

CHAPTER 10

INPUT TAX: WHEN TO RECOVER

10.1 Introduction

As a general rule, when input VAT is incurred by a taxable person it is available for credit (which basically means it is included as input VAT on the VAT Return for the period in which it arises). It is deducted from output tax and hence recovered from HMRC.

[VATA 1994, s.24 & VATA 1994, s.26](#)

If the input tax on a VAT Return exceeds the output tax, HMRC will make a repayment of the net amount.

[SI 1995/2518 Reg 29](#)

There are a number of **conditions** which have to be met before input tax is available for credit.

The conditions are numerous and can be summarised as follows:

- A **supply of goods or services** is being made;
- This supply must be **made to the taxable person** and the trader is a taxable person at the time the supply was made;
- The supply of goods or services must have been made for a **business purpose**;
- The claimant must hold the required **evidence** of their purchase;
- Input tax on the supply must have been **correctly charged**; and
- The goods or services being supplied must have a **direct and immediate link** with a taxable transaction.
- The input tax must not be specifically blocked from credit.

10.2 A supply of goods or services has been made

If, there is no supply for whatever reason, the VAT element of anything that has been paid is not recoverable.

If VAT was paid and a supply does not take place, it is for the customer to go back to the seller to get a refund. A refund cannot be obtained from HMRC because any payment made is not regarded as input tax.

A classic example of this is the transfer of a business as a going concern ("TOGC"). A TOGC is not a supply for VAT. Hence, because no supply is being made, if any VAT has been charged in respect of such a transaction, it cannot generally be recovered from HMRC.

10.3 Supply made to the taxable person

It is not acceptable for a supply to be made to somebody else other than the taxable person who is seeking to recover the input VAT on that supply.

[VATA 1994,
s.24](#)

For example, assume an employee is sent away to work and has to stay in a hotel overnight. The employee settles the hotel bill on his credit card, then reclaims the amount from his employer via normal employment expenses.

In the strict reading of the law, input tax on that hotel bill cannot be recovered by the company because the bill is made out to the employee; the employee was provided with the service not the employer.

This is very unfair, so in practice HMRC give credit in respect of expenses that are specifically reimbursed. However, HMRC do not allow relief for round sum expense allowances, even if the employee accounts for expenditure actually incurred.

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Similar provisions apply to employee mileage claims. Employees are normally reimbursed at 40p per mile for each business mile they travel in their own car. The employer can recover 7/47 of the **petrol element** of such claims.

HMRC have published an approved list of rates for such claims. From 1 June 2010 they are:

<i>Engine size</i>	<i>Mileage rate</i>	
	<i>Petrol</i>	<i>Diesel</i>
Up to 1400cc	12p per mile	11p per mile
1,401cc - 2,000cc	15p per mile	11p per mile
Over 2,000cc	21p per mile	16p per mile

These rates are also used for mileage claims made on company cars.

Illustration 1

Max works for Canmore Ltd. On a recent business trip Max drove 300 miles in his own Mercedes (2,800 cc, diesel engine). In line with company guidelines he submits a mileage claim for £120 (300 miles at 40p).

The fuel element of the claim amounts to £48. This is 300 miles at the diesel rate of 16p for this 2,800 cc car.

In order for the company to recover 7/47 of £48, Max must ensure that a petrol receipt for at least £48 accompanies the mileage claim he submitted to his employer. The petrol receipt must pre-date the business trip and can be a normal retailer's invoice from a garage.

10.4 Supply for business purposes

If a supply is purchased which is used partly for business purposes and partly for

non-business purposes, then the input tax on the supply has to be apportioned and only the input tax which relates to the business purpose is available for credit.

[VATA 1994, s. 24\(5\)](#)

For example, a trader might have to apportion input tax on telephone bills, where the telephone is used both for business and for private use.

The apportionment provisions of *VATA 1994, s 24(5)* were called into question by the ruling in *Lennartz v Finanzamt Munchen III*. The Court ruled that where goods are acquired solely for a private or non-business purpose, VAT incurred is not recoverable, even if the goods in question are later put to a deductible business use.

If, however, a taxable person acquires goods and used them partly for business purposes and partly for private or non-business purposes, he has a right to total and immediate input tax deduction (unless the goods are subject to input tax restriction).

Where the goods are later used for private or non-business purposes, that use is to be treated as a taxable supply of services and output VAT must be accounted for in each VAT period in which private or non-business use of the asset occurs.

Records must be kept showing how the relevant asset has been used.

However, following the *Vereniging Noordelijke Land- en Tuinbouw Organisatie (VNLTO)* case HMRC have announced that, from 22nd January 2010 it will allow **input tax to be reclaimed only on goods where there will be part business and part private use**. Where there will be non-business use, input tax must be disallowed on the part of the cost that relates to the non-business use at the time the goods are purchased.

Typically these provisions might apply to yachts, helicopters or aeroplanes bought by the business.

10.5 Claimant holds required evidence

Input tax is only available for credit if the required evidence is available.

[VATA 1994, s. 24\(6\)](#)

The required evidence takes several forms. The most common form is a **tax invoice** for the supplies that have been purchased from another taxable person. A tax invoice has to satisfy certain conditions (covered in the chapter on VAT records).

[SI 1995/2518 Reg 29](#)

HMRC can accept other documentary evidence as the required evidence but this is at their discretion.

There is an exception from the main rule in certain circumstances. A tax invoice is not required as evidence when claiming a credit for input tax if the expenditure was below £25 on:

- telephone calls from public and private telephones;
- purchases through coin-operated machines;
- car park charges.

10.6 Input tax was correctly charged

Credit for input tax is restricted to the amount properly chargeable on a supply. If VAT was incorrectly charged on a supply that VAT cannot be recovered as input tax.

[VATA 1994, s. 24\(1\)\(2\)](#)

For example, where a business is transferred as a going concern (TOGC) this is outside the scope of VAT – so it is not a VAT supply. Hence, if VAT was mistakenly charged on such a supply, it would generally not be possible to recover this VAT as input tax.

10.7 Direct and immediate link with a taxable transaction

The final condition is that the goods or the services purchased must have a direct and immediate link with a taxable transaction.

To be directly attributable to making a supply, an input has to be a cost component of that supply **at the time it is made**.

10.8 Blocked input tax

In certain cases input tax is specifically irrecoverable. The blocking order includes input tax on **business entertaining** and **motor cars** – input tax can never be recovered on these items even if the trader meets all the conditions outlined in this chapter.

[SI 1992/3222](#)

“Business entertainment” means entertainment (including hospitality of any kind) provided by a taxable person in connection with a business carried on by him, but does not include the provision of any such entertainment for either or both;

- employees of the taxable person; or
- if the taxable person is a company, its directors or persons engaged in the management of the company

unless the provision of entertainment for such persons is incidental to its provision for others.

[SI 1992/3222](#)
[Art 5\(3\)](#)

HMRC regard business entertainment as including;

- provision of food and drink;
- provision of accommodation (hotels, etc.);
- provision of theatre and concert tickets;
- entry to sporting events and facilities;
- entry to clubs, nightclubs, etc; and
- use of capital goods such as yachts and aircraft for the purpose of entertaining.

Where the cost of providing hospitality is passed on as part of the overall charge for a taxable supply, VAT incurred in providing the hospitality cannot be reclaimed.

Staff entertainment. HMRC accept that where an employer provides entertainment for the benefit of its employees (e.g. to reward them for good work or to maintain and improve staff morale), it does so **wholly** for business purposes. Thus, the VAT incurred on entertainment of employees (e.g. staff parties, team building exercises, staff outings and similar events) is input tax and is not blocked from recovery under the business entertainment rules.

There are two exceptions to this general rule.

- Where entertainment is provided only for directors, partners or sole proprietors of a business, the VAT incurred is not input tax as the goods or services are not used for a business purpose. But where directors, etc. attend staff parties together with other employees, HMRC accept that the VAT incurred is input tax and is not blocked from recovery.
- Where employees act as hosts to non-employees, the costs are incurred solely for the purpose of entertaining the non-employees and the input tax is blocked under the business entertainment rules.

VAT Notice
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3.1-3.3

Subsistence expenses. Where meals etc. are provided away from the place of work on a business trip, the VAT incurred on the employee's meal can be claimed as input tax under the subsistence rules.

VAT Notice
700/65/paras
2.5

Staff parties with guests, etc. Where a business entertains both employees and non-employees, it can only recover as input tax the VAT it incurs on entertaining its employees. The portion of the input tax incurred in entertaining others is blocked under the business entertainment rules.

Motor cars. Apart from one or two exceptions, VAT cannot be recovered on the purchase of a motor car.

VAT Notice
700/65/02
paras 3.4

One of the exceptions is on the purchase of a motor car where exclusive business use is **intended**. This condition will not be satisfied where the taxable person intends to make the car available to any person for **private use**. HMRC regard a car as being used exclusively for a business purpose if it is used only for business journeys **and** it is not available for private use.

In most cases though, 50% of the VAT on the rental charges can be recovered provided the car is leased for business purposes.

[SI 1992/3222](#)
[Art.7\(2H\)](#)

Example 1

Fill in the missing words:

The conditions to be satisfied for an input tax claim are:

1. A supply of or services has been made.
2. A supply was made to the
3. The supply was for a purpose.
4. The claimant holds the required
5. tax has been correctly charged.
6. Goods/services have a and link with a taxable transaction.

Answer 1

The conditions to be satisfied for an input tax claim are:

1. A supply of goods or services has been made.
2. A supply was made to the taxable person.
3. The supply was for a business purpose.
4. The claimant holds the required evidence.
5. Input tax has been correctly charged.
6. Goods/services have a direct and immediate link with a taxable transaction.