

Chapter 4 – Input tax

Criteria for recovery of input tax

A VAT invoice must be held. However, for the following supplies it is not necessary to hold a VAT invoice where the total expenditure for each supply is no more than £25:

- telephone calls from public or private telephones;
- purchases through coin-operated machines;
- car park charges;
- single or return toll charges.

HMRC may exercise their discretion in cases where a complete and valid VAT invoice is not held, and they may allow recovery of input tax. HMRC's policy is set out in VIT31200. Where alternative documentary evidence of the supply exists, the supply is not of goods subject to widespread fraud and abuse and there are no grounds to suspect abuse or fraudulent intent on the part of the claimant, HMRC may allow the taxpayer to recover input tax.

Where a third party pays for goods or services supplied to another person, the third party has no right to recover input tax. This commonly happens where legal costs in a court case are paid by the unsuccessful party.

Supplies which are *prima facie* to employees can be treated as supplies to the employer if the employer meets the full cost and the supplies were made for the purposes of the employer's business. Typically this includes road fuel, subsistence costs and items bought over the counter in shops. Where expenses are paid to self-employed representatives, input tax is normally recoverable subject to the normal rules.

Where VAT is charged by a person not registered for VAT, this is not input tax and cannot be recovered. By concession, HMRC allow recovery where the customer acted in good faith.

Where the supplier wrongly charges VAT on a supply which is zero-rated, exempt or reduced-rated, this is not input tax and cannot be recovered.

Timing of recovery

Input tax should be reclaimed in the period in which the time of supply falls, by reference to the rules for basic and actual tax points.

Where a VAT invoice is not held at the time of submission of the VAT return, the input tax recovery must be delayed to a future VAT period. Where a VAT invoice is held but the input tax is not recovered on the correct VAT return, any inclusion on a later return will be subject to the usual error correction procedures.

Pre-registration input tax

Where a newly-registered business has incurred VAT before the date of registration, this may be treated as input tax and recovered in the following cases:

- Goods which have not been re-supplied or consumed before the date of registration and were not purchased more than four years before registration.
- Services which have not been re-supplied nor performed on goods which have been supplied by the business, and which were not supplied to the business more than six months before the date of registration.

Cars

A car is a motor vehicle which has been constructed or adapted solely or mainly for the carriage of passengers or has to the rear of the driver's seat roofed accommodation with side windows. It does not include a vehicle capable of accommodating only one person, or capable of carrying twelve or more seated persons, or of at least three tonnes unladen weight, or constructed to carry a payload of one tonne or more.

Input tax cannot normally be recovered on the purchase of a car. However, it may be recovered on the purchase of a car which is used only for business purposes and is not available for private use. HMRC accept that a pool car will fulfil these conditions when it is normally kept at the principal place of business, not allocated to an individual and not kept at an employee's home.

Where input tax is incurred on the charges for leasing a car, this is subject to a recovery rate of 50%. In the following circumstances, it is possible to recover 100% of the VAT:

- The car is used for business purposes and is not available for private use.
- Daily rental where a car is not hired simply to replace an off-road car, and where the period of hire is no more than ten days.
- Optional additional charges for repairs and maintenance, provided that these are separately described in the contract hire agreement and are genuinely optional.

Input tax on repairs and maintenance of a car is recoverable unless the car is used solely for private motoring by a sole proprietor or partner.

Fuel

Where an employee is reimbursed for fuel used in his/her own car on a business journey, input tax may be recovered subject to the retention of a VAT invoice from the petrol station. The invoice must be dated on or before the date of the travel to which it relates. It is wise for businesses with employees who use their own cars for business travel to ask those employees to retain all fuel invoices.

Where the employee is paid a mileage allowance, HMRC allow the employer to use its advisory fuel rates in calculating how much of the allowance relates to fuel. The rates from 1 March to 31 May 2017 are:

Petrol:

Up to 1,400 cc	11p
1,401 to 2,000 cc	14p
Over 2,000 cc	22p

Diesel:

Up to 1,600 cc	9p
1,601 to 2,000 cc	11p
Over 2,000 cc	13p

Where an employer purchases all the fuel for a car, and some of this fuel is put to private use, it must account for VAT using the “scale charge”. This is a given amount of output tax which depends on the CO₂ emissions of the vehicle and does not vary according to the miles travelled. All input tax may then be recovered.

Alternatively, the employee may keep detailed mileage records and the employer may then recover the business proportion of the input tax. The fuel scale charge is then not required.

The employer may choose not to recover any input tax nor account for the scale charge. This may be preferable if the output tax on the scale charge exceeds the input tax reclaim and the employer does not wish to ask its employees to maintain mileage records.

Whichever of the three methods is used, it must be used consistently for all cars on which private fuel is paid for.

Business entertainment

Business entertainment is hospitality provided free of charge and with no reciprocal agreement. Input tax is irrecoverable except in the following circumstances:

- Where it is provided to employees only.
- Where it is provided to employees and third parties in circumstances in which the employee would normally claim subsistence expenses (for example when the employee is away from the office on a business trip). The employee’s proportion of the input tax may be recovered. None of the input tax is recoverable if the entertainment takes place near the employee’s workplace, or if the sole purpose of the trip is to entertain the non-employee.

- Where it is provided in the form of a staff party with guests. The employees' proportion of the input tax is recoverable.
- Where it is provided to overseas customers and the entertainment has a strict business purpose.

Employees include directors; however, entertainment provided solely for directors is not business expenditure, and input tax cannot be recovered. Input tax incurred on directors' subsistence is recoverable. Job applicants, pensioners and shareholders are not employees.

Mobile phones

Where a mobile phone is provided to an employee by the employer for business use, input tax on the purchase and connection charges can be recovered.

Call charges are subject to the following rules:

- Where there is a policy of not allowing private use, all input tax may be recovered, and small amounts of private use will be disregarded.
- Where the employer charges employees for private use, all input tax may be recovered, but the employer must account for output tax on the charges made.
- Where private use is free, a fair and reasonable apportionment of input tax must be made, for example by analysing a sample of bills over a reasonable period.

Fixed monthly charges which allow a given amount of calls must be treated in the same way as calls.

Hotel accommodation

If one company pays a hotel bill and recharges it to another company, there is no VAT on the recharge unless a profit is made. The problem is that input tax cannot be reclaimed. So if, for example, company A pays for a hotel room at £100 plus VAT and recharges it to company B, company A cannot reclaim the VAT and must charge £120 (with no extra VAT) to company B. Company B will not be able to reclaim the VAT and will therefore have paid £20 more for the room than if company B had paid the bill direct.

There is a way round this apparently iniquitous situation. Company A would have to act as a "disclosed agent". This means that the hotel's invoice would be addressed c/o company A for payment but would identify the hotel guest and the guest's employer (company B). Company A would not reclaim the VAT of £20 and would invoice company B for £120 as a VAT-inclusive disbursement. The words "The disbursement in relation to the hotel bill includes VAT of £20 which is your input tax and can be reclaimed subject to the normal rules" should appear on the invoice.