

1 August 2006

Our ref: ICAEW Rep 43/06

Your ref:

Mr Patrick Wilson  
Partial Exemption Team  
Room 3/43  
100 Parliament Street  
London SW1A 2BQ

By email

Dear Mr Wilson

## **PARTIAL EXEMPTION CONSULTATION**

1. The Charity Sub-Committee of the Institute of Chartered Accountants in England & Wales (the 'Sub-Committee') welcomes the opportunity to comment on the informal consultation paper *VAT: Partial Exemption Consultation* published by Her Majesty's Revenue and Customs in June 2006. This response is separate from, additional to and supports the recommendations of the Tax Faculty of the Institute of Chartered Accountants in England and Wales' response (TaxRep 19/06).

## **WHO ARE WE**

2. The Institute is the largest professional accountancy body in Europe, with more than 128,000 members. The Institute operates under a Royal Charter, working in the public interest. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.
3. The Sub-Committee is responsible for co-ordinating the technical considerations of the charity sector with respect to Chartered Accountants working within or for charities. Its membership represents the interests of practitioners, their clients and Chartered Accountants employed in financial roles within charities.

## **KEY ISSUES**

4. The Sub-Committee welcomes HMRC's intention to retain partial exemption methods in principle. We consider that the new regime should be supported in respect of its intention to speed up the approval of special methods. Further we support the extension of approval of special methods applying to supplies made outside the UK.

5. The Sub-Committee is concerned that a proposed amendment in respect of the declaration made by businesses stating “to the best of their knowledge and belief” their proposed special method will produce a fair and reasonable recovery of input tax, does not take into account the special circumstances of charities and results in an undue burden on them.
6. The first of the Hampton principles arising from the Hampton Review, which HMRC welcomed, is to make better use of advice. Removing the ability of taxpayers, and in particular charities, to rely, with any certainty, on the agreement of HMRC staff to a special method reached through discussions conducted in good faith, is inconsistent with these principles. The consequences of the shift in burden from the HMRC to the charity will constitute a significant risk and burden to charities, which often have limited reserves and no share capital.
7. The measure is targeted at large financial institutions but many charities will be affected. Many smaller charities have special methods, often complex, but may not have access to professional advice to the same extent as large corporations and may be run by volunteers. Retrospective assessment following an honest mistake could be costly and may constitute a further disincentive to suitable candidates for trusteeship. The increasing role of the charity sector in the provision of services to communities and the partnership envisaged by Government cannot be said to be supported by changes which result in greater burdens, risk and uncertainty to the sector.

#### **“Fair and reasonable”**

8. Businesses will need to sign a declaration to the effect that their method is fair and reasonable. As such further clarity is needed to define what is “fair and reasonable” which goes beyond that currently provided for in the special methods guidance. A definition should be included in the regulations to ensure there is no uncertainty.

#### **Impact on charities specifically**

9. In charities the legal directors or trustees are normally all non-executives. As an individual within a business is obliged to act as a knowledge bank for all that business’s activity such as restructuring, acquisitions etc and as such is being asked to foresee all relevant events this may be particularly onerous for charities.
10. The implication from the consultation is that HMRC will carry out little approval work on special methods for smaller registrants, which will leave charities with a potential uncertainty and expose them to greater risk of retrospective recovery, even in respect of an honest mistake. Charities, especially smaller charities, do not tend to have funds or are unable to justify allocation of funds to professional services, but rather are obliged to utilise such funds for their charitable purposes.
11. There is a materiality mis-match in this proposal with HMRC concentrating on major potential losses of tax and charities facing increased uncertainty that could be very material for them.

#### **Retrospective recovery**

12. If HMRC identify an over-recovery of input tax, which was foreseeable, by a business and serves a special method override notice, the department can go back to the beginning of the method (subject to the three year cap). If a business identifies that its special method provides for an under-recovery of input tax then it can apply for a new method which it can only backdate to the start of the current tax year. This would appear inequitable.

### **Matters yet to be addressed by HMRC**

13. The Sub-Committee are keen to receive clarity in respect of the following points;

- how long a declaration will be valid for and how implementation will take effect?
- what will be the position for existing approved methods?
- what are the penalties for misdeclaration and will these depend on the professional standing of the signatory?

### **CONCLUSION**

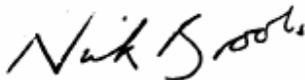
14. Charities are not mentioned in the consultation document and we understand that the intention is not to target charities. However, the Sub-Committee are concerned that these measures will result in inequity for charities. Charities may have limited reserves, often have difficulty accessing expensive expert advice, have limits on the way they can manage their funds and would be detrimentally affected by this proposal.

15. As entities obliged to act in the public interest it would reasonable to argue for an exemption or different treatment for charities. At the very least detailed guidance specifically for charities should be issued by HMRC. The Sub-Committee would be happy to contribute to development of such guidance.

16. We urge HMRC to reconsider the special method regime reform to enable flexibility and equity for charities and to avoid the potentially disastrous impact of a charity making an innocent mistake resulting in an underpayment of tax which is material to the charity and which it is unable to repay.

If you have any queries in relation to the above please contact the Sub-Committee Secretary, Caron Bradshaw on 02079208579 or [caron.bradshaw@icaew.co.uk](mailto:caron.bradshaw@icaew.co.uk).

Yours sincerely



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Chairman, Charities sub-Committee  
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