EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2026

2026 No. 765

1. Introduction

1.1 This Explanatory Memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 Dan Tomlinson MP, Exchequer Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 James Smallbone, Deputy Director in Indirect Tax at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Bilal Hussain at HMRC can be contacted by email at the following address with any queries regarding the instrument: bilal.hussain1@hmrc.gov.uk. Alternatively, the department can be contacted by telephone: 03000 584329.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends Part 15 (Adjustments to the deduction of input tax on capital items) of the Value Added Tax Regulations 1995 (S.I. 1995/2518) (the VAT Regulations), commonly known as the Capital Goods Scheme (CGS).

4.2 It introduces the following simplification measures to the CGS: (1) a computer and an item of computer equipment will be removed from the list of assets covered by the CGS, and (2) the capital expenditure threshold, which determines whether the CGS applies to land, buildings and civil engineering works, will increase, from its current value of £250,000 (exclusive of value added tax "VAT") to £600,000 (exclusive of VAT).

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdiction which the instrument forms part of the law of) is the United Kingdom (UK).

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the UK.

5. Policy Context

What is being done and why?

5.1 The purpose of the CGS is to ensure VAT recovery on high value, long life capital assets reflect their taxable use over time. Businesses acquiring capital assets for their

taxable business activities are entitled to recover the input tax incurred, subject to the normal rules. However, where the use of the asset changes from taxable activities to activities that are exempt or non-business, or changes from exempt or partially non-business use to taxable use, the CGS requires adjustment to the input tax reclaimed over a set period, to reflect the change in use. This ensures that VAT is therefore only recoverable to the extent to which the asset is used in making taxable supplies.

5.2 In 2017, the Office of Tax Simplification (OTS) reviewed several areas of VAT, including the CGS, and recommended simplifying it by considering whether categories other than land and buildings were necessary and whether the expenditure threshold for land and buildings should be increased.

5.3 These recommendations arose because the expenditure threshold for land, buildings and civil engineering works has remained unchanged since the CGS was introduced in 1990, despite significant increases in property values. As a result, many small businesses have become subject to the complex administrative requirements of the CGS for relatively modest property expenditure, contrary to its original intention.

5.4 Following the OTS report, the government launched a Call for Evidence (CfE) in 2019 to explore ways of simplifying the operation of the CGS and engaged with businesses to understand the potential impact of any changes.

5.5 In 2021, the government published a summary of responses, with a commitment to review the responses and take action to simplify the CGS.

5.6 As part of its commitment, the government is introducing the following changes through legislative amendments;

- Removing a computer and an item of computer equipment from the list of assets covered by the CGS.
- Increasing the expenditure threshold which determines whether the CGS applies to land, buildings and civil engineering works. The threshold will be increased from its current value of £250,000 (exclusive of VAT) to £600,000 (exclusive of VAT).

5.7 The primary objective of this change is to ease the administrative burden on businesses. By increasing the threshold for land, buildings and civil engineering work, fewer assets acquired, constructed, refurbished, fitted out, altered or extended will, after the amendments take effect, fall within the requirements of the CGS. This means that many businesses – mainly small businesses – will no longer have assets falling within the scheme and will no longer be subject to its complex requirements.

5.8 A computer and an item of computer equipment are removed as, since the CGS was introduced, the cost of such equipment has decreased significantly. It is now uncommon for these assets to fall within the CGS.

5.9 The changes to the CGS will not apply to any capital item in respect of which the owner incurred relevant capital expenditure, on goods or services supplied to them, on goods imported by them or goods acquired from a member State by them, before 29 July 2026.

What was the previous policy, how is this different?

5.10 Under the previous policy, the CGS applied to the following categories of items: land, buildings and civil engineering works, where the capital expenditure on the asset was £250,000 or more; a computer or an item of computer equipment, where the capital

expenditure on the asset was £50,000 or more; and aircraft, ships, boats, or other vessels, where the capital expenditure on the asset was £50,000 or more.

5.11 The changes introduced by this instrument amend the scheme by removing a computer and an item of computer equipment from assets covered by the scheme.

5.12 Secondly the expenditure threshold for land, buildings and civil engineering works, increases from its current value of £250,000 (exclusive of VAT) to £600,000 (exclusive of VAT).

5.13 The CGS remains unchanged in relation to aircraft, ships, boats and other vessels.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument amends the list of capital items to which the CGS applies, at regulation 113(2) of the VAT Regulations, to remove computers and items of computer equipment. It further amends regulation 113(4) of the VAT Regulations to increase the value of the capital expenditure at which the CGS applies, from £250,000 (excluding VAT) to £600,000 (excluding VAT), for land, buildings and civil engineering works. There are consequential amendments to regulations 113(3), 113A and 114 of the VAT Regulations.

Why was this approach taken to change the law?

6.2 Parliament has conferred regulation-making powers in section 26(3) and (4) of the Value Added Tax Act 1994 (the Act), so these changes are appropriately made by secondary legislation.

6.3 This is the first use of the power in paragraph 15(4) of Schedule 9ZA to the Act, which provides that section 26(1) of the Act has effect as if references to "input tax on supplies and importations" for which a taxable person is entitled to credit at the end of any period includes input tax on acquisitions in Northern Ireland from a member State.

6.4 Regulation 1 of the instrument contains exclusions from the effect of the amendments made to the CGS, including a provision that regulation 2 does not have any effect in respect of a capital item if the owner incurred any relevant expenditure on that capital item in respect of goods acquired from a member State before 29 July 2026.

6.5 Until Implementation Period (IP) completion day, 11pm on 31 December 2020, section 26(1) of the Act included input tax on acquisitions in its definition of input tax, with the word "acquisitions" having been repealed by section 43 of and paragraphs 1 and 26 of Schedule 8 to the Taxation (Cross-border Trade) Act 2018 with effect from IP completion day. By virtue of regulation 3(1) of the Taxation (Cross-border Trade) Act 2018 (Value Added Tax Transitional Provisions) (EU Exit) Regulations 2019, however, this amendment to repeal the word "acquisitions" does not have effect in relation to acquisitions taking place before IP completion day.

6.6 There is, therefore, the power under section 26(3) to make regulations concerning the attribution of input tax on acquisitions from a member State which were made before IP completion day, because, in respect of such acquisitions, section 26(1) still has effect as though the word "acquisitions" had not been repealed.

6.7 From IP completion day, VAT continues to be charged on certain acquisitions of goods in Northern Ireland from a member State of the European Union. As a result of

paragraph 15(4) of Schedule 9ZA, the power in section 26(1) extends to the making of regulations for the attribution of input tax on such acquisitions.

7. Consultation

Summary of consultation outcome and methodology

7.1 At Spring Statement 2019, the government announced it would launch a Call for Evidence (CfE) to explore ways to simplify the operation of the CGS, following the findings of the 2017 OTS VAT review.

7.2 The CfE was open from 18 July 2019 to 26 September 2019. Its purpose was to gather views from a range of stakeholders on potential simplification reforms to the CGS, mainly to increase the CGS threshold for land and property and to remove computers from assets within the CGS.

7.3 The CfE received 80 submissions from stakeholders including businesses, trade associations and accountancy firms. The summary of the responses received to the CfE was published on 23 March 2021[1].

7.4 Most respondents welcomed the simplification of the CGS and were supportive of an increase to the threshold for land and property and of the removal of computers from the CGS. Respondents also provided a range of additional suggestions for potential simplification to the operation of the CGS.

7.5 This instrument reflects the outcome of the government's aim to simplify the CGS. It introduces the changes which the government has decided to take forward following the CfE.

7.6 An announcement of these simplification reforms to the CGS was made at Tax Update: Simplification, Administration and Reform (TUSAR) day on 28 April 2025.

8. Applicable Guidance

8.1 A Revenue and Customs Brief will be published to announce the policy change. HMRC guidance on the Capital Goods Scheme is available in VAT Notice 706/2[2] and Manual PE67000 (PE67000 - Other Partial Exemption issues: The Capital Goods Scheme (CGS)[3]. The Notice and Manual will be updated to reflect the changes made by this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note covering this instrument is available on the GOV.UK website[4].

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[1] Call for Evidence (Summary of responses): https://assets.publishing.service.gov.uk/media/6059d776d3bf7f2f19864aaa/VAT_Partial_Exemption_and_Capital_Goods_Scheme_-_summary_of_responses.pdf

[2] Capital Goods Scheme (VAT Notice 706/2): https://www.gov.uk/guidance/capital-goods-scheme-notice-7062

[3] Manual PE67000: https://www.gov.uk/hmrc-internal-manuals/vat-partial-exemption-guidance/pe67000

[4] Tax Information and Impact Note: https://www.gov.uk/government/publications/capital-goods-scheme-simplification

Impact on businesses, charities and voluntary bodies

9.2 The impact on businesses, charities or voluntary bodies is beneficial. The proposed changes will only impact businesses, charities or voluntary bodies, where they are VAT registered. The proposed changes are expected to reduce administrative costs on businesses, particularly small businesses.

9.3 The legislation does impact small or micro businesses.

9.4 No specific action is proposed to minimise the impact of the requirements on small or micro businesses (employing up to 50 people), as the changes are beneficial.

9.5 The impact on the public sector is expected to be beneficial. The proposed changes will only impact public sector bodies where they are VAT registered.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is through communication with affected stakeholder groups.

10.2 The instrument does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 As the instrument is subject to the negative procedure and does not amend primary legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").