

---

# VALUE-ADDED TAX

## *A Guide to Apportionment of Input Tax*

**October 2001**

Revenue 

---

***This document is a guide to the legislation. It is not a legally binding instrument. Anyone in doubt about the application of the VAT rules should contact the appropriate Revenue office (see appendix) and/or seek independent advice.***

---

## CONTENTS

<b>1.</b>	INTRODUCTION .....
<b>2.</b>	THE BASIC RULES ON DEDUCTIBILITY .....
<b>3.</b>	DUAL-USE INPUTS .....
<b>4.</b>	THE PROPORTION OF TAX DEDUCTIBLE .....
<b>5.</b>	THE PROPORTION OF TAX DEDUCTIBLE FOR A TAXABLE PERIOD
<b>6.</b>	THE REVIEW .....
<b>7.</b>	CORRECTION OF THE ADJUSTMENT .....
<b>8.</b>	TURNOVER METHOD .....
<b>9.</b>	A SECTORAL APPROACH .....
<b>10.</b>	DATE OF INTRODUCTION: TRANSITIONAL ARRANGEMENTS
<b>11.</b>	SPECIFIC AREAS: INTRODUCTION.....
<b>12.</b>	LEASING, HIRE-PURCHASE AND LOANS .....
<b>13.</b>	NON-TAXABLE ACTIVITIES — GRANTS, SUBSIDIES AND DIVIDENDS
<b>14.</b>	PRIVATE USE OF DUAL-USE INPUTS, SELF SUPPLIES AND APPORTIONMENT. ....
<b>15.</b>	ENQUIRIES .....

## **1. INTRODUCTION**

- 1.1** The right of a taxable person to deduct VAT on his or her inputs is a central part of the Value Added Tax system. The right to deduction is provided for in section 12 of the Value Added Tax Act 1972 (as amended). A general outline of the rules is set out in paragraphs 6.6 to 6.12 of the Guide to Value Added Tax 1999.
- 1.2** This Guide deals with the apportionment of input tax. Apportionment arises when a taxable person is not entitled to deduct the full amount of VAT on his or her inputs.
- 1.3** Section 112 of Finance Act, 2000 substituted a new subsection (4) into section 12 of the VAT Act with effect from 23 March, 2000. This subsection provides the legislative basis for the apportionment of input tax. The Value Added Tax (Apportionment) Regulations, 2000 (S.I. No. 254 of 2000) (the “Apportionment Regulations”) were enacted by Revenue with effect from 1 September, 2000. These Regulations provide the procedural details to give full effect to the primary legislation.
- 1.4** There are two parts to this Guide. Chapter 2 to Chapter 10 gives an overview of the legislation, while Chapter 11 to Chapter 14 outlines the implications of the legislation for the most affected sectors, for example, Chapter 12 deals with the financial services sector. Chapter 2 sets out the basic rules on deductibility. Chapters 3 and 4 explain the concept of dual-use inputs and the proportion of tax deductible on the acquisition of dual-use inputs. Chapter 5 deals with the application of the apportionment rules for a taxable period while Chapter 6 explains the concept of the annual review and adjustment of the apportionment method. Chapter 7 sets out the circumstances when interest and penalties on any incorrect adjustments will be waived. Chapters 8 and 9 deal with the turnover method of apportionment and the sectoral approach to apportionment. Chapter 10 sets out the date of introduction and transitional

issues. Chapters 11 to 14 deal with specific areas such as incidental property and incidental financial transactions, financial services such as leasing, hire purchase and stocking loans, and the effect of non-taxable receipts such as grants and dividends, and the interaction with private use.

## **2. THE BASIC RULES ON DEDUCTIBILITY**

**2.1** A taxable person is entitled (with some exceptions - see paragraph 2.3) to deduct VAT payable on his or her inputs when these inputs are attributable to the taxable supply of goods or services or qualifying activities (see paragraph 2.2). A taxable person is not entitled to deduct any VAT on his or her inputs if these inputs are not attributable to taxable supplies or qualifying activities.

**2.2** Input tax is generally not deductible if it does not relate to taxable supplies. However, as an exception, input tax is deductible if it relates to certain non taxable supplies known as 'qualifying activities' and they are generally as follows:

- transport outside the State of passengers and their accompanying baggage;
- certain financial and insurance services supplied outside the EU or services directly in connection with the export of goods to a place outside the EU;
- supplies of goods and services outside the State which would be taxable supplies if made in the State apart from passenger motor vehicles for hiring out for utilisation within the State.

**2.3** On the other hand, VAT is not deductible on the purchase or acquisition of the following goods and services, even when the goods and services in question are attributable to the taxable supply of goods or services or qualifying activities:

- expenses incurred on the provision of food or drink, or accommodation or other personal services, for the taxable person,

his or her agents or employees, except to the extent, if any, that such provision constitutes a supply of services in respect of which he or she is accountable for VAT;

- expenditure incurred by a taxable person on food or drink, or accommodation or entertainment services, where such expenditure forms all or part of the cost of providing an advertising service in respect of which tax is due and payable by the taxable person;
- entertainment expenses incurred by a taxable person, his or her agents or employees;
- the acquisition (including hiring) of passenger motor vehicles otherwise than as stock-in-trade (that is, for resale) or for use in a vehicle hire or driving school business;
- the purchase of petrol otherwise than as stock-in-trade;
- contract work involving the handing over of goods when such goods are themselves not deductible.

**2.4** Section 12(4) and the Apportionment Regulations set out the deductibility rules applicable where goods and services are not used *solely* for the purposes of taxable supplies or qualifying activities.

### **3. DUAL-USE INPUTS**

**3.1** Section 12(4) of the VAT Act defines a number of terms which are central to the rules on apportionment. The key term used is that of 'dual-use inputs'. Dual-use inputs are goods and services that are not acquired solely for the purposes of 'deductible supplies or activities' or for the purposes of 'non-deductible supplies or activities'. An example of dual-use inputs would be where a bank purchases a computer which is used to process both leasing transactions, which are subject to VAT, and personal loans, which are exempt from VAT. The computer is a dual-use input and the VAT payable on its purchase must be apportioned between the amount which is deductible and that which is not.

**3.2** If a taxable person purchases, acquires or imports dual-use inputs then the VAT incurred must be apportioned in accordance with section 12(4) and the Apportionment Regulations. There are three broad types of dual-use inputs:

- consumables such as stationery which are used in making the supplies or carrying out the activity;
- general overheads such as electricity and audit fees;
- capital goods such as premises, computer systems, etc.

## 4. THE PROPORTION OF TAX DEDUCTIBLE

- 4.1 There is a basic rule governing the proportion of input tax deductible on dual-use inputs. The taxable person has an entitlement to deduct

*“...a proportion of tax deductible which correctly reflects the extent to which the dual-use inputs are used for the purposes of that person’s deductible supplies or activities and has due regard to the range of that person’s total supplies and activities”*

-section 12(4)(c).

The entitlement to deduct input VAT is, of course, dependent on the input tax being attributable to some extent to a taxable supply or qualifying activity. To arrive at the correct result, there are many ways of calculating the deductible proportion, for example, the ratio of taxable turnover to total turnover, the ratio of taxable transactions to total transactions, an area based calculation, etc

- 4.2 The key point is that there are two specific conditions which must be met. The proportion must correctly reflect the use to which the inputs are put and also reflect the range of the taxable person’s activities.
- 4.3 Any method which meets these conditions may be used by a taxable person to calculate the proportion of tax deductible. The taxable person decides the method to be used and the result of this method must meet the two conditions. However, the taxable person must be able to, on request, demonstrate to the satisfaction of Revenue that the method used results in a correct proportion of deductible tax.

- 4.4 The following example illustrates that the proportion must correctly reflect the use to which the inputs are put.

**Example 4(a):**

A finance company engages in taxable leasing and exempt personal loans as follows:

	Number	%	Value	%
Leasing agreements entered into:	75	60	€750,000	42.9
Personal loans entered into:	50	40	€1,000,000	57.1
<b>Total:</b>	<b>125</b>	<b>100</b>	<b>€1,750,000</b>	<b>100</b>

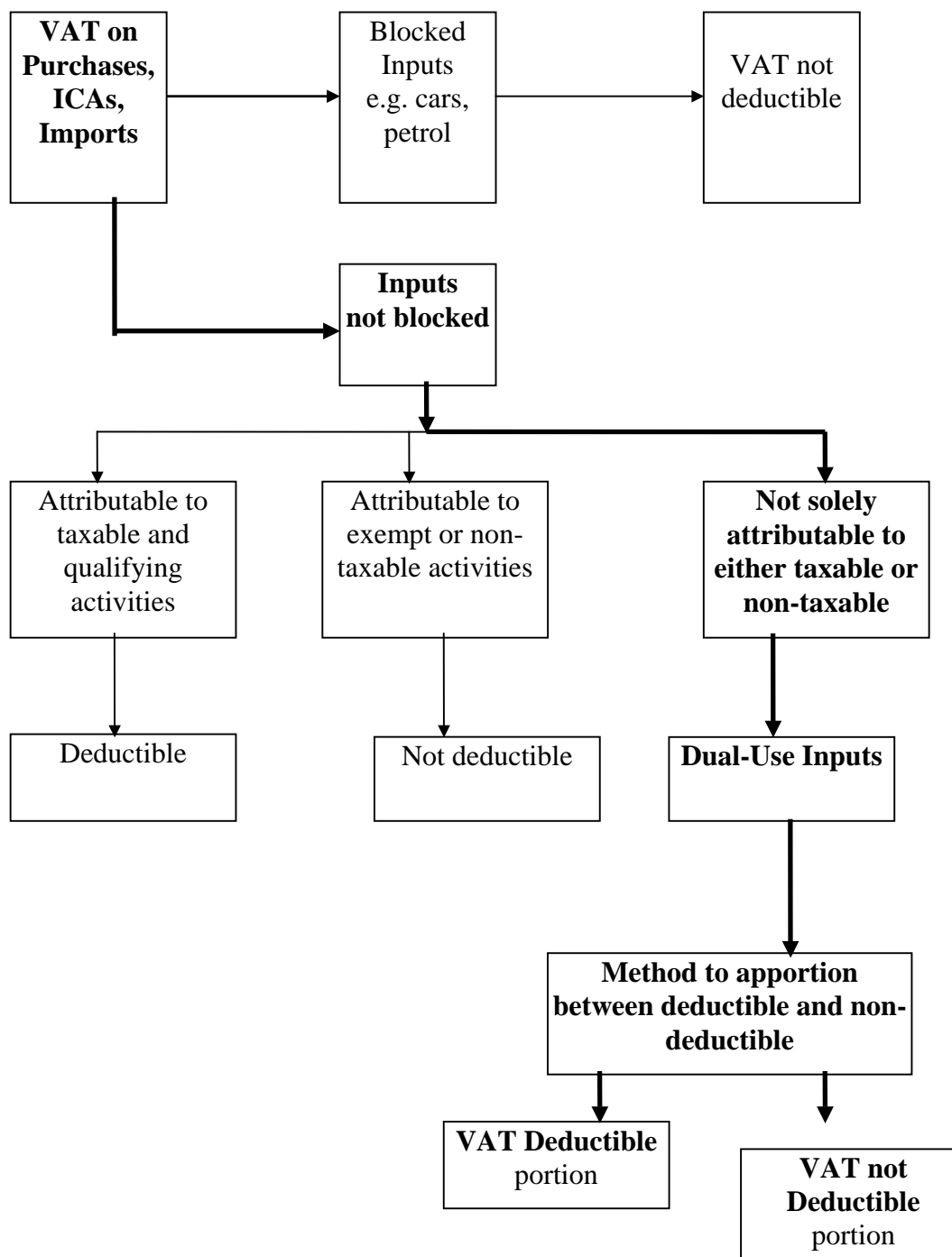
In this case the number of leasing agreements entered into represents 60% of the total number of transactions but only 42.9% of the total value of the finance granted. In this example, the finance company can demonstrate that each transaction requires the same level of inputs regardless of its value. Therefore, it can demonstrate that the proportion of tax deductible should be calculated on the basis of the proportion of the taxable transactions in the total transactions rather than on a turnover basis and it can deduct 60% of the tax incurred on its dual-use inputs.

*(This is a simplified example for illustrative purposes only. In a real case involving leasing and personal loans there will be a range of existing leases and loans in place in addition to new agreements entered into. In these circumstances while the number of transactions will be relevant other measures such as interest received, number of staff involved, etc. may well provide a more realistic basis).*

- 4.5** While it is relatively easy to understand the concept of use, some concern has been expressed about the meaning of the second condition, i.e., that “the proportion of tax deductible ..... has due regard to the range of that person’s total supplies and activities”. This means that any method of calculating the proportion of tax deductible must also have regard to the entire activities of the taxable person.
- 4.6** This condition covers two different types of circumstances. Firstly, many general overheads are not directly used in making supplies. For example a company’s audit fee will relate to the full range of the company’s activities and the method of apportionment must have regard to this. Secondly, in addition to their taxable and exempt activities, a number of taxable persons carry out regulatory and statutory activities which are outside the scope of VAT. These activities may be funded by grant aid, levies, etc. If these activities are, for example, carried out in the same building as the taxable activities, input tax in relation to the premises, lighting, heating, etc. must be apportioned having regard to all the activities, both business and ‘non-business’, of the taxable person.
- 4.7** In effect, the method used to calculate the proportion will depend on the individual circumstances of the case. The decision on what method to use is primarily the responsibility of the taxable person. The taxable person must be able to demonstrate, on request, to the satisfaction of Revenue that the result of the calculation is reasonable.
- 4.8** The basic VAT system provides that VAT is deductible where the goods or services are inputs in relation to a taxable or qualifying output. Chart A (overleaf) illustrates the system.

## CHART A

## DEDUCTIBLE TAX



## **5. THE PROPORTION OF TAX DEDUCTIBLE FOR A TAXABLE PERIOD**

**5.1** The proportion of tax deductible in relation to dual-use inputs should be calculated using a method which correctly reflects the use to which the dual-use inputs are put and reflects the range of the activities carried out in a taxable period. As this would entail a new calculation for every taxable period, the Apportionment Regulations provide that the taxable person may use any of the following to calculate the proportion of tax deductible for a taxable period:

- a method which correctly reflects the use and range for that taxable period;
- the proportion of tax which was deductible for the previous review period (i.e. the previous financial year or calendar year; see section 6 below);
- the taxable person's estimate of what proportion of tax deductible correctly reflects the use and range for the review period within which the taxable period ends (the current review period).

**5.2** In effect the taxable person can calculate his or her proportion of tax deductible on a correct basis for the taxable period, or on the basis of the previous review period's results or on the basis of an estimate of the current year's likely out-turn. Obviously the circumstances of the case will determine the most suitable method. It is envisaged that the previous review period's out-turn will be the most straightforward approach but there will be situations where this approach is neither possible, for example, a start up, nor appropriate due to a significant change in the mix of the business activities.

- 5.3** If a person wishes to apportion his or her inputs based on an estimate of the likely out-turn of the current review period then that person must submit details of the basis of that estimate to that person's Revenue audit office (see appendix). These details must be submitted at the same time as the VAT return is sent separately to the Collector-General's Office. If an audit officer is not satisfied with the basis of the estimate, the audit officer may require the taxable person to use a different basis of calculation for that return and subsequent returns within that current review period.
- 5.4** There are a number of options for a taxable person to apportion his or her dual-use inputs for a taxable period. A series of examples will illustrate the possibilities:

*Example 5(a)*

A partially taxable/exempt company is preparing its September/October 2001 return. Its financial year-end is 30 April and its proportion of tax deductible for the year ended 30 April 2001 was 60%. In September/October 2001 one of its contracts required an unusual level of inputs. It is satisfied that the 60% proportion significantly overestimates the proportion of tax deductible for that period. However, it is entitled to use that proportion. Since this would result in the build-up of a VAT liability it chooses to calculate an accurate proportion of tax deductible using a method which correctly reflects the use to which dual-use inputs are put and the range of business activities carried out for September/October 2001. In this example, the company is satisfied that it can demonstrate the accuracy of the calculation if required by Revenue. The September/October 2001 return must, of course, be reviewed as part of the annual review [see Chapter 6].

Example 5(b)

A partially taxable/exempt company has a reasonably stable mix of taxable and exempt activities. It uses the previous year's proportion in calculating its tax deductible on its dual-use inputs.

Example 5(c)

A partially taxable/exempt company registers for VAT on 1 July 2001. Its financial year-end is 30 June. Its business plan and projections for its first year's trading suggests that the taxable business will represent 20% of its total business. It is satisfied that a turnover based method of apportionment provides the best basis for correctly apportioning the VAT incurred on its dual-use inputs. The company submits its July/August 2001 return by 19 September 2001 to Collector General and at the same time submits details of its apportionment system supported by its first year trading projections to the appropriate tax office. The company can continue to use this basis in completing the returns to May/June 2002 when its first review period ends and it reviews its apportionment ratio. In this case the tax office has not directed the company to use a different method to calculate its deductible proportion.

**5.5** If a taxable person accounts for VAT on an annual basis he or she has three options for calculating his or her proportion of tax deductible on dual-use inputs for its annual return:

- ◆ the actual proportion for the period;
- ◆ the previous year's results; or
- ◆ an estimate of the proportion for the period.

The first method is the preferred method in that it has regard to the actual out-turn for the period in question. However, just as in the case of a person accounting on a bi-monthly basis, it is not always possible to complete a review in the time available to submit the return. In these circumstances both the other options are available to a person on an annual return (see paragraphs 5.1 - 5.4). If the person uses an estimate of the proportion, the rules set out in paragraph 5.3 with regard to notification of the relevant Revenue office apply.

## 6. THE REVIEW

6.1 Section 12(4) and Regulation 6 of the Apportionment Regulations provide that the proportion of tax deductible for a taxable period is subject to review on an annual basis. There are two important definitions in relation to the review mechanism — “accounting period” and “review period”.

- ◆ An **accounting period** is the taxable person’s normal accounting year or if the taxable person does not have a normal accounting year it is the calendar year.
- ◆ A **review period** is a period consisting of all the taxable periods that end in an accounting period. The two definitions can best be illustrated by an example:

### Example 6(a)

A taxable person’s financial year ends on 31 March. Therefore the **accounting period** is the 12 months ending on 31 March while the related **review period** is the six taxable periods March/April to January/February.

6.2 The purpose of the review is to ensure that the proportion of tax deductible in respect of the purchase, acquisition or importation of dual-use inputs for the review period correctly reflects the extent to which the dual-use inputs were used for the purposes of a person’s deductible supplies or activities and has due regard to the range of that person’s total supplies or activities for the review period. Therefore, the taxable person must review the proportion of tax deductible in relation to dual-use inputs for the six taxable periods in the review period and adjust his or her input tax accordingly.

- 6.3** The adjustment must be made in the taxable period following the end of the review period or in a later period agreed between the taxable person and Revenue (see paragraph 6.4).

*Example 6(b)*

A taxable company's financial year ends on 31 March 2002. Its review period is the year ending 28 February 2002. It must review its proportion of tax deductible for the year ended 28 February 2002 and make any adjustment in its deductible VAT for March/April 2002.

- 6.4** Revenue recognise that a review of the proportion of tax deductible may be complicated and for that reason accepts that the adjustment may be made in any of the three taxable periods immediately following the end of the review period. Therefore, in *example 6(b)* the adjustment may be made in the March/April, May/June or July/August 2002 returns. Prior agreement need not be sought from Revenue to exercise this option. However, if the adjustment is not made in any of the three periods Revenue will treat any overclaim of deductible VAT as proper to the first of the three returns for the purposes of calculating any interest or penalties due as a result of that overclaim.
- 6.5** If there are special circumstances which mean that the review cannot be completed in time for inclusion in the third return then prior agreement is required from the relevant Revenue office. In these situations the taxable person should state in writing the reasons why the review cannot be completed and the taxable period within which the adjustment will be made. The taxable person will be advised by Revenue whether the request is agreed to or not. As Revenue have already granted a six month time frame for the adjustment to be made, requests will only be granted in exceptional circumstances.

- 6.6** Although the adjustment for a review period is usually made in a subsequent taxable period, this is not the case in respect of a final accounting period. In this situation the adjustment must be made in the return for the last taxable period. Again two examples will illustrate the position:

Example 6(c)

A company's financial year end is 30 April. Due to cessation the company's final accounting period is the year ended 30/4/2002. Its review period is the six taxable periods to 30/4/2002. Any adjustment arising out of the review should be included in the return for March/April 2002.

Example 6(d)

A company's financial year end is 30 April. The company ceased trading on 31 August 2002. Its final accounting period is from 1 May to 31 August 2002. It must review its proportion of tax deductible for these months and make any adjustment in its July/August 2002 return.

- 6.7** Where a taxable person accounts for VAT on an annual basis and does not base his or her return on the actual out-turn for the annual period (see paragraph 5.5), that person must also review his proportion of tax deductible and incorporate any adjustment in his or her next annual return.

## **7. CORRECTION OF THE ADJUSTMENT**

**7.1** The calculation of the deductible proportion in relation to dual use inputs for a taxable period and the review and subsequent adjustment is subject to audit and examination by Revenue. The method of calculation must be supported by objective evidence. The Apportionment Regulations provide that, subject to certain conditions, interest will not be payable on any additional liability arising out of an incorrect adjustment for a review period.

**7.2** The conditions, all of which apply, are that:

- (a) the adjustment does not involve fraud or negligence;
- (b) the taxable person submitted details to the relevant Revenue office setting out the basis of the adjustment by the due date for submission of the return in which the adjustment was made;
- (c) the additional liability is paid without Revenue having to raise an assessment to recover the tax.

## 8. TURNOVER METHOD

- 8.1 Before the introduction of the new section 12(4) a taxable person was entitled to use the turnover method of apportioning VAT on dual-use inputs. Section 12(4)(d) qualifies the entitlement to use the turnover method. A person is entitled to use the turnover method **only** if the results correctly reflect the use to which the dual-use inputs are put and has due regard to the range of that person's activities.
- 8.2 The turnover method is based on the ratio of turnover from deductible activities to the total turnover of that person's business. The following example illustrates the concept where the non-taxable turnover comes from exempt activities only:

### Example 8(a)

A company's turnover is broken down as follows:

Taxable supplies	€100,000
Qualifying activities	€50,000
Exempt activities	€ <u>350,000</u>
Total turnover	€500,000

$$\text{Standard turnover method } \frac{100,000 + 50,000}{500,000} \times 100 = \mathbf{30\%}$$

Under the turnover method the company is entitled to deduct **30%** of the VAT incurred on its purchase, acquisition or importation of dual-use inputs.

- 8.3 The turnover method has traditionally been seen as the standard method of apportionment as the level of turnover generally provides an objective

measure of the relative use of dual-use inputs. However, the standard turnover method may not be appropriate where the taxable person is in receipt of dividends, grants, subsidies and other 'non-income' receipts. (These issues are dealt with in greater detail in paragraphs 13.1 to 13.10.)

- 8.4** Where there are significant receipts from activities that are not exempt a variant of the standard turnover method may be appropriate. This involves including the other receipts in the denominator. The following example illustrates this approach:

Example 8(b)

A company carries out taxable activities and a statutory function on behalf of a Department of State. The company has three sources of funds:

Receipts from taxable supplies	€50,000
Levy on groups regulated by the company	€100,000
Grant from Department	<u>€500,000</u>
Total Funding	€650,000

Non-standard turnover method:

$$\frac{50,000}{650,000} \times 100 = 7.7\%$$

Under this variant of the turnover method the company is entitled to deduct **7.7%** of the VAT incurred on its purchase, acquisition or importation of its dual-use inputs. This compares with 100% deductibility if the standard turnover method was allowed.

**8.5** Section 12(4)(e)(ii) of the VAT Act provides that certain transactions should be excluded from the turnover method if their inclusion distorts the result. There are two types of supplies that may be excluded -

- incidental financial transactions, and
- incidental property transactions.

The purpose of excluding these incidental transactions is because their inclusion would distort the apportionment system. Whether a supply is an incidental one will depend on the circumstances in which it occurs. If a type of transaction forms an integral and recurring part of the business activity of a company's activities then it is unlikely to be incidental. The key element is whether the inclusion of the transactions distort the calculation of the proportion of tax deductible. Again a series of examples will illustrate the concept:

*Example 8(c)*

A wholesaler supplies taxable goods and its normal range of business is 100% taxable. On a once-off basis it charges one of its customers interest on late payment of the customer's account. The interest is exempt from VAT but since the transaction is an incidental financial transaction apportionment is not required and VAT is fully deductible on its dual-use inputs. Any VAT on inputs that are wholly attributable to the exempt interest charge is, of course, not deductible.

Example 8(d)

A retail outlet sells goods on a full payment basis and on a credit sale basis. 40% of its sales are on a credit basis, on which it receives average interest of 15%. The breakdown of its turnover is as follows:

Cash sale of goods	€600,000
Credit sale of goods	€400,000
Interest received on credit sales	<u>€ 60,000</u>
Total turnover	€1,060,000

Its proportion of tax deductible on dual-use inputs is calculated as follows:

$$\frac{600 + 400}{1,060} \times 100 = \mathbf{94.3\%}$$

In this case the supply of credit is not an incidental transaction and must be included in the calculation of the deductible proportion.

Example 8(e)

A bank decides to close two branches and sell the two premises. One of the properties is developed for VAT purposes and the sale is subject to VAT while the other is not developed and the sale is exempt from VAT. In addition to the two branches the bank also has a significant property portfolio which it leases on a long-term basis. These leases have been chargeable to VAT, subject to the normal VAT on property rules. In this case, although property transactions form an integral part of the bank's activities, both branch sales are incidental to its overall business and should be excluded from the turnover apportionment exercise. Inputs directly attributable to the supply of the 'taxable branch' are deductible while those directly attributable to the 'exempt branch' are not.

- 8.6** The exclusion of certain incidental transactions from the calculation of the proportion of tax deductible on the dual-use inputs also applies to methods other than the turnover method.
- 8.7** For the purposes of accounting for VAT on the receipt of Fourth Schedule services from abroad (see paragraph 4.8 of the Guide to Value-Added Tax, 1999 and/or Information Leaflet No. 9/01, "Received Services"), a taxable person is treated as if he or she is supplying these services to him or herself. This is a legislative drafting mechanism to ensure that the normal rules on payment, collection, etc. apply to any liability that a taxable person incurs in relation to these Fourth Schedule services. The consideration payable to the non-established supplier in relation to the receipt of these services is not turnover for the purposes of section 12(4) of the VAT Act. Therefore, the consideration payable in respect of the receipt of taxable Fourth Schedule services or exempt Fourth Schedule services is not included in either numerator or denominator for the purposes of the turnover method.

## **9. A SECTORAL APPROACH**

- 9.1** Section 12(4)(e)(i) provides that where it is appropriate to do so a taxable person should use a sectoral approach to apportion VAT on dual-use inputs. Again the taxable person is best equipped to determine whether a sectoral approach is necessary. The purpose of using a sectoral approach is to ensure that the results achieved best reflect the use to which the dual-use inputs are put and has due regard to the full range of the taxable person's activities. Obvious areas where a sectoral approach may be appropriate is in the context of group registrations or where there are separate branches or distinct accounting divisions within a company.
- 9.2** Where a sectoral approach is used, a series of calculations is required for each sector of the business. Different methods of calculation may be used for the sectors, for example, one sector may use the turnover method while another may be based on the number of transactions.
- 9.3** As is the case for any method of apportionment the taxable person must be able to demonstrate to the satisfaction of Revenue if required, that the sectoral approach is the most appropriate method. A sectoral approach can only be used where separate sectoral records are kept.

## **10. DATE OF INTRODUCTION: TRANSITIONAL ARRANGEMENTS**

**10.1** There are a number of important dates in relation to the changes in the apportionment rules. Section 12(4) was introduced with effect from 23 March, 2000 (the date of passing of the 2000 Finance Act). The Apportionment Regulations have effect from 1 September, 2000.

**10.2** The effect of these dates is that:

- the return for the period May/June 2000 and all subsequent returns are subject to the new section 12(4);
- the first review period governed by the Apportionment Regulations is the financial year ending 31st August, 2001. This means that, for an individual taxpayer, his or her first review period will be based on his or her first accounting period ending on or after 31st August, 2001. If that person does not have an annual accounting year his or her first review period is the calendar year 2001;
- transitional arrangements as set out below apply to periods May/June, 2000 to July/August, 2001 and to the first review;
- returns for periods September/October 2001 and subsequent periods must be in accordance with the provisions of section 12(4).

**10.3** Revenue recognise that prior to the issue of this guide some taxpayers were not in a position to revise their apportionment system before submission of their VAT returns for the transitional period (1<sup>st</sup> May 2000 to 31<sup>st</sup> August 2001). Accordingly Revenue is prepared to allow leniency in relation to compliance with the new rules for the transitional period. Revenue will allow taxpayers an opportunity to make adjustments based on an apportionment method which meets the two conditions set out in section 12(4) without the imposition of interest or penalties if they comply with the rules in paragraphs 10.4 or 10.5 as appropriate. This concession will only apply where returns during the transitional period were submitted on time and where the apportionment system used was based on the turnover method or a system previously agreed with Revenue but did not in fact meet the two conditions set out in section 12(4).

**10.4** As there are particular issues which arise in respect of the entitlement to apportionment by -

- (i) businesses which span the areas of leasing *and* lending or hire purchase, and
- (ii) in the case of entities which are in receipt of grants or subsidies (apart from training grants, employment subsidies and the like),

taxpayers in either of these sectors must fulfil the following conditions:

- They must adjust their VAT returns for the transitional period (1<sup>st</sup> May 2000 to 31<sup>st</sup> August 2001) to reflect the two conditions set in section 12(4).

returns may be adjusted on a period by period basis or on the basis of one adjustment covering the whole transitional period

or

returns for May/June 2000 and July/August, 2000 may be adjusted on a period by period basis together with a single adjustment covering September 2000 to August 2001.

- Regardless of the option used they must include any adjustments arising in return(s) which must be submitted at the latest by 19 January, 2002. The liability arising as a result of the adjustment must be paid by the due date.
- In the case of taxpayers on the annual return basis whose returns are not based on the calendar year they must submit a supplementary return and pay any liability by 19<sup>th</sup> January, 2002 at the latest.

All taxpayers are obliged to perform the review in accordance with the Regulations in the normal way after 31<sup>st</sup> August 2001 (see examples 10(a) and 10(b)).

*Note: In the examples quoted in this chapter, the reference to “any one of three returns immediately following...” is made in the context of the normal two-monthly returns, and does not refer to three annual returns.*

Example 10(a)

A taxpayer whose business spans leasing and lending transactions has a Financial year ending on 31<sup>st</sup> December. In order to benefit from the terms of this chapter, the taxpayer must make a return by 19<sup>th</sup> January, 2002 at the latest which includes adjustments to the returns submitted for the transitional period (1<sup>st</sup> May, 2000 to 31<sup>st</sup> August, 2001). The taxpayer's first review will cover the calendar year 2001. Any adjustment arising from that review must be made in a return for any of the three taxable periods immediately following 31<sup>st</sup> December, 2001.

Example 10(b)

A taxpayer who receives a grant or subsidy which gives rise to the necessity to apportion input VAT has a financial year ending 30<sup>th</sup> April. In order to benefit from the terms of this Chapter the taxpayer must make a return by 19<sup>th</sup> January, 2002 at the latest which includes adjustments to the returns submitted for the transitional period (1<sup>st</sup> May 2000 to 31<sup>st</sup> August 2001). The first review will cover the period from 1<sup>st</sup> May 2001 to 30<sup>th</sup> April 2002. Any adjustment arising from that review must be made in a return for any of the three taxable periods immediately following 30<sup>th</sup> April, 2002.

**10.5** Taxpayers other than those referred to in paragraph 10.4 who qualify for the concessional treatment must fulfil the following conditions.

- They must adjust their VAT returns for the transitional period (1<sup>st</sup> May 2000 to 31<sup>st</sup> August, 2001) to reflect the two conditions set out in section 12(4);
- They must perform the review as required by the Regulations after 31<sup>st</sup> August, 2001.

These two requirements may be complied with in any one of the three following methods:

a single adjustment may be made covering the periods from 1<sup>st</sup> May, 2000 to the end of the first review period;

or

returns for May/June 2000 and July/August 2000 may be adjusted on a period by period basis followed by a single adjustment covering the period 1<sup>st</sup> September 2000 to the end of the first review period;

or

returns may be adjusted on a period by period basis from 1<sup>st</sup> May, 2000 to the start of the first review period, followed by the adjustment arising for the review period,

- They must include any adjustment necessary, in any of the three returns immediately following the end of the first review period with exception that period by period adjustments must be made

at the latest by 19<sup>th</sup> January, 2002. See examples 10(c), 10(d) and 10(e) following.

- In the case of taxpayers on the annual return basis the adjustment may be made in the return covering the year of the review or the next annual return.

Example 10(c)

A taxable person's financial year ends on 31st March. Therefore the accounting period for the first review is the year ending 28 February 2002.

The taxable person may choose to:

make an adjustment covering the period from 1 May 2000 to 28 February 2002, and include it with one of the three returns immediately following,

or

make two adjustments in respect of the periods May/June 2000 and July/August 2000, which are included in returns by 19 January, 2002 followed by one adjustment from 1 September 2000 to 28 February 2002 and include it with one of the three returns immediately following,

or

make five adjustments in respect of the periods May/June 2000 to January/February 2001, which are included in returns by 19 January, 2002 followed by one adjustment from 1 March, 2001 to 28 February, 2002 and include it with one of the three returns immediately following.

Example 10(d)

A taxable person's financial year ends on 30th April. Therefore the accounting period for the first review is the year ending 30<sup>th</sup> April 2002. The taxable person may choose to:

make an adjustment covering the period from 1<sup>st</sup> May, 2000 to 30th April, 2002, and include it with one of the three returns immediately following,

or

make two adjustments in respect of the periods May/June 2000 and July/August 2000, which are included in returns by 19 January, 2002, followed by one adjustment from 1<sup>st</sup> September 2000 to 30<sup>th</sup> April, 2002 and include it with one of the three returns immediately following;

or

make six adjustments covering the periods May/June, 2000 to March/ April, 2001 which are included in returns by 19 January, 2002, followed by one adjustment from 1<sup>st</sup> May 2001 to 30<sup>th</sup> April, 2002 and include it with one of the three returns immediately following.

Example 10(e)

A taxable person's financial year ends on 31<sup>st</sup> December. Therefore the accounting period for the first review is the calendar year 2001. The taxable person may choose to:

make an adjustment covering the period from 1<sup>st</sup> May 2000 to 31<sup>st</sup> December 2001, and include it with one of the three returns immediately following,

or

make two adjustments in respect of the periods May/June 2000 and July/August 2000 which are included in returns by 19 January, 2002, followed by one adjustment covering the period from 1<sup>st</sup> September 2000 to 31<sup>st</sup> December 2001 and include it with one of the three returns immediately following;

or

make four adjustments for periods May/June 2000 to November/December 2000 which are included with returns by 19 January, 2002, followed by one adjustment from 1<sup>st</sup> January, 2001 to 31<sup>st</sup> December, 2001 and include it with one of the three returns immediately following.

**10.6** Taxpayers who are not entitled to the concessional treatment for the transitional period referred to in paragraph 10.3 and whose returns are not in accordance with section 12(4) must submit correct returns in accordance with the section immediately, and are liable to interest and penalties, where appropriate in the normal way.

## **11. SPECIFIC AREAS: INTRODUCTION**

- 11.1** Apportionment mainly arises where the outputs of a business are partially taxable and partially exempt. The major sector involved here is the financial services sector. In the financial services sector there is often a mix between taxable supplies, qualifying activities and exempt activities. The major taxable supplies include leasing and property transactions, the qualifying activities are exempt financial services supplied to customers outside the EU and the exempt transactions are the normal exempt financial services and exempt property transactions. In paragraphs 12.1 to 12.5 some of the implications for the apportionment system of leasing and other forms of lending transactions are considered.
- 11.2** Another area where apportionment may be required is in situations where taxable persons who in addition to making supplies in the course or furtherance of business also carry out some non-business function. These non-business functions may relate to a statutory or regulatory function. Alternatively they may relate to the holding of an investment portfolio. These types of taxable persons will usually be in receipt of funding, such as grants, subsidies or dividends, which is outside the scope of VAT. Paragraphs 13.1 to 13.10 consider the implications of these type of receipts for a taxable person's right to deductibility.
- 11.3** Finally apportionment may also arise where capital goods are used for both business and non-business purposes. Paragraph 14.1 deals with this.

## **12. LEASING, HIRE-PURCHASE AND LOANS**

**12.1** The VAT treatment of leasing and hire-purchase is fundamentally different. A leasing transaction is a supply of services and is taxable in full on the supply of that service. A hire-purchase agreement is made up of two supplies -

- a taxable supply of goods from the supplier of the goods to the customer, and
- an exempt supply of credit from the supplier of the credit to the customer.

**12.2** VAT is fully deductible on any inputs directly attributable to the taxable supply of leasing services. VAT is not deductible on any inputs directly attributable to the exempt granting of credit. Therefore, in the case of a company that only supplies taxable services apportionment of inputs does not arise. However, where leasing companies also supply personal loans and hire-purchase, apportionment of the VAT on non-directly attributable inputs, i.e. the dual-use inputs, is required.

**12.3** Where apportionment is required the results must meet the two conditions of use and range of activities. The method used must be supported by the circumstances of the case. Under the old apportionment rules a number of financial institutions used the turnover method of apportionment in which the leasing turnover was included in the numerator and the denominator while the interest element of the loans was included in the denominator but the capital element was not. This obviously resulted in a higher input ratio. Under the new rules such a method may not be used. A suitable option may be based on a variant of the turnover method based on interest flows or some other method which compares like with like. Alternatively it can use a non-turnover based method such as number of staff, number of transactions, etc. provided that method is supported by objective documentary evidence such as time sheets, diaries, etc. and that the result of the method meets the conditions of the legislation.

**12.4** An integral part of the financial services sector is that of stocking loans. Stocking loans are a common feature of a number of sectors, e.g., the motor trade, the agricultural sector, etc. Traditionally these loans were normal exempt financial services, but in some cases, usually for security of title reasons, these loans are now treated as two supplies -

- the supply of the goods (usually at cost price), and
- the granting of exempt credit.

Again any VAT wholly attributable to the former is fully deductible and any VAT wholly attributable to the latter is not. However, it is clear that the inclusion of the former in the taxable turnover for purposes of the turnover method would considerably distort the result. Revenue will not accept the standard turnover method to apportion VAT on dual-use inputs in these type of cases.

**12.5** A considerable number of suppliers of goods also operate various credit sale schemes such as hire purchase, in-house store cards, etc. Where these financial services are operated on an on-going basis, apportionment of VAT on dual-use inputs should arise.

## **13. NON-TAXABLE ACTIVITIES — GRANTS, SUBSIDIES AND DIVIDENDS**

- 13.1** VAT inputs are deductible on the purchase, acquisition or importation of goods or services which directly relate to deductible outputs, i.e. taxable supplies and qualifying activities. If the inputs relate solely to deductible outputs then the VAT is fully deductible, if not it must be apportioned. In most cases where apportionment arises, it is because a business makes both taxable/qualifying supplies and exempt supplies — a partially taxable, partially exempt business. However this section deals with businesses which are partially taxable and partially outside the scope of VAT.
- 13.2** The term 'outside the scope of VAT' refers to activities which are neither taxable nor exempt. In Sixth Directive terms it means an activity which is not an economic activity for VAT purposes. The major categories of 'outside the scope' activities are those of public bodies and the holding of shares (but not the trading of shares).
- 13.3** If a taxable person engages in both a taxable activity and an 'outside the scope' activity, VAT is deductible only in respect of the inputs which relate to the taxable activity. Inputs which are not solely attributable to either the taxable activity or outside the scope activity are dual-use inputs for the purposes of section 12(4) and the Apportionment Regulations. Also where funding is given in the form of subsidies directly linked to the price of the taxable supplies, it constitutes consideration for supplies in its own right and is taxable as such. Apportionment does not apply in those cases.
- 13.4** A taxable person who engages in outside the scope activities will usually be in receipt of some form of funding to support the activity. If it is a regulatory or statutory activity this will often be in the nature of some type of grant or subsidy. The individual circumstances underlying the purpose of the grant,

the terms and conditions applicable and the nature of the activity carried out will determine whether an outside the scope of VAT activity is involved and whether or not the issue of apportionment arises.

**13.5** Apportionment will arise only if inputs are being used for both deductible and non-deductible activities. Therefore, for example, where a taxable entity carries out a statutory activity on behalf of the State in addition to its taxable activities, apportionment of dual-use inputs is required. However if, for example, a pharmaceutical company receives grant aid to support a research and development project, the receipt of the grant would not result in apportionment if it amounts only to the funding of a project which is directly attributable to its taxable supplies.

**13.6** In keeping with the fundamental legislative provisions, the legislation governing this area requires a taxable person to calculate the tax-deductible proportion which correctly reflects the use to which the dual-use inputs are put and which has due regard to the range of the taxable person's activities. If apportionment is required then any method may be used provided it meets the requirements of the law. The taxable person must be able to demonstrate, to the satisfaction of the Commissioners, by means of documentary evidence, that the method used meets the requirements of the law. Where a taxable person is in receipt of funding relating to an outside the scope activity, the level of such activity is often proportionate to the level of the funding and accordingly a turnover based method might best reflect the use to which dual use inputs are put.

**13.7** Therefore, in relation to apportionment and funding, be it public or private, national or international, the key issue is whether the funding is in relation to a taxable activity or a non-taxable activity. Apportionment under Section 12(4) can arise only if both activities are carried out.

- 13.8** The European Court of Justice has ruled in a number of cases e.g. Polysar Holdings, that the holding of shares is not an economic activity for VAT purposes and that the receipt of dividends is not consideration for the purposes of VAT. As a result, the Court has held that dividends should not be included in the denominator in the standard turnover method of apportionment as provided for in Article 19.1 of the Sixth VAT Directive. In effect, the ECJ viewed the holding of shares by a taxable person as the personal investment portfolio of the taxable person, be that taxable person an individual or a company, and not part of the economic activity of the taxable person.
- 13.9** This decision of the Court has been incorrectly interpreted to mean that, since the Court found that dividend income should not be included in the denominator, the apportionment of VAT on inputs which relate to the economic activity of the business and also to the personal investment portfolio is not required. **This is incorrect.** VAT is deductible only on inputs which relate to taxable outputs. The ECJ found that the standard Article 19.1 turnover method is not appropriate, not that apportionment itself is not required. As Advocate General Fennelly in his Opinion on Case C-142/99 Floridienne SA and Berginvest SA V Belgian State states:

*“ 38. The result of all this, in so far as Article 19(1) of the Sixth Directive is concerned, is not necessarily that the applicants may deduct all of their VAT inputs. To the extent that the national court is satisfied, notwithstanding the applicants’ contention to the contrary, that a not entirely insignificant proportion of those inputs relates to the performance of non-taxable transactions connected with the shareholding and lending activities of the applicants, no right to deduct may arise pursuant to Article 17(2) of the Sixth Directive. A taxable person may only deduct that proportion of its inputs which may properly be assigned to its economic activities. Every taxable person is obliged by Article 22(2) of the Sixth Directive to ‘keep accounts in sufficient detail to permit application of the value added tax and inspection by the tax authority’, while Article 22(4) requires ‘every taxable person’ to ‘submit a return*

*within an interval to be determined by each Member State', which 'may not exceed two months following the end of each tax period', whose duration is, subject to a maximum of a year, to be determined by each Member State, although it may not 'exceed a year'. The taxable person who seeks to exercise the right to deduct in circumstances where some of its VAT inputs may relate to non-taxable activities is obliged to establish, to the satisfaction of the relevant tax authorities, the proportion of those inputs which it claims are attributable to taxable transactions and thus capable of being deducted.*

*39. Article 19(1) of the Sixth Directive is, however, inapplicable. It can apply only in cases where taxable but exempt activities are mixed with taxable ones, since, otherwise, as in the case where the applicants engage, in my opinion, in taxable and non-taxable activities, there is no difference between the numerator and the denominator of the fraction which that provision envisages. It is therefore for the national court, in the final instance, to determine the extent to which some of the deductible VAT inputs claimed by the applicants may in fact have related to the exercise, respectively, of its non-taxable shareholding activities and its intra-group lending activities and to exclude those inputs from the right of deduction claimed by them.”*

## PRIVATE USE OF DUAL-USE INPUTS, SELF SUPPLIES AND APPORTIONMENT

- 14.1** If goods are purchased, acquired or imported for the purpose of both a taxable activity and for private purposes then these goods are dual-use inputs and VAT should be apportioned in accordance with section 12(4) and the Apportionment Regulations. This can best be illustrated by an example:

### Example 14(a)

A taxable person purchases holiday accommodation which he intends letting through a letting agency for ten months of the year and which he intends using himself for the other two months of the year. The property costs €200,000 plus €25,000 VAT (for simplicity we have ignored fitting costs, professional fees, etc.). As the intention is to have a standard rental charge apportionment is calculated on a time based calculation as follows:

$$\frac{10}{12} \times 100 = 83.3\%$$

The apportionment ratio is **83.3%** resulting in an initial deduction of €25,000 x 83.3% = €20,825. This deduction is subject to review at the year end which may lead to an adjustment of the initial deduction.

## 15. ENQUIRIES

**15.1** This guide sets out the rules and regulations in relation to the apportionment of input VAT. Any queries in relation to the practical application of the apportionment rules should be made to the taxable person's appropriate Revenue office.

[A list of useful addresses, telephone, fax numbers and e-mail addresses can be found here.](#)