CHAPTER 10

INPUT TAX – WHEN TO RECOVER

In this chapter we will look at when to recover input tax including:
- the numerous conditions which must be satisfied before input tax can be reclaimed by a business;
- the definition of a supply of goods or services;
- the definition of taxable persons;
- the definition of business purposes;
- the required evidence to show that input tax was correctly charged;
- how we determine a direct and immediate link with a taxable transaction;
- the situations when input tax recovery is not available.

10.1 Introduction

As a general rule, when input VAT is incurred by a taxable person it is available for credit (i.e. 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.

There are a number of conditions which have to be met before input tax is available for credit. SI 1995/2518, Reg 29

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;
- 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 claims 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.

In practice, however, 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. Notice 700 Para 12.1

Similar provisions apply to employee mileage claims. Employees are normally reimbursed at 45p per mile for each business mile they travel in their own car. The employer can recover 1/6 of the petrol element of such claims, providing a petrol receipt supports the claim.

HMRC have published an approved list of rates for such claims. From 1 June 2015 they are:

<table>
<thead>
<tr>
<th>Engine size</th>
<th>Petrol</th>
<th>Diesel</th>
<th>LPG</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 1400cc</td>
<td>12p per mile</td>
<td>10p per mile</td>
<td>8p per mile</td>
</tr>
<tr>
<td>1,401cc – 2,000cc</td>
<td>14p per mile</td>
<td>12p per mile</td>
<td>9p per mile</td>
</tr>
<tr>
<td>Over 2,000cc</td>
<td>21p per mile</td>
<td>14p per mile</td>
<td>14p per mile</td>
</tr>
</tbody>
</table>

Petrol hybrid cars are treated as petrol cars for this purpose.

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 £135 (300 miles at 45p).

Using the table above calculate the fuel element of the mileage claim.

The fuel element of the claim amounts to £42. This is 300 miles at the diesel rate of 14p for this 2,800 cc car.

In order for the company to recover 1/6 of £42, Max must ensure that a petrol receipt for at least £42 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.**

\[ \text{VATA 1994, s.24(5)} \]

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.

Prior to 1 January 2011 it was possible to recover VAT in full on an asset which was expected to be used for business and private purposes. The private element would then be accounted for by way of a deemed supply over a number of years. This was known as Lennartz accounting. Typically Lennartz accounting was used for yachts, helicopters or aeroplanes bought by the business.

From 1 January 2011 Lennartz accounting cannot apply to the purchase of property, ships and aircraft. Any purchase of these assets from 1 January 2011 will need to follow the apportionment rules, if the usage is not all business.

10.5 Claimant Holds Required Evidence

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

\[ \text{VATA 1994, s.24(6)} \]

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).  

\[ \text{SI 1995/2518, Reg 29} \]

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.  

\[ \text{VATA 1994, s.24(1)(2)} \]

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 entertaining” 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 700/65, paras 3.1-3.3

Entertaining overseas customers. HMRC accept that input tax incurred in entertaining overseas customers is recoverable. However, where the entertainment was not necessarily incurred for a strict business purpose there will be an output tax charge equal to the input tax recovered (a deemed supply). In these cases, HMRC suggest that input tax is treated as non-deductible rather than claiming a deduction and offsetting this with an output tax charge on the deemed supply. HMRC Brief 44/2010

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. VAT Notice 700/65, paras 3.4

Motor cars. Apart from one or two exceptions, VAT cannot be recovered on the purchase of a motor car. Note the VAT is blocked on cars specifically. Vans are not cars and therefore the VAT is not blocked. Also the VAT is not blocked on repairs for the car.

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.

Contrast this to leasing a car which is available for business and private use. In these circumstances the trader is able to recover 50% of the VAT on the lease charges. SI 1992/3222, Art.7(2H)
EXAMPLES

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.
ANSWERS

✓ 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.