VAT recovery and transactions involving shares and securities

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HM Revenue & Customs ("HMRC") has issued further guidance on how it will apply the Kretztechnik decision. As a result, input VAT will be recoverable on a far wider range of transactions involving the issue of shares and securities.

We reported in July 2005 on the decision of the European Court of Justice ("ECJ") in the Kretztechnik case and HMRC's revised guidance issued on 15 June 2005 (click here). Briefly, the ECJ judgment confirmed that the issue of new shares as part of a capital raising exercise was not a supply for VAT purposes and any VAT incurred on costs associated with the share issue formed part of the company's general overheads. Therefore, such VAT could be recovered if the company's supplies were fully taxable, or partly recovered if the company had both taxable and exempt supplies.

HMRC advised in its June guidance that, provided the circumstances mirrored those in the Kretztechnik case, companies are entitled to treat the issue of shares as a non-supply for VAT purposes. The input VAT on costs associated with the share issues will be treated as part of the general overheads of the business and as such a company will be able to reclaim the input VAT either partly or wholly, depending on the nature of the supplies made by the company ("the revised treatment").

HMRC further stated that it was taking legal advice on the extent to which the Kretztechnik decision applied to other situations. That guidance was issued in its business brief of 23 November 2005.

Capital raising

The business brief confirmed the following in relation to shares or securities issued as part of a capital raising exercise:

- the revised treatment applies to all types of share issues, including issues of preference shares, rights issues, bonus issue and scrip dividends;
- the revised treatment applies equally to share issues made by public and private companies; and
- the issue of other securities including bonds, loan notes and units in collective investment schemes will also be treated in the same way as share issues and will, therefore, be treated as non-supplies for VAT.

Other transactions

The key point of the new guidance is that HMRC has also confirmed that the revised treatment will also apply to the issue of shares or securities in situations other than capital raising. In the business brief, HMRC explain:

"An issue of shares or other securities may be one of several transactions that take place in the context of wider arrangements. For example, they may be issued in order to effect a company takeover or as part of a company restructuring through merger or demerger. When the issue does take place as part of such wider arrangements, it should still be regarded as a non-supply for VAT."
Existing exemptions and specified supplies

HMRC’s position on the VAT treatment of the transfer of existing shares or securities for a consideration has not altered – these supplies continue to be exempt. Any input VAT on costs associated with such transfers will be directly attributable to the exempt supply and will not be recoverable (unless the transfers are outside the EU).

Intermediary and underwriting services in relation to shares will also remain exempt.

The special rules about input VAT recovery on the issue of shares made outside the EU have also been amended.

Making claims

Claims should be made for the recovery of input VAT on transactions that fall into the circumstances discussed above that took place in the last three years. The three-year period runs from the end of the prescribed accounting period in which the input VAT recovery was not made and as a result output tax was overdeclared.

The claim is made by way of a voluntary disclosure (click here for further guidance). If protective claims have previously been made, companies should now be able to rely on this further guidance to finalise such claims.

If you require any further information about HMRC’s guidance as a result of the Kretztechnik decision or about the making of a voluntary disclosure, please contact your usual team contact or one of the contacts below.

**Philip Moss**
- t +44 117 917 4264
- f +44 117 917 4265
- philip.moss@osborneclarke.com

**Erika Jupe**
- t +44 117 917 4260
- f +44 117 917 4261
- erika.jupe@osborneclarke.com

**Michael Bell**
- t +44 117 917 4312
- f +44 117 917 4313
- michael.bell@osborneclarke.com

**Tracey Rutland**
- t +44 117 917 3370
- f +44 117 917 3371
- tracey.rutland@osborneclarke.com