

VAT Recovery – The Capital Goods Scheme

Introduction

This guide explains how VAT may affect YIF-funded building projects where total costs exceed £250,000 (including VAT). In these cases, the Capital Goods Scheme (CGS) may apply. The CGS tracks how a building is used for VAT purposes over a 9-year period and can require VAT to be repaid or reclaimed if that use changes.

Commissioned by the Youth Investment Fund, the guide was developed by Sayer Vincent, specialist charity accountants with extensive experience advising charities on VAT and capital projects.

This guide covers:

- When the Capital Goods Scheme applies to a building project
- How changes in building use can affect VAT recovery
- The 9-year adjustment period and record-keeping requirements
- When VAT may need to be repaid or can be reclaimed
- The position for organisations that register for VAT after construction
- When and why specialist advice should be sought

The guide provides a practical overview to help organisations plan ahead, remain compliant, and manage VAT implications confidently throughout the CGS period. As the scheme is complex and fact-specific, specialist advice should be sought where it applies.

Capital goods scheme – summary of key principles

- Where the VAT bearing capital costs of the works will exceed £250,000 the Capital Goods Scheme ('CGS') applies. The capital costs are referred to as a 'capital item'.
- The CGS will apply to all of the VAT incurred on the capital item. Capital costs mean costs capitalised in accordance with UK GAAP (i.e. FRS 102 and the Charity SORP).
- As these costs are incurred, the VAT should be recovered as usual.
 - If the capital item only supports taxable activities, the VAT is fully recoverable
 - In the majority of cases, the capital item will be supporting a mixture of activities. VAT is recovered using the appropriate VAT recovery rate in force at the tax point of the invoice and then adjusted by an annual adjustment if necessary.
 - Non-VAT registered entities will recover no VAT.

- Under the CGS, there are 10 ‘adjustment intervals’. The first adjustment interval runs to the end of the VAT year in which the building is first put to use. At the end of the first adjustment interval an organisation must calculate the baseline recovery rate:

$$\text{Baseline recovery rate} = \frac{\text{VAT reclaimed on the capital item}}{\text{VAT incurred on the capital item}} \times 100\%$$

For a non-VAT registered entity that cannot reclaim VAT, the baseline recovery rate will be generally nil.

- By default a business’ VAT year end is the end of the VAT quarter ending 31 March, 30 April or 31 May. It is possible to change a VAT year end by agreement with HMRC to align with the financial year end if desired.
- At the end of the 2nd to 10th VAT years, the organisation must reassess how the capital item has been used during the year.
 - If the capital item only supported taxable activities, this will be 100%
 - If supporting a mixture of activities, the recovery rate must be adjusted to reflect that used for the current year.
- VAT registered organisations must then make a CGS adjustment as follows:

$$\text{CGS adjustment} = \frac{\text{VAT incurred on the capital item}}{10} \times (\text{recovery rate in year} - \text{baseline recovery rate})$$

- If this figure is positive because the recovery rate has increased, the amount is claimed from HMRC in the VAT return box 4.
- If it is negative, it is paid to HMRC in VAT return box 4.
- The adjustment should be made in the second VAT return following the end of the VAT year.
- Organisations that register for VAT within the 10-year adjustment period can make adjustments under the scheme. Since the baseline recovery would be 0%, any taxable use would mean the adjustment would result in a reclaim from HMRC.