

VAT partial exemption and the COVID-19 pandemic

If you consider that the COVID-19 pandemic has rendered your existing VAT partial exemption or business/non-business recovery method unfair or unreasonable, then there are several options for dealing with this.

Business/non-business methods

If the problem arises from a business/non-business method that hasn't been formally agreed with HMRC, you should be able to apply a correction to render the method fair and reasonable without the need to pre-agree this with HMRC. However, you will need to retain evidence to support the correction, in case of query by HMRC.

Special methods

If the problem arises from a method (business/non-business, a partial exemption special method or 'PESM' or a combined method) that has been formally agreed with HMRC, you are likely to have to seek permission from HMRC to vary the method. Written agreements will usually specify how to deal with the method being unfair or unreasonable, and this usually involves notifying HMRC and agreeing a revised method. It may be possible to serve a Special Method Override Notice on HMRC. This is a notice that an existing PESM or combined method is no longer considered to be fair or reasonable and the method has been corrected to deal with this, until a replacement method can be agreed and implemented.

Standard partial exemption method

If a problem arises with the standard partial exemption method, then if the conditions for a standard method override are met (see below), HMRC advise affected businesses to use a standard method override to deal with the problem. If not, the business can write to HMRC to seek a special method to address the problem.

HMRC approval

On 23 March 2021 HMRC announced that they will be using an accelerated process to make sure coronavirus-related changes to VAT recovery methods, special methods or Special Method Override Notices are considered, and if appropriate, approved swiftly. HMRC say:

Where the nature of the supplies you make has changed as a result of coronavirus, but you anticipate moving back toward a pre-pandemic position in due course, then HMRC is likely to accept proposals which use representative income streams from the previous tax year to get a fair and reasonable recovery rate.

If you can demonstrate that the prior year on its own is not representative of the use of the costs, then a representative period of up to a maximum of the previous 3 years may be used.

Where costs are incurred in relation to an activity that was planned but has been delayed due to coronavirus, then projected income from the activity may provide an appropriate method of apportionment. This should be supported by business plans or similar commercial evidence.

For cancelled events, HMRC say:

Where planned supplies have been prevented as a result of coronavirus, for example the cancellation of a conference or event, ordinarily an adjustment to the supply values used in outputs-based partial exemption calculations would be necessary to reflect the refunds made to the customers. Requests not to make an adjustment to the value of supplies for such refunds will be considered sympathetically.

Conditions

HMRC will allow changes to be applied retrospectively beyond the tax year in which the proposal and supporting declaration are received, if they are caused by the COVID-19 pandemic.

HMRC will set a default time limit of one tax year for the special method, and, subject to any other changes, the method will revert to the previous calculation after this point. If at the end of the year it is apparent that this will not be sufficient, businesses must submit a further request to continue the changes into a second tax year.

Requests

Requests should be sent to the email address: PESMcoronavirus@hmrc.gov.uk. All PESH or Combined Method requests must be accompanied by a declaration that the method proposed is fair and reasonable. An example of the format this should take is available in [appendix 1 of Partial Exemption \(VAT Notice 706\)](#).

The standard method override

Under the standard method override, some (but not all) VAT registered businesses or groups that use the standard partial exemption method (turnover based) are required to make a VAT partial exemption correction if the standard method does not produce a fair and reasonable result and the difference exceeds:

- £50,000, or
- 50% of the residual input tax incurred and £25,000

The standard method override correction is usually applied in the annual adjustment for the VAT year concerned. However, this only applies to businesses whose residual input tax is more than £50,000 per year or £25,000 per year for group undertakings which are not members of the same VAT group.

Further information

Revenue and Customs Brief 4/21: <https://www.gov.uk/government/publications/revenue-and-customs-brief-4-2021-partially-exempt-vat-registered-businesses-affected-by-coronavirus-covid-19/revenue-and-customs-brief-4-partially-exempt-vat-registered-businesses-affected-by-coronavirus-covid-19>

The standard method override: <https://www.gov.uk/guidance/partial-exemption-vat-notice-706#section5>

Special Method Override Notices: <https://www.gov.uk/guidance/partial-exemption-vat-notice-706#section8>