A PRACTICAL GUIDE

Partial exemption without the spreadsheet

How modern accounting practice can handle one of UK VAT's most error-prone calculations without breaking the digital link to the ledger.

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By Option to VAT Ltd
Five pages. Ten minutes to read.

Why partial exemption is so painful

Partial exemption affects more UK businesses than most accountants realise. Charities running trading subsidiaries, medical practices with attached pharmacies, financial intermediaries, property businesses with mixed lettings, holiday-let operators, dental practices selling denture-related goods alongside exempt services — all of them have to decide which input VAT they can recover. None of them can answer that question from a standard accounting return.

The calculation itself isn't conceptually hard. You separate input tax into three pots: directly attributable to taxable supplies (recoverable in full), directly attributable to exempt supplies (not recoverable at all), and residual (recoverable on a partial basis computed from the value of taxable versus exempt supplies in the period). You apply the de minimis test. You post a journal. Then you do it again at year-end as an annual adjustment.

The pain isn't in understanding the rules. The pain is in the workflow.

Xero, QuickBooks, Sage, and FreeAgent are excellent at standard VAT. But none of them handle partial exemption out of the box. Xero's own product team has acknowledged this on their public ideas board. Intuit's community managers state plainly that VAT margin schemes (a related problem) are not supported in QuickBooks Online. AccountingWEB threads going back years contain the same advice: do the calculation outside the software, post a manual journal back, hope nothing changes between now and the annual adjustment.

> On Xero's product-ideas board, one practitioner wrote: "We deal with a lot of medical practices with pharmacies. We cannot bring them on to Xero as the partial exemption is too complicated to do."

That's the situation OneSixth was built to fix. Not by replacing the ledger — Xero, QBO, Sage, and FreeAgent are good at what they do — but by sitting alongside it, taking the specialist calculation off the spreadsheet and back into a connected system, and posting the result back as a journal that maintains the audit trail.

The moment the spreadsheet opens, the trail breaks

MTD for VAT requires a 'digital link' between the source records and the figures submitted to HMRC. HMRC explicitly accepts spreadsheet-based partial exemption workings as compliant with this requirement — provided the link to source data is digital and unbroken. In practice, this is where everything starts to go wrong.

What 'unbroken digital link' means in real life

The standard partial exemption workflow on Xero, QBO, Sage, or FreeAgent looks like this. You configure tax rates to separate taxable, exempt, and residual input VAT. At quarter-end you run a transactions-by-tax-rate report. You export it. You paste the figures into a spreadsheet. The spreadsheet computes the recovery percentage and the de minimis test. You eyeball the answer, post a manual journal back to the VAT control account, and submit the return.

In theory this preserves the digital link. In practice it depends on perfect discipline from everyone touching the books between quarter-end and year-end. Any backdated invoice, any miscoded transaction subsequently corrected, any expense reclassified after a partner review — and the spreadsheet your last return was based on is no longer current.

The annual adjustment problem

Partial exemption is provisional all year. Each quarter's return uses the prior year's recovery percentage (or a best-guess for new businesses). At year-end you have to redo the calculation using actual figures for the whole year, post the difference as an adjustment on the first return of the next VAT year, and live with the consequences if the underlying transactions have moved.

> From a practitioner guide: "During the year, you reclaim input VAT based on a provisional recovery percentage. At year end, you recalculate using actual figures, and the difference between provisional and actual recovery flows through the control account as an adjustment on the first return of the next VAT year."

This is the moment errors compound. The spreadsheet that supported your Q1 return is twelve months stale. The figures your annual adjustment is based on may not match the ones in any of your quarterly workings. The single corrective journal you post at year-end moves the control account but leaves no trail back to which transactions caused which movement. If HMRC asks why, the answer involves rebuilding workings from screenshots and memory.

How OneSixth handles partial exemption

OneSixth treats partial exemption as a connected calculation, not a one-shot spreadsheet. We sit alongside Xero, QuickBooks, Sage, or FreeAgent — never replacing them — and pull transactions on demand through the same APIs your accountant or finance team already uses.

What that means in practice

Connected calculation	Tax rates assigned in your ledger flow into OneSixth automatically. Transactions update; calculations update. No copy-paste, no stale spreadsheets.
All four major platforms	Xero, QuickBooks Online, Sage Business Cloud, and FreeAgent — same calculation engine, same audit trail, regardless of which ledger your client uses.
Standard, simplified, and special methods	Whichever method HMRC has approved for your client. De minimis tests run automatically with the full Test 1, Test 2, Test 3 working visible.
Annual adjustment without the panic	Year-end recalculation runs against the actual transactions in the ledger as they stand today. The adjustment journal carries a full attached working showing exactly which transactions drove which figures.
Journal entries with attached audit trail	When the calculation is finalised, OneSixth pushes the adjustment journal back to the ledger. A PDF working paper attaches to the journal entry — so the audit trail lives with the figures, not in someone's filing cabinet.
MTD compliant by construction	Because the link from source ledger to calculation to submitted return never breaks, the digital link requirement is satisfied without spreadsheet bridging.

What we deliberately don't do

We don't replace your ledger. We don't ask you to migrate clients onto a new platform. We don't hold the official VAT return — that still lives in Xero, QBO, Sage, or FreeAgent, submitted via the route HMRC already approves. OneSixth handles the specialist calculation and the audit trail. The rest stays where it is.

If you want to take a closer look

OneSixth is built by Option to VAT Ltd, a UK company focused on VAT specialist tooling for professional services firms and finance teams. We're currently working with a small number of early-access partners across accountancy practice and in-house finance, and we're actively looking for more.

Three ways to engage

Book a 20-minute call. If you have clients in partial exemption, TOMS, or VAT margin schemes, the call is the fastest way to see whether OneSixth fits your workflow. We'll walk through the calculation engine on a real Xero or QBO sandbox and you'll be able to see exactly how the audit trail looks.

Try the early-access programme. Connect a single client organisation, run one period's calculation, see the journal entries push back to your ledger. No commitment to scale up.

Stay on the changelog. If now isn't the right time, the public changelog at onesixth.app shows what we're building and when. Sign up to get product updates by email.

> **The shorter version of this guide:** partial exemption isn't hard to understand, but it's hard to do in a way that survives an HMRC challenge. The standard answer — spreadsheet plus manual journal — is what HMRC tolerates rather than what they want. OneSixth keeps the calculation connected to the underlying ledger, every working documented, every adjustment traceable. The cost of getting partial exemption wrong is almost always higher than the cost of doing it properly. We exist because the spreadsheet workflow has been the default for too long.

Get in touch

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