

**Client Newsletter – VAT and mileage allowances
November 2005**

You may have heard that earlier this year the European Court ruled that the UK's treatment of VAT on road fuel was incorrect in the way that businesses (and local authorities) were allowed to reclaim VAT on the fuel element of mileage allowances paid to employees. This was on the basis that the fuel was not supplied to the business (i.e. it was supplied to the employee) and that the business did not hold an invoice to support the recovery of VAT.

The Government has now introduced new legislation which comes into effect from 1 January 2006 to allow VAT registered persons to continue to recover VAT on the fuel element of mileage allowances. This is the Value Added Tax (Input Tax)(Road Fuel Purchased By Employees) Order 2005. The Order allows employers to recover VAT on fuel which is for use in their business in making taxable supplies provided that the business holds a VAT invoice.

So what does this mean for businesses? When they pay a mileage allowance to an employee, they can reclaim VAT on fuel, provided it is used in making taxable supplies, but their employees must provide a VAT invoice to support the input tax claim.

But what about local authorities? Will the rules be the same for section 33 claims? Certainly, under the old legislation, Customs allowed local authorities to treat VAT incurred on non-business activities as though it related to taxable activities. This was because the VAT on mileage allowances was a significant amount for many authorities and Customs were keen to see local authorities have the same ability as other taxable persons to recover VAT. It is likely that they will be happy for the same treatment to continue, with the addition of a requirement to hold a VAT invoice to support recovery. There are, however, a number of practical difficulties for larger organisations, such as section 33 bodies.

When an employee buys fuel, will he retain his VAT receipt in the expectation that he might be putting in a mileage claim in the next week or two? What if he doesn't keep his VAT receipts, will you pay him less? What if he forgets to obtain a VAT receipt but has, say, a credit card receipt? What if he is unwilling to let you have his credit card receipt, or doesn't want to have to ask for a VAT receipt each time he fills up? What if he attaches a VAT receipt to his monthly mileage claim, but for his next month's claim he is still using the fuel covered by last month's receipt? The possibilities are endless.

It seems to us that local authorities have a good case to ask for special treatment, bearing in mind that many employees who claim mileage allowances only do so from time to time. As the VAT is reclaimed under section 33, VAT Act 1994, it is not automatically covered by the 2005 Order, so Customs *could* specify a particular treatment for local authorities. It is hoped that this will be raised at the CIPFA VAT Working Party this month and that members of that worthy group push hard for special treatment.