TC03533

Appeal number: TC/2013/03060

Value Added Tax - Claim for bad debt relief by a firm that had invoiced a client on a contingent basis at the time it was reporting for VAT on the cash basis, followed by the payment of the VAT at the point the firm deregistered - Whether bad debt relief could be claimed, following the write-off of the receivables in 2013 - Whether we had jurisdiction to deal with secondary claims based on reliance by the Appellant upon claimed phone discussions with HMRC officers in which it was said that the officers had indicated that bad debt claims could be made - Appeal dismissed

FIRST-TIER TRIBUNAL

TAX CHAMBER

HURNDALLS **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE & CUSTOMS **Respondents**

Tribunal: JUDGE HOWARD M NOWLAN

MR JOHN CHERRY

Sitting in public at 45 Bedford Square in London on 16 April 2014

Anthony Hurndall of Hurndalls, solicitors, in person

Rita Pavely of HMRC on behalf of the Respondents

DECISION

Introduction

1. This was an unfortunate case in which the Appellant had correctly accounted for VAT in respect of certain contingent receivables. The VAT was not accounted for when the client was invoiced in both 2002 and 2005 because at that time the Appellant was reporting for VAT on the cash basis. The Appellant had to pay, and did pay, the VAT in 2006, however, at the point when it deregistered for VAT purposes. The contingency upon which the debts would become immediately due and payable has never arisen. The Appellant formally wrote off the receivables in its accounts in 2013 and subsequently sought bad debt relief. HMRC has refused the claim for relief, essentially because there is an unfortunate gap in the legislation in relation to the somewhat special circumstances of this case. Although there is a 4 year and 6 month period during which bad debt claims must normally be made from the later of the dates of the provision of the services and the date when the receivables became due and payable, the Appellant's failure to recover the VAT in this case does not principally result from any delay in making its claim for bad debt relief. The feature that undermines the claim in the present case is that Regulation 165A of the VAT Regulations 1995/2518 provides that claims must be made within a particular time period and in the present case that is a period that has never technically commenced to run.

The law in simple cases

2. Had the Appellant remained registered at all times, and had it continued throughout to account for VAT on the cash basis, there would naturally have been no problem. No cash would ever have been received, so that no VAT would have been paid in respect of the contingent receivables, and no question of seeking to recover VAT would have arisen.

3. Had the facts been quite different, and indeed along more common lines, with the Appellant simply rendering an ordinary invoice for immediate payment, and dealing with its VAT on an accruals basis, the outcome would again have been simple. VAT would have been accounted for at the outset, but if the client had failed to pay the amount owing on the invoice, once 6 months had elapsed from the date the invoiced amount became payable, the Appellant could have made a claim for bad debt relief under section 36 VAT Act, by writing off the unpaid receivable in its accounts. In accordance with Regulation 165A, it would then have had 4 years and 6 months from the later of the dates of supply and the date when the invoiced amount became due and payable in which to bring that claim. No claim could be made after the expiry of that period, and equally no claim could be made during the period of 4 years and six months from the later of the two relevant events unless the receivable had actually been written off in the claimant's accounts. This is because one of the three pre-condition to the making of the claim under section 36 VAT Act 1994 (i.e. the write-off) would not have occurred.

4. We note, in passing, a slightly odd point in the drafting of Regulation 165A. In specifying the time period within which claims must be made, and therefore in referring to the later of the dates of the supply and the due and payable date, reference is somewhat strangely made to:

> *"the date on which the consideration (or part) which has been written off as a bad debt* ***becomes*** *due and payable to or to the order of the person who made the relevant supply"*.

Since one would normally, if not always, expect the consideration to have become due and payable before it could be said that the debt might be written off as a bad debt, it seems odd that the Regulation seems to contemplate that the consideration might become due and payable after the date of write off. One would ordinarily expect the debt to have become due and payable before the debt was written off as a bad debt, so that at the very least one might have expected the Regulation to refer to the debt having been written off after the date on which the consideration **"had become"** due and payable, or perhaps **"had become or becomes"** due and payable. Whether this observation be right or not, what is clear is that if the sequence is that the services are supplied in year 1, and invoiced and become payable in year 1 (with VAT becoming payable at that point on the accruals basis), and the trader defers writing off the debt until year 4 and 3 months, there only remain 3 months in which to make the claim. Time does not run from the date when the debt is written off.

The facts in this Appeal

5. The present Appellant rendered legal services to a property developer client, and the Appellant's evidence was that the invoiced amounts for these services (invoiced in 2002 and 2005) would only become due and payable if the developer realised cash in some way from the relevant proposed development. This was not specified in the invoices. The invoices were worded in slightly different ways, but they indicated that interest would run from the date 28 days after the invoices were rendered until the date of payment. While this did not reflect the claim that the invoiced amounts were not even to become immediately payable until the developer had realised cash in some form, we did accept the Appellant's evidence that this contingent feature was clearly agreed between the parties. The Appellant said that some solicitors were prepared to work on an even vaguer basis without even invoicing the client or specifying the amount of the charge that the solicitors thought appropriate. In those cases the client would simply be invoiced at the later date if and when the developer realised cash in some manner. The present Appellant had not been prepared to operate in this manner. It thought it better to fix the amount of the charge and then to provide that interest would run from day 28 until actual payment. Nevertheless the debt would not be immediately payable until either the developer raised third party finance to proceed with the development, or finished the development and realised cash from sales or lettings, or simply sold off the property to some third party with a view to that third party proceeding with the development.

6. Since the Appellant was dealing with its VAT liabilities on a cash accounting basis it did not account for VAT in respect of these receivables since it had plainly received no cash. No thought had been given at the time to the feature that Regulation 58 (2)(e) of the 1995

VAT Regulations provided that the cash accounting scheme could not apply to *"supplies where a VAT invoice is issued and full payment of the amount shown on the invoice is not due for a period in excess of 6 months from the date of the issue of the invoice."* We considered during the hearing whether this provision only applied where the invoiced amount was said to be immediately payable only after a certain period which manifestly exceeded 6 months, or whether the provision might also prevent the cash accounting basis from applying to the type of contingent indebtedness that might become payable well within the 6 month period, or well after it, or indeed never at all. We consider that in the event little turns on this point but the conclusion that we reached, supported significantly by the representative for the Respondents, was that the relevant provision did not apply in this case, such that the cash accounting basis was not disapplied. Accordingly our conclusion in relation to the VAT treatment at the time the various invoices were issued is that VAT was correctly not paid because the cash accounting basis applied.

7. In 2006 the Appellant de-registered for VAT purposes. The consequence of this was that Regulation 63 of the same VAT Regulations applied and provided that *"where a person operating the* [cash accounting] *scheme… ceases to be registered he shall within 2 months or such longer period as the Commissioners may allow, make a return accounting for, and pay, VAT due on all supplies made and received up to the date of cessation which has not otherwise been accounted for, subject to any adjustment for credit for input tax."* In accordance with this provision, the Appellant duly paid the VAT in respect of the three invoices dating from 2002 and 2005.

8. In 2013 the Appellant wrote off the receivables in respect of the 2002 and 2005 invoices in its accounts; wrote to the client informing the client of the accounts write off (there being no actual release of the contingent debt) and applied for bad debt relief. We will refer later to the fact that the Appellant claimed to have discussed this in advance over the phone with HMRC officers and had allegedly been led to believe that the claim for relief, and for the refund of the VAT, would all be accepted.

9. HMRC refused the claim on the basis that Regulation 165A of the 1995 VAT Regulations precluded the making of the claim. This Regulation provided that:

> *"(1) Subject to paragraph (3) below, a claim shall be made with the period of [4] years and 6 months following the later of:*
>
> *(a) the date on which the consideration (or part) which has been written off as a bad debt becomes due and payable to or to the order of the person who made the relevant supply; and*
> *(b) the date of the supply."*
>
> *(2) A person who is entitled to a refund by virtue of section 36 of the Act, but has not made a claim within the period specified in paragraph (1) shall be regarded for the purposes of this Part as having ceased to be entitled to a refund accordingly.*
>
> *(3) This regulation does not apply insofar as the date mentioned at sub-paragraph (a) or (b) of paragraph (1) above, whichever is the later, falls before 1st May 1997."*

10. We have quoted Regulation 165A in full, partially to illustrate that the cross-reference to paragraph (3) made in paragraph (1) is irrelevant, but also to highlight the slight disconnect that there is between the terms of section 36 and Regulation 165A. What we mean by this is that, even though Regulation 165A only bars the making of a claim when a person entitled to a refund under section 36 has failed to make a claim within the paragraph (1) time period, this appears not to envisage that the person entitled to a refund under section 36 will necessarily have actually been able to make that claim. Entitlement under section 36 appears to be based on satisfying the three conditions that VAT has been accounted for in respect of the supply of goods or services, 6 months have elapsed since the making of the supply and the consideration for the supply has been written off in the accounts as a bad debt. It will commonly be the case of course, as we have already noted, that the debt will be bound to have become due and payable prior to being written off as a bad debt, so that in all normal circumstances, the person that meets the conditions of section 36 will have had the opportunity to make the claim within the time period specified in Regulation 165A. In the present case, however, we have the odd situation that all the conditions for entitlement under section 36 have been satisfied, but because the debt has plainly not become due and payable, the time period for the making of the claim has not commenced.

Our decision

11. Our regrettable decision is that the terms of Regulation 165A do preclude the Appellant from making its claim in this case. The time period in which the claim must be made only starts with the later of two events, the second of which has not yet occurred in the present case. Theoretically it would seem that if the present contingent debt became due and payable and was not then discharged, the relevant period would commence 6 months after the date when the debt became immediately due and payable. Plainly the debt has already been written off. Of course if the satisfaction of the contingency resulted in the debt not only becoming due and payable but in being discharged then the present issue would all drop away. But in the meantime, we must conclude that the relevant time period has not commenced to run, and that the claim cannot thus be made.

12. The Appellant suggested that Parliament cannot have intended the present result and that it would therefore be appropriate to interpret Regulation165A in some manner that provided relief in the present case. We certainly agree that the present result is unfair and one that cannot have been intended by the legislation. We fail to see any way in which we can legitimately interpret Regulation 165A to achieve a more sensible result however. We cannot modify the wording and run the time period from the date of the write off because it is perfectly obvious that the 4 year and 6 month point is meant to effect any adjustments that are ever to be made within the relevant period of the debt becoming immediately due and payable, and therefore from the date when the VAT is likely to have been accounted for. A semi-coherent solution in the present case might have been to deem the debt to have become due and payable at the point of deregistration, and in other words at the point when the VAT was paid. It is, however, perfectly clear that Regulation 63 that applied at the point of deregistration did not operate by deeming the debt to become due and payable and by applying the accruals basis at that time. It simply deemed VAT to be payable when supplies had been made, and those pre-existing supplies had not attracted a liability to VAT.

Moreover if we sought to interpret Regulation 165A in some manner such that the time period commenced when the Appellant deregistered, then that result would achieve nothing since well more than 4 years and 6 months have elapsed since 2006. Indeed, once we conclude, as we do, that we cannot run the 4 year and 6 month period from the date when the debt was written off, it becomes obvious that if we somehow treated some event as having started the 4 year 6 month period running, whatever that event was, the period would plainly have expired by 2013 when the present claim was made. That would therefore undermine the claim on that different basis.

13. We agree with the Appellant, and we are pleased to be able to record that the representative for the Respondents also agreed that whilst HMRC and we as the Tribunal must apply the law and we cannot amend it, this result is very unfortunate. It is not perhaps surprising that Parliament has failed to deal with a situation that appears only to arise when invoices are issued on a contingent basis, the cash basis initially applies, the VAT becomes payable upon deregistration, and by the time the debt is written off and the bad debt claim is made, the debt has never become due and payable. That however does appear to be the result and a very unfortunate one.

14, We have mentioned that the Appellant sought to rely on a secondary contention along the lines that he had spoken to an HMRC officer and been told that the present claim would be in order once the debt had been written off. We have decided, however, that we have no jurisdiction to deal with legitimate expectation or other judicial review type claims. We did not seek to take the evidence, being essentially a claim made by the Appellant as to the content of a telephone discussion, since the claim was one that we could not deal with. We should however mention that the Respondents claimed that they had no record of the conversation. We had little doubt that the Appellant's reference to the telephone conversation was true, but it might very well be that the conversation was casual, preliminary and quite possibly not of the unambiguous category to found any claim for reliance on anything supposedly said. In any event, this is something that we cannot deal with ourselves.

Conclusion

15. As already indicated, our decision is that the Appellant's claim cannot be made and that the Appeal is dismissed.

Right of Appeal

16. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) Tax Chamber Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 28 April 2014