PESM Workshop

MODEL ANSWERS

10 November 2026

IDEAS | PEOPLE | TRUST

MODEL ANSWERS

CASE STUDY 1

Standard method recovery

- Direct Attribution:
  - Legal fees: £20k recoverable (non-UK); £50k not recoverable (UK)
  - Residual VAT: £400k
  - Taxable income = £1.4m + £0.2m = £1.6m (disregard sublet)
  - Exempt income = £0.6m + £0.8m = £1.4m
  - Total income = £3m
  - Recovery % = 1.6/3 = 53.33% ~ round up to 54%
- Recoverable residual VAT – 54% x £400k = £216,000
- Total recoverable = £216k + £20k = £236k

MODEL ANSWERS

CASE STUDY 1

Is standard method suitable?

- Whilst it is the default method for VAT recovery and HMRC's position is to generally favour value-based methods, this method would normally not be suitable for banks.
- If there are a lot of different business lines, it would be more appropriate to have a sectorised method and so would need to submit a PESM.
- Values based methods in banks can also create distortions – as an example, if there are large value transactions which consume similar level of costs to small valued transactions. Each bank would need to evaluate the extent which this is the case.

What info needed to consider PESM?

- Key things to consider are what are the key drivers of costs for the business, how these costs are consumed across the business and the revenue it generates. The bank would need to consider factors such as:
  - Which business units consume costs – why and how?
  - For each business unit, what drives costs (e.g. revenue numbers, number of transactions, customers, etc)

MODEL ANSWERS

CASE STUDY 1

Consider costs

- Property and IT are normally large VAT-able costs
- Consider typical bank and what other costs they may consume (e.g. recruitment, professional fees, cyber security, payment fees such as SWIFT, etc)

Sectors?

- Lending/Interest, Payment services, Property rental.
- Although no data provided, you could consider further sub-sectors such as commercial vs retail as a discussion point.
- Metrics that drive use of sector – income, headcount, floor space
  - Income could be distortive especially if the level of inputs to drive revenue varies between lending and payments
  - Floorspace HMRC does not like for non-property/space businesses – issues with 'communal' space could be exploited. However, this method can be potentially used to split property rental business with banking business as rent can be linked floorspace.
  - Headcount – if costs are staff heavy then this could be an option to divide between sectors
  - Outside data, could look at accounting allocation, time card, etc
- Metrics that drive sector recovery – income, transaction count, no of customers

MODEL ANSWERS

CASE STUDY 1

Example PESM (Note – alternative methods can be suitable if fair and reasonable)

- Split property rental with banking business using floor space:
- 1000/5500 = 18% property sector; 82% banking business – only for property costs. Balance goes to residual.
- Have lending and payment sectors – allocate by customer facing headcount: 30:20 → 60%:40%
- Recoveries:
  - Property sector – 100% as option to tax
  - Lending – number of customers non-UK vs UK – 60%
  - Payment – transaction count non-UK vs UK – 50%

- Property cost VAT split - £100k x 18% = £18k recoverable; £82k added to banking residual
- Banking residual - £382k, of which £100k directly allocated to payment services → 50% x £100k = £50k recoverable
- Non allocated residual - £282k:
  - Step 1, allocate by headcount to lending and payments: 60% x £282k = £169,200 Lending; £112,800 Payments.
  - Step 2, sector recovery:
    - Lending recovery = 60% x £169,200 = £101,520;
    - Payments recovery = 50% x £112,800 = £56,400
  - Total residual recovery = £18k + £50k + £101,520 + £56,400 = £225,920.

MODEL ANSWERS

CASE STUDY 1

Justification – model answer

- Floorspace to split property costs between rental and banking business, as property costs driven by sqm. However floor space not suitable for further splitting of banking business in line with HMRC policy
- Income too distortive – some customers may have large loans which compared to payments income can skew the allocation
- Headcount allocation justified as costs are staff driven – however, HMRC will expect businesses to be able to demonstrate it
- Recovery for lending – number of customers – same cost for each customer; similar to transaction count so adds comfort of fair and reasonableness
- Recovery for payments – transaction count – costs driven by transaction volume. (Could suggest income of fixed charge for transaction)
- Other methods not suitable for business, some hard to measure (e.g. no headcount split for UK vs non-UK), or could be distortive

MODEL ANSWERS

CASE STUDY 2

Issues in the banking sector and new VAT group

- PESM does not transfer to new registration – new PESM must be sought. This means modelling exercise, proposal to HMRC, negotiations, etc.
- If new business lines, proposing again the old PESM would not work as input tax also needs to reflect all business activities
- Modifications – new sectors? FX, split commercial and retail?
- Use standard method in the interim, with a Standard Method Override or first year use-based clause (self-assessed)
- Bulgarian supplier – bank needs to reverse charge (charge itself output tax). How does it recover the reverse charge VAT? Depends on the PESM methodology. If app used for retail, and retail customers mostly UK, then looking at low recovery.
- Head office supplies – complex from a VAT perspective and has been subject to case law
  - Bought in services into a VAT group, could be subject to self-supply (like reverse charge) – VAT cost
  - Internal services – normally not subject to self-supply BUT, if head office in the EU, you may need to consider whether cross-border purchase made. Speak to a VAT specialist.
  - If services from HO are bundled, then very complicated – speak to VAT specialist.
- Some supplies from overseas could be VAT exempt – again subject to case law if under FS exemption (e.g. payments processing, intermediary services, etc)

MODEL ANSWERS

CASE STUDY 2

HMRC review

- If PESM covers all activities, HMRC can still challenge whether allocation drivers or recover rates still fair and reasonable – HMRC policy has shifted to favouring value based methods more. In banking sector, income could be distortive – key is to check if this is valid for your business and whether you can demonstrate it
- HMRC may want to see auditability of metrics and robustness of data – for example for headcount, has the staff levels changed significantly? What constitutes a 'headcount'
- If business has carried out periodic reviews (every 2-3 years) can show that business is monitoring the use of costs. HMRC may ask to see models.
- If the business has new activities, can the bank argue that these fall within the existing sectors? May be easier if the agreed PESM is broadly worded – but depending on the specifics, this too can have its own downside. Best practice to notify HMRC of new activities even if sectors not changed – check the wording in the PESM.
- Consider profit/cost centres, business units – if new activity falls into existing centre or unit then persuasive (e.g. new buy-to-let product could fall into lending sector)
- If new activity not covered in the PESM, consider use based clause for short term, but a wider review and updated PESM if necessary – need to evaluate factors such as level of cost, level of income, scale and continuity. If one-off may not necessitate a new PESM.

FOR MORE INFORMATION:

Aditi Hyett

Aditi.Hyett@bdo.co.uk

020 7893 3080

Syeed Reza

Syeed.Reza@bdo.co.uk

020 7893 3665

This publication has been carefully prepared, but it has been written in general terms and should be seen as containing broad statements only. This publication should not be used or relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained in this publication without obtaining specific professional advice. Please contact BDO LLP to discuss these matters in the context of your particular circumstances. BDO LLP, its partners, employees and agents do not accept or assume any responsibility or duty of care in respect of any use of or reliance on this publication, and will deny any liability for any loss arising from any action taken or not taken or decision made by anyone in reliance on this publication or any part of it. Any use of this publication or reliance on it for any purpose or in any context is therefore at your own risk, without any right of recourse against BDO LLP or any of its partners, employees or agents.

BDO LLP, a UK limited liability partnership registered in England and Wales under number OC305127, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. A list of members' names is open to inspection at our registered office, 55 Baker Street, London W1U 7EU. BDO LLP is authorised and regulated by the Financial Conduct Authority to conduct investment business.

BDO is the brand name of the BDO network and for each of the BDO member firms.

BDO Northern Ireland, a partnership formed in and under the laws of Northern Ireland, is licensed to operate within the international BDO network of independent member firms.

Copyright © November 2026 BDO LLP. All rights reserved. Published in the UK.

www.bdo.co.uk

JOB NUMBER