplified tests should be retained, but the £625 exempt input VAT threshold should be increased significantly, as stated at 3.1 above.

4. Capital Goods Scheme (CGS)

4.1 As the thresholds have not changed since they were initially brought in, they should be increased to a reasonable level in order to account for natural changes over the course of time arising from indexation. In our view, the figure of £250,000 for property should be increased significantly in order to account for the effect of price rises over time. In our experience, due to the increase in property prices over time, it is now rare for a business not to be in possession of a commercial property less than £250,000 and this threshold should be increased significantly. The CGS threshold for land and buildings should be increased in order to simplify VAT for smaller and medium businesses by taking businesses outside of the capital goods scheme regime.

4.2 Current interval lengths should not be lengthened, as, in practice, capital goods scheme adjustments can often be relatively low value. In our view, 10 intervals strike a reasonable balance between maintaining the need to monitor the use of the asset with the amount of VAT at stake at each interval. From a taxpayer's perspective, some wish to reflect the change of use from exempt to taxable after a number of years and would benefit from a longer period, while other taxpayers who changed from exempt to taxable fairly promptly would wish to shorten the periods. This could only be improved if the taxpayer were able to opt for the length of the periods at the outset.

4.3 In our experience, a computer falling within the capital goods scheme is rarely ever seen in practice. Computers should be removed from the scheme entirely.

5. Conclusion

We welcome the Government's ambition to simplify and improve PE and CGS. There are some clear areas of improvement in relation to the above areas of VAT as we note that, in particular, the thresholds for PE and CGS should be increased significantly as they have never increased since these were introduced. In addition, the procedures for PESMs should be relaxed and more frameworks introduced with flexibility which is permitted to taxpayers provided these are not subject to abuse, which could be challenged by HMRC. The

administrative difficulties caused for businesses in applying PE and CGS is unduly high when compared to the levels of VAT sometimes at stake. We would suggest that this was not the intention of the original legislation, nor is it a desirable current ambition, and therefore we welcome the simplification of these areas to make a more modern tax system in which businesses can thrive.

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