

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (INPUT TAX) (SPECIFIED SUPPLIES) (EU EXIT)
(NO. 2) REGULATIONS 2019

2019 No. 408

1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury (the Treasury) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument is one of a number of instruments to be made in preparation for the withdrawal of the United Kingdom (UK) from the European Union (EU).
- 2.2 The Value Added Tax (VAT) system requires VAT to be charged by businesses on most goods and services supplied in the UK. Where VAT is charged, businesses may reclaim any VAT they pay on the costs of making those 'taxable' supplies. VAT is not generally charged on supplies of financial services but, in turn, businesses cannot reclaim any VAT they pay on the costs of making those 'VAT exempt' supplies. To maintain international competitiveness, businesses supplying customers outside the EU with certain exempt financial services, or services in connection with an export of goods to a place outside the EU, may reclaim any VAT they pay on the costs of making those supplies, even though those services would be exempt. These types of supplies are known as 'specified supplies' and are specified in the Value Added Tax (Input Tax) (Specified Supplies) Order 1999 (SSO).
- 2.3 This instrument extends the existing treatment so that, on EU exit, UK businesses will be able to reclaim VAT in relation to specified supplies made to customers in the EU. This brings the VAT treatment of supplies to EU customers in line with the VAT treatment of supplies to customers in the rest of the world. As before, businesses will not be able to reclaim any VAT they pay on the costs of making similar supplies to UK customers which will remain VAT exempt.
- 2.4 Businesses that make both taxable and exempt supplies have to calculate the proportion of the VAT that they can reclaim. They calculate this using a partial exemption method. Bespoke methods of calculation are known as Partial Exemption Special Methods (PESM). This instrument ensures that a PESHM agreed before the UK exits the EU will be interpreted in accordance with the VAT treatment that will apply under the SSO after the UK exits the EU. This avoids increased administrative burdens on both business and HMRC as, otherwise, businesses would need to apply for a new method which would require approval from HMRC.
- 2.5 The instrument also allows specific businesses that supply financial services alongside their main business activity to apportion VAT on supplies of such services in accordance with the VAT treatment that will apply under the SSO after the UK exits the EU.

3. Matters of special interest to Parliament

Matters of special interest to Select Committee on Statutory Instruments

- 3.1 This instrument makes provision required in connection with the UK leaving the EU without a deal. It will therefore only come into force on a date or dates specified in a separate instrument (made using powers in section 52 of the Taxation (Cross-border Trade) Act 2018 (TCTA)) in the event that the UK withdraws from the EU without a negotiated arrangement.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the whole of the United Kingdom.
- 4.2 The territorial application of this instrument is the whole of the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 This instrument is made using powers in section 51 and 52 of TCTA which provide that the Treasury may make regulations that they consider appropriate in consequence of, or otherwise in connection with, the withdrawal of the UK from the EU and for those regulations to come into force on a day to be appointed.
- 6.2 Sections 51 and 56 of TCTA provide the power for the Treasury to make further provision subject to negative procedure (unless amending primary legislation) in relation to VAT as a consequence of, or otherwise in connection with, the withdrawal of the UK from the EU and in consequence of TCTA itself. Section 57(1) of the TCTA provides (amongst other things) that sections 51 and 52 (Part 5: other provisions connected with the withdrawal from EU) and section 56 (Part 6: final provisions) come into force on the day on which the Act is passed. The TCTA received Royal Assent on 13 September 2018.
- 6.3 Article 3 of the SSO currently allows businesses involved in the export of certain financial services, for example supplies of credit or insurance, or businesses that supply those financial services in connection with the export of goods from the EU, to reclaim the VAT incurred in making the supplies of those services.
- 6.4 This instrument amends article 3 of the SSO to allow businesses to reclaim the VAT incurred in making supplies of specified financial services, or in connection with making certain supplies, to customers belonging outside the UK. This means that supplies to EU customers will have the same tax treatment as those to customers in the rest of the world. It also ensures that the current tax treatment for similar supplies made to persons belonging in the UK will continue. This instrument is an alternative

to the changes made by the Value Added Tax (Input Tax)(Specified Supplies)(EU Exit) Regulations 2019 S.I. 2019/175. That instrument will not now be commenced.

- 6.5 This instrument also amends regulation 102 of the Value Added Tax Regulations 1995 (the 1995 Regulations) to allow businesses that have a PESM which allows them to attribute VAT to specified supplies to make an attribution in relation to the additional supplies specified in the SSO as amended by this instrument. It also ensures that the current VAT treatment in respect of supplies made to persons belonging in the UK is maintained after the UK exits the EU.
- 6.6 This instrument also amends regulation 103B(3)(a) of the 1995 Regulations to ensure that, where a business uses a ‘use based apportionment’ calculation, this calculation reflects the changes to the SSO following the UK’s exit from the EU in respect of supplies of financial services made to EU customers (where input tax recovery will be allowed). It maintains the current VAT treatment in respect of supplies made to persons belonging in the UK (where recovery will not be allowed).

7. Policy background

What is being done and why?

- 7.1 In the event that the UK withdraws from the EU without a negotiated arrangement, it is necessary to ensure that the UK’s VAT regime continues to operate as required and intended.
- 7.2 Providers of financial services generally cannot reclaim the VAT they incur on their costs because their services are VAT exempt. However VAT can be reclaimed in relation to ‘specified supplies’ as specified in the SSO (see paragraph 2.2).
- 7.3 The SSO was previously limited to supplies made to customers outside the EU. This instrument extends the ambit of the SSO so that it also covers supplies made to customers within the EU. This aligns the treatment for supplies made to all customers outside the UK. It also ensures that supplies made to UK customers remain exempt as they are now.
- 7.4 Businesses which make a mix of taxable and exempt supplies must use a method to calculate the proportion of VAT they may reclaim. This is because some costs will be used to support both types of supplies, for example accountancy fees. Many businesses have agreed a PESM with HMRC. This instrument ensures that, after the UK leaves the EU, the wording of any previously agreed PESM will be interpreted in accordance with the terms of the SSO as revised by this instrument. This means that businesses will not need to apply for a new PESM after the UK leaves the EU which will avoid increased administrative burdens on both business and HMRC.
- 7.5 Certain businesses, such as accountants, lawyers and financial advisors, that make incidental supplies of financial services alongside their main activities are required to determine the amount of VAT they can reclaim by using an apportionment calculation based on how the VAT costs are used in making their supplies. This ‘use based’ calculation currently treats supplies that a business makes in the UK or the EU as supplies on which VAT cannot be reclaimed and supplies made to the rest of the world as supplies on which the VAT can be reclaimed. This instrument ensures that, post EU exit, the ‘use based’ calculation will continue to restrict the recovery of VAT on supplies made in the UK (to maintain the current VAT treatment), but will also allow VAT to be reclaimed in respect of supplies to EU customers.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument is not being made under the European Union (Withdrawal) Act but relates to the withdrawal of the UK from the EU. Without the amendments made by this instrument, there would be an unintended change to the VAT treatment of supplies of certain financial services made to UK customers on EU exit. Also supplies from the UK to the EU would be treated differently to those from the UK to the rest of the world.

9. Consolidation

- 9.1 This instrument amends the SSO. There are no plans to consolidate this legislation.

10. Consultation outcome

- 10.1 No consultation has been carried out. The changes extend the scope of recovery under the SSO so that it also covers supplies made to customers within the EU. They also ensure that any business with a current PESM will not have to apply for a new PESM as the existing PESM will be interpreted in accordance with this instrument and the revised SSO.

11. Guidance

- 11.1 In the event of a ‘No Deal’ outcome, as a result of the changes made by this instrument, businesses will be able to recover input tax under the SSO in relation to supplies made to customers in the EU but will continue to restrict recovery in relation to similar transactions within the UK. There is already guidance on this on www.gov.uk in the [partial exemption VAT Notice 706](#). This will be updated where necessary and any updates will be available prior to commencement of this instrument.

12. Impact

- 12.1 This instrument removes the requirement for businesses to amend their PESMs to reflect the extended VAT recovery so there is no, or no significant, impact on business, charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector. Any impact will relate to enquiries regarding the amendment to legislation.
- 12.3 This instrument will be covered by an HMRC overarching impact assessment on VAT and services which will be published and available on the website at <https://www.gov.uk/government/collections/customs-vat-and-excise-regulations-leaving-the-eu-with-no-deal>

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses employing less than 50 people as the rules are by necessity of general application.

14. Monitoring & review

- 14.1 The approach to monitoring of this legislation is that this legislation will be kept under review through communications with key stakeholder groups, including the Joint VAT Consultative Committee (made up of a wide range of representatives) to ensure that it meets the policy objectives set out in section 7 above.
- 14.2 This instrument does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015

15. Contact

- 15.1 Karen Ogilvie at HMRC Telephone: 03000 585719 or email: karen.ogilvie@hmrc.gsi.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Eileen Patching, Deputy Director VAT Principles and Risk, Customs & Indirect Tax Directorate, at HMRC, can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Mel Stride MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.