

# VAT Alert

## HMRC finalises guidance on VAT treatment of compensation and termination payments

### New rules take effect from 1 April 2022

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On 7 February 2022, HM Revenue & Customs (“HMRC”) published Revenue & Customs Brief (“RCB”) 2 (2022) on the VAT treatment of early termination fees and compensation payments.

The revised policy means that most termination fees and compensation payments will be viewed as additional payment for the underlying supply and, where the original supply was taxable, will be subject to VAT. The main exceptions will be most dilapidation payments and certain other payments where HMRC do not consider there is reciprocity between the supplier and the customer.

This Brief replaces the RCB 12 (2020) in September 2020, which was suspended in January 2021 and announces the revised policy that HMRC is adopting.

HMRC's previous policy on early termination fees and compensation payments was they were generally outside the scope of VAT, as they were not viewed as being consideration for a supply.

The new policy has been formulated on the basis of the Court of Justice of the European Union decisions in *Meo C-295/17* and *Vodafone Portugal C-43/19*.

There are some nuances to the announcement:

- Dilapidation payments made by an outgoing tenant to its landlord at the end of a lease (to compensate for excess wear and tear of the property) will remain outside the scope of VAT. This is provided there is no value shifting or avoidance motive to the payments.
- Despite the very recent judgement of the Court of Justice in *Apcoa Parking Denmark C-90/20*, which found that parking control fees are standard rated, HMRC are maintaining their policy that some parking fines and penalties levied by private operators can continue to be VAT free, while excess charges remain standard rated.

**Comment:** Businesses who adopted HMRC's policies from September 2020, may have been disadvantaged. The legal issues around making claims for overpaid VAT are complex, particularly if tax has been paid in accordance with legal principles, but HMRC policy would have allowed concessionary treatment. However HMRC are inviting claims through the error correction process. If you are affected in this way please contact us.

We will also be pleased to help if you need guidance on applying the new policy.

## Relevant HMRC documents

[Revenue and Customs Brief 2/2022](#) This points to HMRC Guidance Manuals on these pages:

- [VATSC05910](#) Consideration: Compensation and liquidated damages that are consideration: When are compensation payments consideration for a supply?
- [VATSC05920](#) Consideration: Compensation and liquidated damages that are consideration: Compensation payments: Early termination of contracts
- [VATSC05930](#) Consideration: Compensation and liquidated damages that are consideration: Liquidated damages

The guidance VATSC06710, 06720 and 06730 has been withdrawn. The suspended September 2021 version of guidance VATSC05910, VATSC05920 and VATSC05930 is also withdrawn.

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