

# VAT LIAISON EDUCATION UPDATE

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## In this Issue:

### Lennartz mechanism update



Following our report on changes to the Lennartz accounting mechanism in our August 2007 newsletter, there have been a number of developments and this update sets out to explain them.

Briefly, for those not familiar with the Lennartz mechanism, it allows bodies such as further education colleges to recover a proportion of the VAT incurred on the construction of certain new and extended buildings which are to be used partly for non-business purposes, provided there is an intention to make some taxable supplies from the building. Taxable supplies could include catering outlets, vending machines and income generated from third parties in respect of hairdressing and beauty salons and motor vehicle workshops.

Once the building has been completed and brought into use, the college has to make a payment to HM Revenue & Customs (HMRC) each VAT quarter to account for their non-business use of the building. If the non-business use of the building remains constant, the amount repaid will equal the amount originally claimed. A significant cash flow saving is thereby achieved.

When the mechanism was originally allowed by HMRC the payback period was 20 years. Following changes in the 2007 Budget the payback has been reduced to 10 years.

HMRC have now published new guidance on the use of the Lennartz mechanism and have set out various formulas for calculating the revised payback for those bodies which have already recovered VAT in relation to new buildings and are already making payments to HMRC.

### Transitional rules

There are two issues to be considered for those colleges which have received Lennartz refunds and are already making quarterly paybacks:

- A revised payback period will need to be calculated using the formula set out by HMRC in their Information Sheet.
- A revised payback value will need to be calculated. This will be based on a formula using the cost of the asset, the level of non-business use and the revised payback period.

### Possible removal of Lennartz mechanism

The EU has recently published a draft Directive which would, if agreed, remove the right of VAT registered businesses to use the Lennartz mechanism. Organisations would then have to revert to the old method of apportioning VAT on the cost of such assets and only claiming the VAT attributable to taxable use. The EU is proposing that this new rule is implemented from July 2008.

HMRC have not issued any guidance on this proposal so it is not clear how this would affect projects in progress. We will update you when more information is available.

### How can we help?

VAT Liaison has advised many colleges on VAT issues. If you have any queries regarding this Update please contact the VAT Liaison<sup>®</sup> Tax Helpline on 0800 700 652 or your usual VAT Liaison Advisor.

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