

VAT Partial Exemption - “De Minimis” VAT Recovery

Recovery of VAT on Costs

VAT incurred by a business on its costs is allocated to the supplies to which those costs relate.

This will therefore include:-

- a) Supplies on which VAT is charged at the standard rate (e.g. most supplies of goods and services)
- b) Supplies on which VAT is applied, but at zero rate (e.g. sale of new build residential property)
- c) Supplies on which VAT is charged at the reduced rate (e.g. certain building conversion works)
- d) Supplies which are exempt from VAT (e.g. residential lettings, health and welfare supplies)

VAT registered businesses can recover VAT suffered on costs (“Input Tax”) except where it relates to exempt business supplies.

There are also specific rules to block certain specific types of expenditure, particularly that relating to entertainment, non-business use or motoring costs.

De Minimis Rule

In addition to recovering VAT relating to standard, reduced rate and zero rated supplies, there are special “de minimis” rules that also allow VAT-registered traders to also recover Input Tax suffered on costs relating to exempt supplies within certain limits.

The rules permit VAT of up to £625 per month, £1,875 per quarter or £7,500 per annum to be recovered, provided that it does not exceed 50% of the total Input VAT recovered on business supplies.

The 50% limit stops the de minimis rules from applying if the exempt Input Tax is more than the other Input Tax, as this is an absolute test which allows either all or none of the exempt VAT to be reclaimed.

Similarly, the financial limits mean that recovery of all exempt VAT where it is less than £7,500 per annum is possible, but if this threshold is exceeded, even by £1, then none of the exempt VAT can be reclaimed.

The calculation of de minimis VAT is made for each VAT Return period, but an annual adjustment calculation is also required.

This annual check is undertaken for the “partial exemption year” which is the 12 months to 31 March, 30 April or 31 May depending on which VAT Return periods are in use. Where monthly VAT Returns are made, the annual review will cover the year to 31 March annually.

The partial exemption year can be changed to another date, such as the accounting year end if desired, but this requires prior permission from HMRC.

Any annual adjustment to the Input VAT claimed is included in the next Return period (e.g. quarter to 30 June, where periods fall to 31 March), but can be declared earlier, in the final Return of the year if desired.

The first partial exemption period after registration will be a short period to the dates described above.

Further guidance

HMRC Notice 706 “Partial Exemption”

This document has been prepared for information purposes only and does not constitute advice. All information correct as at July 2024.