[2014] UKFTT 0744 (TC)

TC03863

Appeal number: TC/2012/08675

VALUE ADDED TAX – hire-purchase agreements – whether input tax on repossession costs fully allowable – subsequent adjustment to appellant's VAT account – whether a decrease in consideration leading to an adjustment for the purposes of regulation 38 VAT Regulations 1995 – whether an entitlement to bad debt relief under section 36 VATA 1994 – whether valid claim or amendment to claim - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BRITISH CREDIT TRUST LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE GUY BRANNAN
JULIAN STAFFORD

Sitting in public at Bedford Square on 28 and 29 April 2014

Kevin Prosser QC, counsel, instructed by Macfarlanes LLP, for the Appellant

Peter Mantle, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against a decision by the Respondents ("HMRC") dated 10th August 2012 refusing British Credit Trust Limited's ("BCT") claim for input tax not previously claimed and for output tax over declared, amounting in total to £1,301,395.06 plus interest. The claim was initially made by way of a voluntary disclosure in a letter dated 23 December 2010.

Background facts and issues in dispute

2. The facts in this appeal were not in dispute. Our outline of the relevant facts is taken largely from the parties' helpful skeleton arguments, supplemented as necessary by relevant extracts from the bundle of documents provided to us. In addition, we refer to the evidence of Mr James Irvine, Head of Operations of BCT. Mr Irvine provided a witness statement and briefly gave oral evidence in chief but was not cross- examined.

3. At all material times, BCT carried on a motor vehicle finance business which included entering into hire-purchase ("HP") agreements with individual, non-business, customers who were introduced to BCT by car dealers. BCT would make an assessment whether to enter into a HP agreement with the customer after making credit checks with credit reference agencies such as Experian, confirmation that the customer had regular employment income etc. The HP agreements were in standard form and although two versions of the agreements were used over the periods relevant to this appeal nothing turned on these slight variations in wording. The HP agreements were governed by the Consumer Credit Act 1974.

4. For example (using the sample figures provided in the bundle of documents), in relation to a vehicle which the dealer had offered to sell to the customer for a cash price of £6,095 including VAT, BCT purchased the vehicle from the dealer for £6,095 and at the same time entered into a HP agreement with the customer under which the vehicle was hired for 5 years, at the end of which the customer had an option to purchase the vehicle for £90, and in return the customer paid an initial deposit of £300 and, over the life of the hiring, aggregate rentals of £9,300, made up of the £6,095 cash price (there was no mark up on the vehicle made by BCT), interest of £2,905 and an arrangement fee of £600.

5. By paragraph 1(2) of schedule 4 to the Value Added Tax Act 1994 ("VATA"), that transaction was at the outset a supply of goods, the vehicle; the consideration for that supply was the £6,095 cash price. In addition, over the period of the hire BCT provided the customer with credit of £3,595, treated as exempt supplies of services under item 2 of group 5 of Schedule 9 to the 1994 Act.

6. Thus, BCT received a taxable supply of goods from the dealer for a consideration of £6,095 and made an onward taxable supply of the goods to the

customer for a consideration of the same amount. Those transactions were therefore neutral for VAT purposes: the input tax allowable matched the output tax due, so that BCT was not liable to recover or pay any VAT in respect of the transactions.

7. The HP agreement was in the usual form. BCT supplied the vehicle to the customer but retained legal title until all outstanding instalments had been paid. When all payments had been duly made the customer had the option to purchase the vehicle by paying BCT an option fee. At this point title to the vehicle was transferred to the customer. If the customer did not exercise the option then the vehicle would be returned to BCT for onward sale.

8. At the time, BCT did not account for the matching input tax and output tax on its acquisition and sale of the vehicles by entering them in its VAT account, or in its VAT return. However, BCT subsequently made the entries in its VAT account, and gave details to HMRC by a letter dated 31st January 2012. We shall return to this point later because the effect of these later entries in BCT's VAT account is a point of contention between the parties.

9. If BCT terminated the HP agreement because the customer was in breach, the customer was then obliged to return the vehicle, and if he failed to do so, BCT repossessed the vehicle using a specialist repossession company, as well as a solicitor where necessary (usually, where the customer had paid at least one third of the instalments, the Consumer Credit Act 1974 would require a court order to repossess the vehicle). The customer was contractually obliged to pay BCT's repossession costs.

10. Those costs represented taxable supplies of services from the repossession company and (where necessary) a solicitor to BCT, and the first issue in this appeal ("**the repossession issue**") is whether the input tax charged on those supplies is fully allowable. Essentially, BCT argued that the input tax is attributable to taxable supplies made by it and is therefore wholly recoverable. HMRC contend that the input tax is attributable to both taxable and exempt supplies and therefore constitutes "residual" input tax of which only a proportion would be allowable in accordance with BCT's partial exemption special method. "Residual" input tax is sometimes referred to as "non-attributable input tax" in order to contrast it with input tax which is directly attributable to taxable supplies. For a helpful explanation of these and other related terms reference should be made to the judgment of Carnwath LJ in *Mayflower Theatre Trust Limited v HMRC* [2007] STC 880 at [24 – 27].

11. The total amount of VAT at stake in connection with the repossession issue, for the period from 1st January 2007 to 30th September 2010, is £552,242.32.

12. In consequence of the early termination of the HP agreement, there would in certain circumstances be a decrease in the outstanding balance payable by the customer. In particular, having recovered the vehicle from the customer, BCT would sell it at auction, and under the HP agreement the customer was credited with the sale proceeds against the outstanding balance. For VAT purposes, BCT argued that there was therefore a "decrease in consideration" for BCT's supply of the vehicle to the

customer as defined by regulation 24 of the Value Added Tax Regulations 1995 ("the Regulations"). Accordingly BCT subsequently adjusted its VAT account to reflect that decrease, pursuant to Regulation 38 of the 1995 Regulations (see *CCE v GMAC (UK) plc* [2004] STC 577).

13. Thus the second issue in this appeal ("**the Regulation 38 issue**") is whether BCT was wrong to adjust the consideration, given that it had not (i.e. in the VAT period in which the vehicle was acquired and the HP agreement was concluded) accounted for the output tax by entering it in its VAT account or in its VAT return. The adjustment to its VAT account was only made in January 2012.

14. Next, insofar as the customer failed to pay the outstanding balance BCT has claimed bad debt relief under Section 36 of the 1994 Act and Part XIX of the Regulations in respect of the VAT element of the bad debt. The third issue in this appeal ("**the bad debt relief issue**") is, therefore, whether bad debt relief is precluded by the fact that BCT did not originally enter the output tax in its VAT account or in its VAT return.

15. The total amount of VAT at stake in connection with the Regulation 38 and bad debt relief issues, for the period from 1st January 2008 to 30th November 2010, is £749,152.74.

16. Finally, and closely related to the bad debt relief and Regulation 38 issues, there is a dispute between the parties about the effect of BCT's subsequent accounting for VAT in respect of its HP transactions. As we have mentioned and as we shall explore in greater detail later in this decision, BCT did eventually record its transactions in its VAT account as set out in a letter to HMRC of 31 January 2012. The fourth issue in this appeal is, therefore, whether that letter constituted a valid claim to relief under Regulation 38 and Section 36 ("**the claim issue**").

Legislation

17. The right to deduct input tax is set out in Article 168 of Directive 2006/112/EEC ("the VAT Directive"). Article 168 provides that a taxable person is entitled to deduct VAT due or paid in respect of supplies of goods or services to him from the VAT which he is liable to pay in so far as the goods and services are used for the purposes of the taxed transactions of the taxable person. There is, however, no right to deduct VAT due or paid in respect of supplies of goods or services which are used by the taxable person for the purposes of exempt transactions.

18. Regulation 102(1) of the VAT Regulations enables HMRC to approve or direct the use by a taxable person of a partially exempt special method.

19. In relation to the Regulation 38 issue, Article 90 Council Directive 2006/112/EEC 28 November 2006 provides for the adjustment of consideration for VAT purposes where the price is reduced after the supply takes place. Article 90 provides:

"1. In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States."

20. The words "taxable amount" are defined in earlier Articles of the Directive. Thus, Article 73 provides:

"In respect of the supply of goods or services, other than as referred to in Articles 74 to 77, the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply."

21. Regulation 38 of the VAT Regulations 1995 provides:

"(1) This regulation applies where—

(a) there is an increase in consideration for a supply, or

(b) there is a decrease in consideration for a supply,

which includes an amount of VAT and the increase or decrease occurs after the end of the prescribed accounting period in which the original supply took place.

(1A)…

(1B)…

(1C) Where an increase or decrease in consideration relates to a supply in respect of which it is for the recipient, on the supplier's behalf, to account for and pay the tax, the prescribed accounting period referred to in paragraph (1) is that of the recipient, and not the maker, of the supply.

But this paragraph does not apply to the circumstances referred to in regulation 38A.

(2) Where this regulation applies, both the taxable person who makes the supply and a taxable person who receives the supply shall adjust their respective VAT accounts in accordance with the provisions of this regulation.

(3) Subject to paragraph (3A) below, the maker of the supply shall—

(a) in the case of an increase in consideration, make a positive entry; or

(b) in the case of a decrease in consideration, make a negative entry,

for the relevant amount of VAT in the VAT payable portion of his VAT account.

(3A) Where an increase or decrease in consideration relates to a supply on which the VAT has been accounted for and paid by the recipient of the supply, any entry required to be made under paragraph

(3) shall be made in the recipient's VAT account and not that of the supplier.

(4) The recipient of the supply, if he is a taxable person, shall—

(a) in the case of an increase in consideration, make a positive entry; or

(b) in the case of a decrease in consideration, make a negative entry,

for the relevant amount of VAT in the VAT allowable portion of his VAT account.

(5) Every entry required by this regulation shall, except where paragraph (6) below applies, be made in that part of the VAT account which relates to the prescribed accounting period in which the increase or decrease is given effect in the business accounts of the relevant taxable person.

(6) Any entry required by this regulation to be made in the VAT account of an insolvent person shall be made in that part of the VAT account which relates to the prescribed accounting period in which the supply was made or received.

(7) None of the circumstances to which this regulation applies is to be regarded as giving rise to any application of regulations 34 and 35."

22. Regulation 24 of the VAT Regulations 1995 defines the term "an increase in consideration" as follows:

> "increase in consideration" means an increase in the consideration due on a supply made by a taxable person which is evidenced by a credit or debit note or any other document having the same effect and "decrease in consideration" is to be interpreted accordingly…."

23. Regulation 31 requires a trader to keep a VAT account as part of its business records:

> "(1) Every taxable person shall, for the purpose of accounting for VAT, keep the following records—
>
> (a) his business and accounting records,
>
> (b) his VAT account…"

24. Regulation 32 sets out in detail how a VAT account should operate:

> "(1) Every taxable person shall keep and maintain, in accordance with this regulation, an account to be known as the VAT account.
>
> (2) The VAT account shall be divided into separate parts relating to the prescribed accounting periods of the taxable person and each such part shall be further divided into 2 portions to be known as "the VAT payable portion" and "the VAT allowable portion".
>
> (3) The VAT payable portion for each prescribed accounting period shall comprise—

(a) a total of the output tax due from the taxable person for that period,

(b) a total of the output tax due on acquisitions from other member States by the taxable person for that period,

(ba) a total of the tax which the taxable person is required to account for and pay on behalf of the supplier,

(c) every correction or adjustment to the VAT payable portion which is required or allowed by regulation 34, 35, 38 or 38A, and

(d) every adjustment to the amount of VAT payable by the taxable person for that period which is required, or allowed, by or under any Regulations made under the Act.

(4) The VAT allowable portion for each prescribed period shall comprise—

(a) a total of the input tax allowable to the taxable person for that period by virtue of section 26 of the Act,

(b) a total of the input tax allowable in respect of acquisitions from other member States by the taxable person for that period by virtue of section 26 of the Act,

(c) every correction or adjustment to the VAT allowable portion which is required or allowed by regulation 34, 35 or 38, and

(d) every adjustment to the amount of input tax allowable to the taxable person for that period which is required, or allowed, by or under any Regulations made under the Act."

25. Regulation 4 of the Value Added Tax (Cars) Order 1992 as amended by the Value Added Tax (Cars) (Amendment) Order 2006 sets out the circumstances in which the sale by BCT of a repossessed car at auction constitutes a taxable supply:

(1) Subject to paragraphs (1A) to (2) below, each of the following descriptions of transactions shall be treated as neither a supply of goods nor a supply of services–

(a) the disposal of a used motor car by a person who repossessed it under the terms of a finance agreement, where the motor car is in the same condition as it was in when it was repossessed;

(b) …

(c) …

(d) …

(e) …

(f) …

(1A) …

(1AA) Paragraph (1)(a) above shall not apply where adjustment, whether or not made under regulation 38 of the Value Added Regulations 1995, has taken account, or may later take account, of VAT on the initial supply under the finance agreement as a result of

repossession and the motor car delivered under that agreement was delivered on or after 1st September 2006.

26. In other words, in broad terms, where the initial supply under the HP agreement is taken account of by the trader for tax purposes (particularly under Regulation 38) the sale of the vehicle at auction by the trader will be a taxable supply.

27. In relation to bad debt relief, Section 36 VATA provides so far as material:

> "(1) Subsection (2) below applies where–
>
> (a) a person has supplied goods or services for a consideration in money and has accounted for and paid VAT on the supply,
>
> (b) the whole or any part of the consideration for the supply has been written off in his accounts as a bad debt, and
>
> (c) a period of 6 months (beginning with the date of the supply) has elapsed.
>
> (2) Subject to the following provisions of this section and to regulations under it the person shall be entitled, on making a claim to the Commissioners, to a refund of the amount of VAT chargeable by reference to the outstanding amount."

28. Regulation 167 of the VAT Regulations 1995 sets out requirements relating to the manner in which a claim for bad debt relief must be made:

> "Save as the Commissioners may otherwise allow, the claimant, before he makes a claim, shall hold in respect of each relevant supply—
>
> (a) …
>
> (b) records or any other documents showing that he has accounted for and paid the VAT thereon, and
>
> (c) records or any other documents showing that the consideration has been written off in his accounts as a bad debt."

The repossession issue

Further facts

29. As described above, the repossession issue relates to the costs of repossessing motor vehicles on the termination of an HP agreement. The repossession issue relates to VAT accounting periods from 1 January 2007 to 30 September 2010.

30. BCT's standard form HP agreement (2007 version) provided:

> "7.2 If you are at any time in breach of this Agreement, we will serve you a Default Notice as required by the Consumer Credit Act 1974. Failure to comply with the terms of that Notice will give us the right to terminate this Agreement.

> 7.3 If we do terminate the [HP Agreement] you must immediately return the vehicle to us at your own expense and [in good condition]. If you do not do so, we will be entitled to repossess the vehicle.
>
> 7.4 In addition, you will also have to pay us:
>
> 7.4.1 compensation for our loss that we may suffer as a result of the breach of this Agreement by you prior to termination, such as (but not limited to) any reduction in value of the vehicle on return due to your failure to [keep the vehicle in good condition]; and
>
> 7.4.2 the Outstanding Balance by way of pre-estimated compensation for our loss resulting from such termination. You will get credit for any rebate due to you under the provisions of the Consumer Credit Act 1974 if and when payment of this sum is made; you will also get credit for any proceeds of the sale of the vehicle (net of the costs of repossession and sale) on the date we receive them."

31. The "Outstanding Balance" was defined by Condition 2.4 as:

> "the aggregate of unpaid instalments (not including the option fee) together with any sums that may have fallen due such as (but not limited to) interest, legal fees and/or administration charges."

32. We were taken to sample documents which showed how the sale proceeds of the vehicle, once it was repossessed and sold at auction, were credited to the account of the customer and used to reduce the customer's outstanding balance owed to BCT. The outstanding balance consisted of amounts owed to BCT in respect of the purchase price of the vehicle and charges in relation to the supply of credit.

33. On the first page of the HP agreement, entitled "Key Information Box", under the heading default charges, the agreement specified:

> "4. If we have to repossess the vehicle or enforce the agreement, you will have to pay our reasonable expenses.
>
> 5. If we have to terminate this agreement early... you may have to pay us compensation (see Condition 7.4.2)."

34. On the second page of the "Key Information Box" the HP agreement, reflecting the customer's rights under section 99 Consumer Credit Act 1974, stated:

> "If you do not keep your side of this agreement but you have paid at least one third of the total amount payable under this agreement… we may not take back the goods against your wishes unless we get a court order."

35. On the second page of the "Pre-contract Information" documentation, which was provided to customers in accordance with the Consumer Credit Act 1974, the charges that were payable following a breach of the HP agreement by the customer were summarised (cross-referring to the default charges shown in the Key Information Box) as follows:

> "**Solicitors Charges**

You will be liable for all legal costs incurred if we have to involve a solicitor.

As applicable

Repossession

If we have to repossess the vehicle you will be liable for all our costs, including any related legal costs.

As applicable."

36. Thus, it will be seen that the HP agreement imposed an obligation (Condition 7.3) on the customer to return the car to BCT once the HP agreement had been terminated as a result of the customer's breach. The HP agreement did not give the customer a right to opt to have the car collected by BCT. If the customer failed to return the car, thereby creating a further breach of contract, BCT was entitled, but was under no obligation, to repossess the car. Amounts payable by the customer following termination of the agreement by BCT were payable under Condition 7.4.2 as "compensation for loss" resulting from termination. These amounts are referred to in the Key Information Box as "reasonable expenses" of repossession for which the customer would be liable on a default.

37. As we have indicated, BCT would employ a specialist repossession company in order to repossess a vehicle following the termination of an HP agreement. Usually the standard fee charged by the repossession company was approximately £175 net of VAT. In addition, if it was necessary to obtain a court order to repossess a vehicle, BCT would also employ a solicitor. The repossession company and the legal fees carried VAT and it is this VAT which BCT claims is attributable exclusively to taxable supplies made by it and, therefore, wholly deductible. These costs of repossessing the vehicle (and the auctioneer's fees) were then added to the balance of the defaulting customer's account with BCT.

38. In practice, the repossession company would deliver the repossessed vehicle directly to one of the regional collection points maintained by or on behalf of the auctioneer. BCT's preferred auctioneer was Scottish Motor Auctions ("SMA"). SMA maintained approximately 50 – 60 drop-off points around the country. The vehicle would then be transported by or on behalf of SMA to one of its auctions and sold at auction. In a very small number of cases, where the vehicle was in such bad condition that it could not be sold, the vehicle would be scrapped. We inferred from Mr Irvine’s evidence that, obviously enough, a car could not be sold at auction unless it had first been repossessed from the customer and delivered to SMA. In correspondence between the parties, and before this tribunal, HMRC accepted that the input VAT on the auctioneer's fees were attributable to the sale of the vehicle at auction and were therefore wholly allowable i.e. they were attributable to a taxable supply. It was common ground that the sale of the vehicle at auction was a taxable supply by BCT.

39. When the vehicle was sold at auction the proceeds of sale were credited to the customer’s account with BCT and, as we have described, the costs of repossession (those of the repossession company and, where necessary, the solicitor’s fees) and the auctioneer’s fees were debited to that account. During the period relevant to this

appeal, BCT treated the input tax incurred by it on the repossession of a vehicle as residual input tax, rather than as directly attributable to a separate taxable supply made by it. We were informed that under the partial exemption special method which it applied, BCT deducted 15% of that input tax. This was in line with the partial exemption method agreed between the Finance & Leasing Association and HMRC.

40. As we shall see, after taking tax advice from Deloitte, BCT made a number of voluntary disclosures to HMRC by which it now seeks to deduct 100% of the input tax incurred on repossession services supplied to it by the specialist repossession companies and, where applicable, legal fees incurred to obtain a court order securing possession of the vehicle.

Submissions on the repossession issue

41. Mr Prosser QC, for BCT, argued that VAT charged on the taxable supplies made to BCT by a repossession company and, where applicable, by a solicitor, for the purposes of repossessing a vehicle was fully allowable because those supplies were directly attributable to a taxable supply made by BCT.

42. Mr Prosser advanced three alternative arguments in support of this proposition.

43. First, by repossessing (or arranging for the repossession of) the customer's vehicle BCT was supplying a separate service to the customer. The consideration for the supply of this service was a contractual obligation of the customer to pay BCT's reasonable expenses, including legal fees (as provided for in the "Key Information" section of the HP agreement). The costs of the specialist repossession company and, where applicable, legal fees were directly attributable to BCT's taxable supply of repossession services to its defaulting customers.

44. Mr Prosser submitted that the primary obligation on the customer, where the agreement was terminated by BCT following the customer's default, was to return the vehicle at his/her own expense. Where the customer failed to do this, BCT relieved the customer of this obligation by repossessing the vehicle itself. The obligation of the customer to reimburse BCT for its reasonable expenses incurred in repossessing the vehicle constituted consideration for the supply of the service by BCT (compensation could constitute consideration for these purposes – see *Parker Hale Ltd v Customs and Excise Commissioners* [2000] STC 388).

45. Secondly, and in the alternative, Mr Prosser argued that the repossession of a vehicle by BCT was a necessary incident of the terms by which BCT gave possession of the vehicle when it hired the vehicle to the customer under the HP agreement. Mr Prosser recognised that an HP agreement was treated as an outright supply of the vehicle at the outset. Nonetheless, the possibility of BCT repossessing the vehicle on the termination of the hiring was always a possibility. In this way, according to Mr Prosser, the repossession of the vehicle by BCT was part and parcel of a single economic transaction i.e. the hiring of or giving possession of the vehicle to the customer.

46. Finally, Mr Prosser's third alternative argument was that BCT repossessed a vehicle for the purpose of selling it at auction. The sale of the vehicle at auction was a taxable supply where an adjustment had to be made under regulation 38 VAT Regulations 1995. There was a direct link between the repossession services received by BCT and its onward taxable supply of the vehicle.

47. Although this third argument was put forward last in Mr Prosser's submissions, in the course of the hearing Mr Prosser came to regard it as BCT's strongest argument on the repossession issue. Also, in the course of the hearing, Mr Prosser accepted that if we found merit in this third argument then any input tax claim relating to the repossession issue would be limited to VAT on expenses (the specialist repossession company and, as the case may be, solicitors fees) incurred in respect of vehicles that were sold at auction. The point here was that Mr Irvine’s evidence was that occasionally BCT repossessed a vehicle which was found to be in such bad condition that it was simply scrapped. Mr Prosser accepted that in these "scrapping" cases no claim to input tax could be maintained.

48. Mr Mantle, for HMRC, argued that BCT's arguments in support of the repossession issue were misconceived.

49. In relation to Mr Prosser's first argument, Mr Mantle submitted that there was no separate, free-standing supply of services by BCT to the customer where BCT repossessed a vehicle. The customer under the HP agreement had not agreed that BCT should provide repossession services when the customer breached the agreement. The repossession arose out of the customer's breach of contract and the customer's liability to reimburse BCT for costs arising from the customer's breach. It was not a payment for a service provided by BCT to the customer.

50. Moreover, HMRC's analysis was consistent with economic reality. It was unrealistic to characterise the customer as receiving a service when, in fact, what was being done was to deprive him/her of possession of the vehicle and return it to the control of BCT. BCT was, in reality, acting solely to protect its interests. Repossession, when looked at from the point of view of the customer, was something to which the customer was subjected rather than a service of which he/she was a recipient. Economic reality demonstrated that the repossession services were for the benefit of BCT and not for the customer.

51. Mr Mantle submitted that the error in BCT's first argument was revealed by the claim in relation to input tax incurred by BCT on solicitors' fees. These fees were incurred where, under the Consumer Credit Act 1974, it was necessary to obtain a court order to obtain possession (where the customer had paid one third of the instalments). Mr Mantle submitted that BCT's proposition that legal advice used to obtain a court order enabling BCT to repossess a vehicle was a service to the customer was absurd.

52. In response to Mr Prosser's second argument, Mr Mantle submitted that the attribution of the expenses of repossession solely to the hiring of the vehicle under the HP agreement ignored the fact that the original HP agreement was both a taxable

supply and an exempt supply of credit. Accordingly, the correct treatment was to regard the input tax incurred by BCT on repossession as an overhead of BCT's business and not directly attributable solely to one element of that business.

53. Finally, in relation to Mr Prosser's third argument (that the input tax was attributable to the sale of the vehicle at auction), Mr Mantle argued that the sale proceeds of the car would be applied both towards the instalments relating to the purchase of the car and also to the balance on the customer's account which related to charges for the supply of credit. Accordingly, as with the second argument, the correct treatment was to treat the input VAT as an overhead of BCT's business so that BCT's recovery of input tax would be determined by its partial exemption method.

Discussion of the repossession issue

54. In our view, BCT did not make an independent, free-standing supply of a service to a customer when it repossessed a vehicle on termination of an HP agreement.

55. In reality, BCT was exercising a right arising on a breach of contract under the original HP agreement. In doing so it was protecting its position and not supplying a service to the customer. It is true that the primary obligation under the HP agreement, on termination, was for the customer to deliver the vehicle to BCT and that BCT's right to repossession arose only when the customer was in breach of that obligation (BCT having first elected to terminate the agreement as a result of the customer's earlier failure to pay the agreed instalments). However, in reality, BCT was simply realising its security (the recovery of possession of the vehicle to which BCT had legal title) in the context of and under the terms of the HP agreement and doing so for its benefit. Borrowing the language of the CJEU in *Card Protection Plan Ltd v Customs and Excise Commissioners* Case C-349/96 at [30], BCT's action in repossessing the vehicle under the HP agreement could not be regarded as being, for the customer, "an aim in itself." The relevant principles were recently helpfully summarised by Warren J in the Upper Tribunal decision in *HMRC v David Finnamore* [2014] UKUT 0336 (TCC) at [24] in relation to the correct categorisation of a supply, a question which was informed by the question whether there was a composite or multiple supply:

> "a. The essential features or characteristic elements of the transaction must be examined in order to determine whether, from the point of view of a typical consumer, the supplies constitute several distinct principal supplies or a single economic supply. Those same features and characteristics will inform the answer to what is the nature of the single supply, from the point of view of a typical customer, in a case where the conclusion is that there is a single supply.
>
> b. Where one or more elements are to be regarded as constituting the principal services, while one or more elements are to be regarded as ancillary services, the overarching supply will take the tax treatment of the principal element.

> c. A service must be regarded as ancillary if it does not constitute for the customer an aim in itself, but is a means of better enjoying the principal service supplied.
>
> d. A single supply consisting of several elements is not automatically similar to the supply of those elements separately and so different tax treatment does not necessarily offend the principle of fiscal neutrality."

56. In applying the CJEU's judgment in *Card Protection Plan* the House of Lords ([2001] STC 174) (Lord Slynn delivering the leading opinion) said:

> **"[22]** It is clear from the Court of Justice's judgment that the national court's task is to have regard to the 'essential features of the transaction' to see whether it is 'several distinct principal services' or a single service and that what from an economic point of view is in reality a single service should not be 'artificially split'. It seems that an overall view should be taken and over-zealous dissecting and analysis of particular clauses should be avoided."

57. In our view, the same approach should be adopted in this case. It seemed to us artificial to split the right of BCT to repossess a vehicle from the rest of the rights and obligations under the HP agreement in order to treat it as a separate supply. BCT's repossession rights were simply ancillary to its other rights and obligations under the HP agreement and arose on a breach of contract by the customer. Accordingly, we conclude that BCT did not make a separate supply of repossession services to its customers.

58. Our conclusion that BCT did not make a separate supply of repossession services to the customer makes it strictly unnecessary to consider whether the obligation of the customer to reimburse BCT its reasonable expenses constituted consideration for the supply. However, we accept Mr Prosser's submission that the fact that a payment for a service may be compensation does not prevent it constituting consideration for the supply for the purposes of VAT. In this respect, we respectfully agree with the judgment of Moses J (as he then was) in *Parker Hale Ltd v Customs and Excise Commissioners* [2000] STC 388. In that case, handguns were removed from public ownership by statute and compensation was provided to persons surrendering handguns pursuant to a government scheme. Moses J held that the compensation constituted consideration for a supply for the purposes of VAT. The learned judge said [398]:

> " In my judgment, the compensation in this case clearly falls within the definition of consideration paid in return for the acquisition of title to the guns, as explained in *Trafalgar Tours Ltd v Customs and Excise Comrs* [1990] STC 127. Slade LJ (at 135) said that—
>
> '... the expression "consideration" in s 10(2) [of the Value Added Tax Act 1983] means everything which the supplier has received or is to receive from the purchaser, the customer or a third party for the relevant supplies ...'
>
> These payments were clearly received by the appellant from the government for the supply of the guns. The market value was

> irrelevant. I conclude that the compensation paid was consideration for the supply of the guns. "

59. However, as we have said, for the reasons given above, we do not consider that BCT made a separate supply of repossession services to its customer under the HP agreement and, therefore, we reject Mr Prosser's first argument on the repossession issue.

60. Turning to Mr Prosser's second argument, we consider that it is not possible to regard the supply of repossession services to BCT as being attributable solely to that element of the supply under the HP agreement which was taxable (the supply of the vehicle) rather than those elements which were exempt (the supply of credit). There seemed to be no good reason why the supply of repossession services should be attributed to one aspect of the HP agreement (the taxable supply of the vehicle) rather than to the overall supply, which was both taxable and exempt. In any event, as will be clear from the following discussion of Mr Prosser's third argument, we consider that the supply of repossession services to BCT was not attributable to the services supplied under the original HP agreement, in the sense of having an immediate and direct link, but rather to the sale of the vehicle at auction.

61. As regards Mr Prosser's third argument that the supply of repossession services to BCT was attributable to BCT's sale of the car at auction, we consider that Mr Prosser was correct to regard this as BCT's strongest point on the repossession issue. Mr Prosser accepted that he could only succeed on this third argument where an adjustment, whether or not made under regulation 38 of the VAT Regulations 1995, has taken account, or may later take account, of VAT on the initial supply under the finance agreement as a result of repossession (and the vehicle was delivered under the finance agreement on or after 1 September 2006): Regulation 4 (1AA) Value Added Tax (Cars) Order 1992 as amended by the Value Added Tax (Cars) (Amendment) Order 2006.

62. We accept Mr Prosser's submission that the input tax charge by the specialist repossession company to BCT was attributable to the supply of the vehicle at auction by BCT.

63. In *BLP Group plc v. Customs & Excise Commissioners* (Case C – 4/94) [1995] STC 424 ("BLP") a holding company disposed of shares (an exempt supply) in a subsidiary and claimed to deduct the VAT paid on invoices for professional services supplied by advisers in relation to the sale. BLP claimed that the purpose of the sale was to raise funds to discharge debts which had arisen directly from its taxable transactions. The CJEU rejected this claim. The Court held that where a taxable person uses services for an exempt transaction, he is not entitled to deduct the input tax paid even if the ultimate purpose of the transaction is the carrying out of a taxable transaction. The Court said at [19] that to give rise to a right to deduct:

> "the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant".

64. The Court, emphasising the objective nature of the "linkage test", made it clear that the test was not one of the intention of the recipient of the services. The Court said at [24]:

> "Moreover, if BLP's interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question."

65. The *BLP* case was considered and distinguished by the Court of Appeal in *Customs & Excise Commissioners v UBAF Bank Ltd* [1996] STC 372. In this case a bank incurred input tax on professional fees when it acquired shares in three leasing companies. The bank arranged for the leasing companies to transfer the underlying leasing businesses of the three companies to itself the next day. The bank claimed to deduct the input tax in full as attributable to the taxable supplies to be made by its fully taxable leasing business. The Court of Appeal held that the input tax was indeed attributable to the bank's taxable leasing activities because the VAT Tribunal had found as a matter of fact that the bank's purpose in acquiring the shares was to expand those leasing activities and the acquisition of the shares and subsequent transfer of the businesses were so "closely linked" as to be regarded as one transaction. Neill LJ concluded [at pages 379- 380] that:

> "The tribunal considered the evidence and came to the conclusion (at 158) that the transactions whereby UBAF acquired the three companies and their businesses 'were intended to, and did, enable the Bank to add substantially to its own existing leasing business and, in VAT terms, to make taxable supplies of leasing.' It seems to me that this was a finding of fact that there was a direct link between the acquisitions and the making of the taxable supplies. It is true that the assets acquired were not physical assets but the assets clearly included rights under the existing leases between the three companies and their lessees."

66. Thus, in *UBAF* the Court of Appeal analysed the transaction in respect of which input tax had been incurred as, in effect, an acquisition of assets to be used in making taxable supplies and, accordingly, attributed the input tax to the making of taxable supplies.

67. In *Dial-a-Phone Ltd v. Customs & Excise Commissioners* [2004] EWCA Civ 603, [2004] STC 987 the taxpayer had sold mobile telephones with a "free" three month period of insurance cover. Its income came partly from commissions from network service providers and partly from commissions from the underwriter of the insurance. As regards the provision of insurance cover it was acting as an insurance intermediary and thus making an exempt supply. The issue before the Court of Appeal was whether input tax incurred in respect of its marketing and advertising costs was exclusively attributable to its taxable outputs (as the taxpayer contended), or was to be treated as used both for the taxable supplies and the exempt supplies. The tribunal

found that the advertising and marketing costs related to both supplies. This finding was upheld by the Court of Appeal. The taxpayer had argued that the input tax was more directly related to the making of its taxable supplies rather than its exempt insurance commissions. Jonathan Parker LJ rejected this argument at [74 – 75] in the following terms:

> "74. As to Mr Anderson's submissions directed at the factual relationship between the insurance intermediary services and the taxable supplies made by [the taxpayer] (and in particular his submissions regarding timing), it is important to bear in mind that (as the Advocate-General observed in *Abbey National* (see paragraph 29 above)) a 'direct and immediate link' may exist between the marketing and advertising costs and the insurance intermediary services despite the fact that there may be an even closer link between those costs and [the taxpayer]'s taxable supplies. In other words, the quest is not for the closest link, but for a *sufficient* link.
>
> 75. It follows that it matters not that the insurance intermediary services may be viewed as being in a commercial sense secondary to the making of the taxable supplies, or even that they may be provided only after a taxable supply has been made, *provided that a sufficient 'direct and immediate link' exists between them and the marketing and advertising costs*." [emphasis added]

68. It will be seen from this passage that the question is not whether the input tax incurred by BCT on a repossession was more closely related to its taxable rather than its partially exempt supplies, but rather whether a sufficient direct and immediate link existed between the repossession (and legal) services supplied to BCT, on the one hand, and either or both its taxable (sale at auction) and partially exempt supplies, on the other.

69. These authorities were helpfully summarised by Carnwath LJ (as he then was) in In *Mayflower Theatre Trust Limited v HMRC* [2007] STC 880. Carnwath LJ explained the general principles to be applied when considering deduction of input tax where a person makes both taxable and exempt supplies on page 885 at [9] as follows:

> "i) Input tax is directly attributable to a given output if it has a "direct and immediate link" with that output (referred to as "the *BLP* test" [*BLP Group Plc v HM Customs and Excise* (Case C–4/94) [1995] STC 424]).
>
> ii) That test has been formulated in different ways over the years, for example: whether the input is a "cost component" of the output; or whether the input is "essential" to the particular output. Such formulations are the same in substance as the "direct and immediate link" test.
>
> iii) The application of the *BLP* test is a matter of objective analysis as to how particular inputs are used and is not dependent upon establishing what is the ultimate aim pursued by the taxable person. It requires more than mere commercial links between transactions, or a "but for" approach.

> iv) The test is not one of identifying what is the transaction with which the input has the most direct and immediate link, but whether there is a sufficiently direct and immediate link with a taxable economic activity.
>
> v) The test is one of mixed fact and law, and is therefore amenable to review in the higher courts, albeit the test is fact sensitive."

70. Applying these principles, it seems to us that there was a direct and immediate link between the supply of repossession services by the repossession specialists to BCT and the sale of the vehicle by BCT at auction. Mr Irvine's evidence was that the repossession specialists took possession of the vehicle and delivered it to one of the auctioneer's numerous collection sites. The auctioneer then transported the vehicle to the auction. We have further found that a car could only be sold at auction if it had been first repossessed and delivered to the auctioneer. In our view, that establishes a clear, direct and immediate link between the supply of the services by the repossession specialists to BCT and the sale of the vehicle by BCT at auction.

71. We also consider that the supply of legal services in order lawfully to repossess a vehicle was also directly and immediately linked to the subsequent sale of the vehicle at auction. Where a court order was required by the Consumer Credit Act 1974 in order to repossess a vehicle, that was a necessary step to be taken in order that the vehicle should be repossessed and delivered to the auction house.

72. Were the services supplied by the repossession specialists and the solicitors also directly and immediately linked to the partially exempt supply by BCT under the HP agreement? In our view they were not so linked. It is true that the purpose of the repossession was to enable the vehicle to be sold so that the proceeds of sale of the vehicle could be used to reduce both the amount owed by the customer in respect of the purchase price of the vehicle and in respect of the charges made for the supply of credit. In our view, however, the application of the proceeds of sale does not provide a sufficiently immediate and direct link for the attribution of the disputed input tax. An analogy can be drawn with the *BLP* case where the input tax was incurred for the purpose of an exempt supply (the sale of shares). The fact that the proceeds of the sale were to be used for the purposes of BLP's taxable business failed to establish the necessary or sufficient link. The ultimate aim of the taxpayer in relation to the proceeds of sale did not provide a sufficient nexus to attribute the input tax to the taxable activities. In this case, taxable supplies have been received by BCT in order to enable it to make a taxable supply (of the vehicle at auction) albeit that the ultimate objective was that the sale proceeds would be used to reduce the debt due in consequence of a transaction which was in part taxable and in part exempt. That does not, in our view, provide a sufficiently immediate and direct link between the taxable supply received by BCT and the exempt transaction.

73. Moreover, the fact that the HP agreement contained provisions which set out the rights and obligations of the parties on a repossession does not, in our view, provide a direct and immediate link between the supplies made by the repossession companies and the supplies (exempt and taxable) made under that agreement. We are mindful of the Court of Appeal's guidance in *Dial-a-Phone* that the correct test is not whether an input has a *more* direct and immediate link with one supply than another

but whether it has a *sufficient* link. A HP agreement is different in legal form from a secured lending but in economic terms the result is much the same. The agreement set out the means by which, in economic terms, BCT could realise its security (its ownership interest in the car) in order to produce cash which would reduce its credit exposure to the customer. That, however, seems to us to be an indirect and insufficiently immediate link between the supply of repossession services to BCT and the partially exempt supplies under the HP agreement. Again, it seems to be more analogous to the ultimate purpose (the discharge of debts incurred in a taxable business) of the input tax incurred in *BLP*.

74. Accordingly, we accept Mr Prosser's third argument with the result that we consider that none of the disputed input tax on the supplies to BCT should be attributed to BCT's exempt supplies but rather to its taxable supplies viz the sale of the vehicles at auction.

The Regulation 38 issue

Further facts

75. As already mentioned, it is common ground that BCT did not, at the time, make entries in its VAT account in respect of the supply to it of vehicles by dealers and BCT's onwards supply to customers under the HP agreements. Because BCT did not make a mark-up on the sale price of the vehicles under the HP agreements it was also common ground that, had BCT entered the input tax and output tax on these supplies, they would have offset each other with the result that there would have been no VAT liability on BCT.

76. As we shall see, BCT subsequently made these entries in January 2012.

77. We set out below the correspondence between the parties at some length because one of the issues that arose at the hearing was whether BCT had made a claim under Regulation 38 (for the adjustment of consideration) and Section 36 VATA 1994 (bad debt relief) after the date on which it subsequently made entries in its VAT account recording input and output tax on the purchase and immediate sale of the vehicles under HP agreements for the relevant periods.

78. On 23 December 2010, BCT's tax advisers (Deloitte LLP), wrote to HMRC on behalf of BCT. In the submissions before the tribunal this letter was referred to as the "**first letter**" and we adopt this terminology for convenience. The letter, so far as material, read as follows:

> "Dear Sirs
>
> BRITISH CREDIT TRUST LIMITED
>
> VOLUNTARY DISCLOSURE
>
> VAT REGISTRATION NUMBER: 603992139
>
> We have been assisting our client, British Credit Trust Limited ("BCT") in carrying out a review of VAT accounting processes with a

view to ensuring that it is fully compliant for VAT purposes. In the light of two new directors being appointed in CitiCapital to take over the management of the business which was facing some challenges, we were asked to review VAT processes and controls.

We have identified five areas (A – E) where the company's VAT accounting procedures require change:

- A – (i) Input VAT is under-recovered in relation to legal and repossession costs directly attributable to a taxable supply, and (ii) bad debt relief is required to be claimed for the subsequent charges made to customers that have been written off; [this relates to the repossession issue]
- …
- C – Output VAT adjustments are required to be made in relation to hostile and voluntary terminations [this relates to the regulation 38 and bad debt relief issues]
- …
- …

This letter covers input and output VAT adjustments for the period from 1 December 2006 which the business is required to correct. Areas A through to C result in a net payment to the business, and areas D and E give rise to a historic output VAT liability, and amounts payable to HMRC.

…

The appendices to this letter fully explain how BCT's adjustment to input and/or output VAT arises in disclosures B to D. As you will see, there is a significant amount of data involved and the spreadsheets are relatively complex and therefore, should you wish, we would be pleased to send them to you electronically and/or meet with you so you can review the calculations in more detail.

BCT is claiming a refund of VAT for the period 1 November 2009 to 31 January 2010 under B, and the period 1 December 2006 to 30 November under C…

C Bad debt relief/Reg 38	**Reg 38**	**BDR**
(i) HT – New	38,577.71	16,708.73
(ii) HT – Used	398,010.07	432,628.82
(iii) VT	267,730.80	
		1,153,656.13

79. The letter contained an eight page appendix (Appendix B) in respect of the Regulation 38 and bad debt relief issues. This appendix outlines the nature and reasoning behind the claims. For present purposes, it is only material to select a few paragraphs from this appendix, as follows:

"Historically BCT's method of accounting for VAT on the simultaneous purchase and sale of the vehicles it sold on hire purchase terms was not technically correct.

…

To date BCT has neither recovered the input VAT charged by the dealer nor accounted for output VAT on the immediate sale of the vehicle to the customer.

However, despite this error there has been no revenue loss to HMRC as the correct amount of output VAT has been paid in the correct VAT period by the dealers. BCT's position is VAT neutral in all transactions. For the purposes of this claim we have not included the identical amounts of input VAT and output VAT on the basis that these would cancel each other out, although we would be happy to do so if required.

Hostile Terminations ("HT's")

Where the customer has defaulted outside the terms of the Consumer Credit Act, BCT will generally repossess a car under a "hostile termination". BCT can then make a Regulation 38 VAT adjustment and claim bad debt relief on the output tax paid at the time of supply.

BCT has previously submitted a Regulation 38 VAT adjustment and bad debt relief claim in relation to new vehicles subject to HT's as it could easily identify these vehicles as "qualifying" for VAT purposes. A voluntary disclosure of the historical three-year period was submitted on 4 May 2006. This claim was subsequently settled by HMRC. The most recent claim was submitted by the business for the period ending 31 March 2009. This claim has not yet been settled.

…"

80. Deloittes wrote again to HMRC on 31 January 2011. The purpose of the letter was to provide information about the methodology and calculations for adjustments A and E. However, as a result of additional information, BCT claimed a reduced amount in respect of C, as follows:

C Bad debt relief/Reg 38	**Reg 38**	**BDR**
(i) HT – New	34,287.70	13,427.73
(ii) HT – Used	367,594.39	397,456.01
(iii) VT	256,041.41	
		1,068,807.24

81. HMRC replied on 6 July 2011. The letter read as follows, so far as material:

"**C: Bad Debt Relief/Regulation 38 claim –** whilst I understand the previous claim in 2006 was paid, the department did not concede on any of the original points: –

- The failure of the company to record on the VAT returns the purchase and sales of cars being supplied on HP

- The bad debt relief and regulation 38 rules and whether they apply if no output tax has previously been brought into account

> As you have confirmed the business has not accounted for output tax on the original supply of the car, the amount having been netted off against the input tax recoverable. Following the decision in *Times Right Marketing Limited* (LON 2006 1376) the Department issued Business Brief 18/09 advising of the change in treatment of Bad Debt Relief claims where net VAT due on a return has not been paid or has partly been paid. Bad debt relief rules still require the output tax to have been brought to account on the VAT return.
>
> A regulation 38 claim for reduction in consideration is also clear in its requirement for VAT to have been accounted for on the original supply.
>
> I am still awaiting advice from Policy on some of the above points but thought that an outline of our current position would be beneficial at this time."

82. Deloittes replied to HMRC on 16 September 2011 as follows:

> "… We note at the outset that your letter does not constitute a decision, but does set out HMRC's preliminary view regarding BCT's recently submitted voluntary disclosures. We understand that you are expecting to receive further advice from Policy on some of the issues. Please let us know if that advice changes the views expressed in your letter. Following a detailed review of your letter, we have undertaken an extensive exercise to explore the technical issues in point, and would like to take this opportunity to set out our response with a view to reaching agreement in relation to all five error corrections [the voluntary disclosures A – E] previously submitted on behalf of our client."

83. The letter continued by putting forward BCT's arguments in respect of the repossession issue, the regulation 38 issue and the bad debt issue.

84. HMRC wrote to BCT on 6 December 2011. As regards the Regulation 38 and bad debt relief issues, the letter read as follows:

> "**C – Bad Debt Relief**
>
> Details of Claim
>
> Hostile terminations – new = £13,427.73
>
> Hostile terminations – used = £397,456.01
>
> Total amount reclaimed = £410,883.74
>
> There is some history with this section of the claim as an identical claim was made in your agent's letter of 4 May 2006. This claim was initially rejected – HMRC letter of 05 February 2007 – on the following grounds: –
>
> *'Requirements to claim Bad Debt Relief are outlined in Notice 700/18 and Regulations 185 to 189 VATA 1994, there is a requirement that*

BCT Finance should have accounted [f]or output tax. As they have not accounted [f]or output tax, this regulatory requirement clearly has not been met.'

Subsequently our letter of 23 October 2007 advised you to withdraw your appeal and the claim was settled. It was, however, pointed out that HMRC were not conceding any of the points in the original argument.

Further examination of the matter, taking into account recent changes to guidance and your continued failure to account for the relevant VAT on your VAT returns over the subsequent periods, finds that the conditions for the recovery of Bad Debt Relief remain unchanged. The claim is refused on the grounds that you have continued – despite being aware of the need to correctly account for your supplies – to fail to account for the relevant VAT on your VAT returns. Revenue & Customs Brief 18/09 clearly states that –

'*One of the conditions is (for the claim of relief from VAT on your bad debts) that you must already have accounted for and paid VAT on the supplies you want to claim bad debt relief on.'*

C – Regulation 38

Details of Claim

Hostile terminations – new = £34,287.70

Hostile terminations – used = £367,594.39

Voluntary terminations = £256,041.41

Total amount reclaimed = £657,923.50

As with the BTR claim above, this was also the subject of the 2006 claim and was initially refused on the following grounds: –

'*It is clear when reading Regulation 38 and VAT Information Sheet 05/04 that to make a Regulation 38 claim for reduction in consideration, BCT Finance would have to provide evidence that VAT has been accounted for on the original supply. From correspondence and the submission it is confirmed that BCT Finance have not accounted for such output tax.'*

Further examination of your records have [sic] shown that you have continued to fail to account for output VAT on the relevant supplies and the claim is, therefore, rejected.

…

You have the right to request a reconsideration of this decision. Should you wish to follow this course of action please respond within 30 days of the date of this letter. The matter will then be referred to the relevant review team and you will be informed of their decision.

You also have the right of appeal to an independent VAT and Duties Tribunal, which must be made to the tribunal within 30 days of the date of this letter."

85. Deloittes replied to this letter on 5 January 2012. The letter reiterated Deloittes' arguments in relation to the Regulation 38 and bad debt relief issues. The letter concluded by stating:

> "Our view is that HMRC's position in relation to disclosures A [the repossession issue] and C [the regulation 38 and the bad debt issues] is incorrect and that BCT is entitled to effect the VAT adjustments contained in disclosure letters dated 23 December 2010 and 31 January 2011.
>
> I trust that the above is clear, and we would like to take this opportunity to request an independent reconsideration of your decision by an officer not previously involved in this case."

86. Deloittes wrote again to HMRC on 31 January 2012, also in response to HMRC's letter of 6 December 2011 to BCT. The parties referred to this as the "**second letter**" and we adopt this terminology. The letter stated:

> "Our understanding is that you have rejected BCT's disclosures under areas A and C on several grounds, most notably because your view is that the business is not entitled to bad debt relief under either disclosure as it has not accounted for output tax in relation to its original supplies.
>
> As you will see from the content of this letter, our view is that BCT has now accounted for and paid the output tax in question under disclosures A and C. We would suggest that this is enough for you to reconsider your original decision, and process payment of the revised disclosure values contained in this letter and I would therefore be grateful if you could do so.
>
> If, after reviewing the content of this letter, you are of the same view as that expressed in your decision letter dated 6 December 2011, I would be grateful if you could forward this and all previous correspondence on this matter to an independent officer not previously involved in BCT's case for reconsideration of that decision.
>
> We also write to separately disclose an amount of output tax that BCT hereby brings to account and the revised value of disclosures A and C, the methodology for which is contained in Appendix 1.
>
> …
>
> As a consequence of the legal advice obtained by BCT, our client has taken steps to adjust its VAT account which has given rise to a revised value of disclosures A and C. A comprehensive account of the steps taken by the business to arrive at the revised values is contained in Appendix 1, but a summary of amounts now due is outlined below.

87. The letter then set out a summary of the input tax and output tax in relation to various kinds of hostile and voluntary terminations from 1/4/09 and the relevant Regulation 38 adjustments and bad debt relief claims. Later in the letter, Deloittes dealt in detail with the bad debt relief issue and the Regulation 38 issue. So far as material the letter stated:

"**Disclosure Area C – Bad Debt Relief**

On the basis that input tax and output tax relating to the purchase and resale of motor vehicles always cancelled each other out, BCT did not report these transactions on its VAT returns.

There has been no revenue loss to HMRC as BCT's VAT position in relation to these transactions was neutral, with identical amounts of input and output tax cancelling out, so our view is that no voluntary disclosure by BCT in relation to these elements of transactions is strictly necessary.

Our understanding is that the basis for HMRC's rejection of this part of the disclosure is that BCT did not historically declare the equal values in boxes 1 and 4 of its VAT returns, even though this does not give rise to a loss of revenue. Our considered view is that the result of HMRC taking this position is a harsh and punitive outcome, particularly in the light of the fact that there is no loss of revenue involved. However, for the avoidance of doubt, BCT is now amending its VAT account to include a full declaration of the input tax incurred and output tax due in relation to the purchase and sale of used VAT qualifying cars subject to a hostile termination for HP agreements entered into from 1 January 2008 to 30 November 2010, and for new VAT qualifying cars subject to hostile termination where the HP agreement commenced in the period 1 April 2009 – 30 November 2010.

BCT has therefore recalculated its bad debt relief claim, for VAT qualifying cars subject to a hostile termination, to only include HP agreements where BCT has now accounted for input tax and output tax on the purchase and sale of used VAT qualifying cars. Further details of the steps taken to recalculate this disclosure are contained in Appendix 1.

We trust that this deals with any technical concern that you may have about the output tax not being accounted for. As all the other conditions for bad debt relief in section 36 of the VAT Act are met, this claim should now be repaid.

Disclosure Area C – Regulation 38

…

Our understanding is that HMRC has not challenged the accuracy of BCT's calculations, but that HMRC is likely to reject BCT's claim for overpaid output tax on the basis that:

(i) BCT did not account for output tax on its supplies of cars in the first instance; and

(ii) therefore, Regulation 38, which directs a taxable person to adjust their VAT account in accordance with a decrease in the consideration received for the supply, cannot apply because BCT had not accounted for output tax VAT on the initial transaction in the first place.

We have reviewed Regulation 38 with Counsel, and he is of the view that there is nothing contained in this part of the legislation to preclude BCT receiving a repayment of overpaid output tax."

88. The letter went on to state the arguments in favour of BCT's position that Regulation 38 did not require BCT to have accounted for VAT on the earlier supply of the vehicles. The letter concluded:

> "Our view is that HMRC's position in relation to disclosures A and C is incorrect and that BCT is entitled to effect the VAT adjustments contained in our disclosure letters dated 23 December 2010 and 31 January 2011, subject the amendments contained in Appendix 1 to this letter.
>
> I trust that the above is clear, and to the extent that you are not able to reverse your own decision in the light of the new information provided, we would like to take this opportunity to request an independent reconsideration of your decision by an officer not previously involved in the case."

89. We were not provided with a copy of the letter from HMRC in which HMRC set out its conclusions on the independent review requested by Deloittes. We were, however, supplied with a letter dated 24 August 2012 from HMRC to BCT which apparently responded to queries raised in respect of HMRC's review letter. So far as material, this letter stated:

> "I refer to your telephone call on Friday, 17 August 2012 with regard to the review conclusion letter dated 10 August 2012 forwarded to BCT and copied to Deloitte LLP.
>
> You have queried two paragraphs in my letter which are both on the last page and under the heading "regulation 38 and Dad Debt Relief Claim as follows:
>
> '*As you are aware, I referred your case for further technical advice due to the disclosure made of the unaccounted for input tax and output tax figures in the review request of 31 January 2012. These figures have been forwarded to satisfy the requirement as set out in Regulation 167b of the SI 1995/2518 in relation to Bad Debt Relief. I have been advised that HMRC's position remains as set out in the decision letter of 6 December 2011.*'
>
> and;
>
> *'In addition, I note that despite the letter dated 23 October 2007 in which you were informed to account for both the output tax and input tax on these initial transactions of the supplies of the cars, you have continued to fail to account for the output tax on the relevant supplies.'*
>
> Regulation 167 (b) states:
>
> '*Save as the Commissioners may otherwise allow, the claimant, before he makes a claim, shall hold in respect of each relevant supply –*
>
> *(b) records or other documents showing that he has accounted for and paid the VAT thereon, and…"*
>
> It has been established that BCT continued to fail to account for either input tax or output tax on the relevant supplies following the letter of 23 October 2007 to Deloitte from [HMRC officer]. In the review

> request of 31 January 2012 you have included figures for input tax incurred and output tax due on the purchase and sale of VAT qualifying vehicles in relation to Disclosure C. You consider that by forwarding the figures for the supplies in question, BCT has now accounted for and paid the output tax in question and you suggested that this was sufficient for the decision of 6 December 2011 to be reconsidered and the payment can be processed for the revised values contained in Appendix 2 of the review request.
>
> These facts were included in the request for technical advice. HMRC still consider that the requirements of Regulation 167 (b) (SI 1995/2518) have not been met in that the output tax on the relevant supplies on which the Bad Debt Relief is claimed had not been accounted for. The claim in relation to Bad Debt Relief remains rejected."

Submissions of the parties on the Regulation 38 issue

90. Mr Prosser referred to Article 90 of the Council Directive 2006/112/EEC which provides for the adjustment of consideration for VAT purposes where the price is reduced after the supply takes place "under conditions which shall be determined by the Member States." In his submission Article 90 contained a fundamental principle of VAT to the effect that VAT should only be charged on the actual amount of consideration eventually paid. Mr Prosser referred to *Goldsmiths (Jewellers) Ltd v Customs and Excise Commissioners* (Case C – 330/95) in which the CJEU observed at [15] in relation to the corresponding provision (Article 11 A (1) (a)) of the earlier Sixth Directive:

> " That provision embodies one of the fundamental principles of the Sixth Directive, according to which the basis of assessment is the consideration actually received (Case 230/87 *Naturally Yours Cosmetics* v *Commissioners of Customs and Excise* [1988] ECR 6365, paragraph 16) and the corollary of which is that the tax authorities may not in any circumstances charge an amount of VAT exceeding the tax paid by the taxable person (Case C-317/94 *Elida Gibbs* Ltd v *Commissioners of Customs and Excise* [1996] ECR I-5339, paragraph 24)."

91. Mr Prosser argued that the type of "conditions" that could be imposed by Member States were limited. The conditions envisaged were those which related to ensuring that no reduction was granted unless it was justified and included, for example, documentary evidence of payments having been made (see paragraph 74 of the opinion of Advocate General Jacobs in *EC Commission v Germany* Case C – 427/98 and paragraph 65 of the judgment of the Court where the Court envisaged a check of accounting records).

92. Regulation 38, Mr Prosser submitted, did not expressly or impliedly require that the obligation of a trader to adjust its VAT account to reflect a decrease or an increase in the consideration was conditional upon having previously entered the relevant output tax in its VAT account and/or VAT return. In any event, it would not be

legitimate to impose such a condition because no output tax is payable as BCT's supply of the vehicle under the HP agreement was exactly matched by its input tax on its purchase of the vehicle from the dealer. That would conflict with the fundamental principle of the Directive referred to above and was not the sort of condition envisaged by Article 90.

93. Mr Prosser, in support of his submissions, put forward an example. If a trader was liable for output tax in respect of a supply in Period 1 of £100 but in Period 6 the consideration for the supply doubled to £200, Regulation 38 required an entry in the VAT account to show the extra £100. It would be odd if the requirement to make that adjustment only applied where the trader had previously accounted for the original £100. That could not, Mr Prosser argued, have been intended. The requirement in regulation 38 for an adjustment to be made to the VAT account were there was an increase or decrease in consideration was "free-standing" in the sense that there was no requirement for VAT on the original consideration to have been correctly accounted for.

94. The requirement in regulation 38 that a trader should "adjust" its VAT account was, according to Mr Prosser, simply a "lead word" indicating that something needed to be done. "Adjust" simply meant a requirement to do something – the legislation could just as easily have said "make entries." There was no implication that "adjust" meant that BCT had previously to have accounted for VAT on the original transactions.

95. Mr Mantle argued that Regulation 38 should not be construed to permit a negative entry to be made in BCT's VAT account under Regulation 38 (3) (b) if BCT had not properly accounted for output tax on the relevant supply. The purpose of the regulation was to allow a downward adjustment to the VAT which had already been accounted for on the relevant supply.

96. Mr Mantle drew attention to the word "adjust" in Regulation 38 (2). Regulation 38 (2) provides:

> "Where this regulation applies, both the taxable person who makes the supply and a taxable person who receives the supply shall adjust their respective VAT accounts in accordance with the provisions of this regulation."

97. The word "adjust" clearly contemplated a change to an earlier entry in BCT's VAT account. In context, this made sense. The adjustments contemplated by Article 90 of the Directive related to events taking place after the original supply had been made. Article 90 could not be understood without referring back to the earlier Articles defining "taxable amount" (e.g. Article 73). In that sense, there was nothing "free-standing" about the adjustment required by Regulation 38 – it presupposed that VAT on the original consideration had been correctly accounted for.

98. As regards the "conditions" that could be imposed by Member States pursuant to Article 90, there was nothing in EU Law which prohibited the member state

requiring a trader to have first accounted for output tax before claiming an adjustment under domestic provisions implementing Article 90.

99. Mr Mantle argued that the appellant should first have corrected its omission to record the original purchase and HP of the vehicles in its VAT account under Regulation 34 or 35 of the Regulations.

Discussion of the Regulation 38 issue

100. Although Regulation 38 requires that a mandatory adjustment be made in the event of a decrease in consideration there is no explicit requirement that VAT on the supply should have previously been accounted for. As we shall see, the wording of Regulation 38 is different from that of Section 36, the latter having an explicit reference to VAT having been previously accounted for. It seems to us, however, that the word "adjust" in Regulation 38 (2), when read in the relevant statutory context, contemplates that a prior entry in the trader's VAT account in respect of the supply had been made, although we recognise that the issue is less clear-cut than the position in respect of the bad debt relief claim under Section 36.

101. We are also mindful that under Regulation 32(2) the VAT account at the end of each prescribed accounting period consists of two totals – the VAT payable and the VAT allowable. If at a later date a Regulation 38 adjustment is required, the adjustment is to the historical total of the VAT payable (or allowable as the case may be) not to the individual entries which originally made up that total.

102. We accept Mr Mantle's submission that Regulation 38 (implementing Article 90) is not a "free-standing" provision leading to a "free-standing" adjustment. It refers back to the taxable amount on which VAT was charged (Article 73). It assumes that VAT on the taxable amount has been accounted for.

103. In construing the word "adjust" in Regulation 38 (2) it is important to bear in mind its statutory context – it is not a provision drafted in isolation. Regulation 38 is part of Part V of the Regulations which deals with accounting, payment and records in respect of VAT. Regulation 32 imposes an obligation on traders to keep a VAT account and to record the total amount of input and output tax due for each period (Regulation 32 (3) (a) and (4) (a). Regulation 32 also requires adjustments to be made in respect of Regulation 38 (Regulation 32 (3) (c) and (4) (c). Regulation 32 is a mandatory requirement – a trader must account for input and output tax for each prescribed accounting period and must make every adjustment to the VAT payable portion required by Regulation 38. Regulation 32 imposes mandatory obligations upon a trader.

104. For completeness, Regulation 34 permits (but does not require) a trader to correct an overstatement or understatement in a return where, broadly, the error does not exceed £50,000. If the error is not corrected under Regulation 34, then it must be corrected under Regulation 35 in such manner and within such time as the Commissioners may require (see e.g. Notice 700/45/13).

105. It is against this statutory background that the requirement in Regulation 38 (2) that a trader must adjust its VAT account has to be construed.

106. In our view, the drafter of Regulation 38 must have made the assumption that a trader would have complied with the obligation in Regulation 32 to have correctly recorded its input and output tax for each period in its VAT account. In that context, the requirement to adjust a trader's VAT account in respect of increases and decreases in consideration presupposes that the VAT account already contains entries in respect of the transaction in the amount of the original consideration.

107. In argument, Mr Prosser drew attention to what he described as the absurd consequences which would follow from a requirement that no adjustment to the VAT account could be made under Regulation 38 unless VAT had previously been accounted for in the VAT account. For example, if in period 1 VAT had not been accounted for but in, say, period 3 there had been an increase in consideration then, according to HMRC, no adjustment in the VAT account would need to be made in period 3.

108. The answer to Mr Prosser's argument, as Mr Mantle pointed out, is that a trader is under a mandatory obligation (ultimately under Regulation 35) to correct earlier errors. Therefore, in Mr Prosser's example a trader would be required under Regulation 35 to correct the omission to account for the original transaction and to make the adjustment required by Regulation 38. This would admittedly still cause problems where the earlier omission was out of time to assess.

109. There is nothing in Community law which prohibits Member States imposing a requirement that before a negative entry in a VAT account (to reflect a decrease in consideration) can be made VAT on the initial supply should have been properly accounted for. We do not understand the comments made by the CJEU and/or the Advocate General in *Goldsmiths* and *EC Commission v Germany* as being an exhaustive description of the "conditions" that can be laid down by Member States.

110. For these reasons, subject to the claim issue and, although we consider the matter to be finely balanced, we reject BCT's Regulation 38 claim as originally formulated prior to the adjustment of its VAT account.

111. As we have seen, BCT did subsequently account for the original supply of vehicles in January 2012. We consider later in this decision the effect of this subsequent accounting on the Regulation 38 issue.

The bad debt relief issue

Submissions on the bad debt relief issue

112. Mr Prosser referred to his earlier submissions in relation to Article 90 and repeated them in respect of the bad debt relief provisions in Section 36 VATA.

113. In Mr Prosser's submission the words "has… paid VAT on the supply" in Section 36 (1) and the equivalent words in Regulation 167 (b) did not apply to output tax which, being offset by an equal amount of allowable input tax, was not actually payable at all. The purpose of this language in section 36 was not to preclude a refund because the trader had previously made a mere accounting error.

114. Mr Prosser gave the following example. If the taxpayer incurred an output tax liability of £100 in respect of the supply and correctly enters the output of his VAT account, together with £75 input tax allowable in respect of the purchase of the same goods in the same period, the taxpayer would be obliged to account for only £25 of output tax to HMRC for that period. If the recipient of the supply defaulted and failed to pay any of the consideration due, the taxpayer would be entitled to bad debt relief of £100 on making a claim. The taxpayer's entitlement to a refund of £100 was not affected by the fact that he did not pay £100 VAT in the first place.

115. Thus, Mr Prosser argued that in Section 36 (1) and Regulation 167 (b) the words "has…paid VAT on the supply" had to be construed purposively and meant "has paid VAT on the supply *insofar as the same is payable*".

116. Mr Prosser submitted that the same arguments applied to the words "accounted for" in Section 36 (1) and Regulation 167 (b).

117. Thus, in the present case, where BCT could show that output tax was not payable because it was matched by an equal amount of input tax, the entitlement to a refund was not conditional on BCT having previously entered the output tax in its VAT account or in its VAT return.

118. Mr Mantle submitted that Section 36 expressly required a claimant to have "accounted for unpaid VAT on the [relevant] supply". Therefore, output tax had to be recorded either in the VAT account or in the return.

119. BCT was required by regulations made under VATA (schedule 11 paragraph 6 (1)) to keep and maintain a VAT account. It should have accounted for VAT on its acquisition and supply of the vehicles but it had not done so.

120. In addition, Regulation 167 of the Regulations relating to the manner in which a claim for bad debt relief must be made required, inter alia, that before a person makes a claim he must hold documents showing that he has accounted for VAT on the relevant supply.

121. Mr Mantle argued that Mr Prosser's submissions appear to elide the concept of accounting for and paying VAT. HMRC's objection to BCT's bad debt relief claim focuses on the fact that BCT had not "accounted for" VAT on the original transactions. Accounting for VAT meant that both inputs and outputs had to be recorded, even if they were exactly equal amounts which resulted in a nil net figure. A nil net figure meant that no VAT was payable. The statutory approach was that output tax was payable unless input tax was claimed.

Discussion of the bad debt issue

122. In our view, the statutory language of Section 36 is clear. It requires that a trader "has accounted… for VAT" on the supply as a precondition to obtaining bad debt relief. It is a condition to the application of Section 36 (1), the provision which sets out the main requirements for bad debt relief.

123. We were not persuaded by Mr Prosser's arguments that those words should be qualified by inserting additional words "insofar as VAT was payable" into the statute. There seemed to us to be no good reason why these words should be read into the statute. To the extent that no VAT was actually payable on the original transactions (because output tax was equalled by input tax) then we respectfully adopt the reasoning of VAT and Duties Tribunal in *Times Right Marketing Ltd (In Liquidation) v HMRC* [2008] UKVAT 20611 which regarded output tax as having been "paid" where it was offset by an input tax credit (see paragraph 30). This, in our view, is the answer to Mr Prosser's objection to the requirement in Section 36 (1) that output tax must have been accounted for and paid in circumstances where there was no actual requirement to pay output tax because it had been fully offset by allowable input tax.

124. We observe, in passing, that the Tribunal in *Times Right Marketing* appear to have assumed (paragraph 29) that it was a prerequisite for claiming bad debt relief that VAT should have been accounted for on the relevant supplies.

125. Moreover, it seems to us entirely consistent with Article 90 that the requirement for accounting for VAT should be a condition of obtaining bad debt relief under Section 36 VATA. This requirement enables HMRC to ensure that tax is not refunded in circumstances where it had not been duly accounted for and paid on the original supply. There seems nothing objectionable in that requirement.

126. In our view, the same observations apply to Regulation 167 of the Regulations. We agree with HMRC's submission that Regulation 167 of the Regulations requires BCT to have accounted for VAT before it makes a claim under Section 36 for bad debt relief. Regulation 167 (b) provides:

> "the claimant, *before he makes a claim*, shall hold in respect of each relevant supply—
>
> (a) …
>
> (b) records or any other documents showing that he has *accounted for and paid the VAT thereon*…." (emphasis added)

127. It seems to us, therefore, that the reference to "he has accounted for… the VAT thereon" supports the view that a trader must have recorded the original supply in its VAT account before claiming bad debt relief.

128. Accordingly, subject to our views on the claim issue, we reject BCT's claim for bad debt relief as originally formulated prior to adjustment of its VAT account.

The claim issue

129. It will be seen from the above discussion of the Regulation 38 and bad debt relief issues that HMRC's objection to the granting of both reliefs was, in essence, that BCT had failed to account for the original acquisition and sale of the vehicles in its VAT account. For the reasons given above, we agree with HMRC on both issues.

130. BCT did, however, adjust its VAT account as recorded in the second letter (31 January 2012) and thereby accounted for VAT. HMRC did not, as we understand it, dispute the fact that BCT had, at last, properly accounted for VAT on the original acquisition and sales of the vehicles for the relevant periods. Nonetheless, HMRC continued to resist BCT's refund claims under Regulation 38 and Section 36 on the basis that both reliefs had been claimed before the transactions had been accounted for in BCT's VAT account. Mr Mantle submitted that Regulation 38 and Section 36 (and, in the case of the latter, Regulation 167 of the Regulations) required VAT to have been accounted for *before* a claim was made under those provisions.

131. Mr Mantle argued that in this case a claim under Regulation 38 and Section 36 had been made in the first letter (23 December 2010) and that VAT had only been accounted for at the time of the second letter (31 January 2012). Mr Mantle argued that the second letter did not constitute a claim but, rather, an amendment to an existing claim i.e. the claim made in the first letter. Mr Mantle did not appear to object to the form of the second letter – in other words, he did not seek to argue that the letter was defective because it was not in an appropriate form. Indeed, Mr Mantle accepted that the first letter was a claim, albeit one which did not give an entitlement to the requested reliefs because of the failure by BCT to account for VAT. Instead, he argued that the second letter was simply not a claim in its own right because it was merely amending an existing claim.

132. Although Mr Prosser, in his skeleton argument, made it clear that he was relying on the fact that BCT had, albeit late in the day, accounted for VAT in relation to both the Regulation 38 and Section 36 issues, HMRC's argument that the adjustment had been made too late (i.e. after the original claim had been submitted in the first letter) was not made explicit in HMRC's skeleton argument.

133. Mr Prosser did not, to his credit, object to HMRC raising this technical point – which Mr Prosser described as a "snakes and ladders" argument – and it was agreed that the parties would deal with the issue in written submissions after the hearing and, in particular, with the issue whether the second letter constituted a claim or an amendment to a claim.

134. The parties agreed that the claim issue should be dealt with by written submissions after the hearing.

Submissions on the claim issue

135. Mr Prosser argued that HMRC's objection to the second letter as a valid claim was artificial and unrealistic. BCT had made a claim in the first letter but HMRC had said that the claim was defective because BCT had not accounted for the relevant

supplies in its VAT account. BCT had then corrected the alleged defect by recording the supplies in its VAT account and then repeated its claim under Regulation 38 and Section 36. This was a sensible and practical approach

136. Mr Prosser referred to 2 relevant authorities in relation to the meaning of the word "claim." First, in *Marks and Spencer plc v Revenue & Customs* [2009] UKFTT 64, the taxpayer had made a claim for group relief in 2003 and another claim in 2007. HMRC argued that at the time the 2003 claim had been made the taxpayer was not entitled to group relief (because the taxpayer had not satisfied the test in an earlier CJEU decision that there were no other possibilities for the losses in question to be taken into account at the date of the group relief claim). Nonetheless, HMRC argued that the claim was a valid claim (albeit one which did not carry an entitlement to relief) which precluded the making of the 2007 claim because only one claim could be made. The Tribunal dismissed HMRC's argument as "illogical" in the following words:

> "36. We have found that at the time the first claims were made MSG and MSB could not satisfy the no-possibilities test. Accordingly, no valid claim for group relief could be made at that time. Mr Ewart was contending at the same time that it was a valid claim but that the Appellant was not entitled to any group relief. We think this is illogical. If the no-possibilities test is not satisfied there can be no entitlement to group relief and so the claim did not validly claim anything."

137. Mr Prosser suggested that HMRC's argument (i.e. a valid claim was made before the adjustment to the VAT account) was also illogical. If HMRC were correct that BCT could not claim a Regulation 38 adjustment or bad debt relief at the time of the first letter because it had not accounted for the original supplies it must follow that the first letter was not a valid claim. Accordingly, the second letter could not be an amendment to a claim but was, instead, a valid claim in its own right.

138. Secondly, Mr Prosser referred to the decision of the Upper Tribunal (Roth J) in *Reed Employment Ltd v HMRC* [2013] UKUT 0109. In that case the Upper Tribunal had to decide whether a demand for a repayment of overpaid VAT made in 2009 was a new claim under section 80 VATA (in which case it was out of time), or whether it was simply an amendment to an earlier claim (which had been made in time). Roth J held that:

> (1) "claim" should be given its ordinary meaning, absent any statutory definition (paragraph 31);
>
> (2) in context a claim was "a demand for repayment of overpaid tax";
>
> (3) what is an amendment is very much a question of fact and degree, judged by reference to the particular circumstances (paragraph 33);
>
> (4) a further demand is an amendment if it arises out of the same subject matter as the original claim, without extension to facts and circumstances that fall outside the contemplation of the earlier claim (paragraph 33)

(5) examples of an amendment would include the correction of arithmetical errors or the omission of some supplies which were clearly intended to be included. A further example of an amendment would include a claim which is made but where the taxpayer does not have full details or documentation but submits its further details and documentation at a later stage, that later submission would not be a new claim.

(6) The issue was one of substance rather than of labels (paragraph 35). Even if the demand is drafted in the form of an amendment it will not be an amendment if it is not an amendment in substance.

139. Mr Prosser argued that the second letter was a "claim". It demanded a refund of separately specified and calculated amounts of VAT. The letter stated "this claim should now be repaid", later, "the total amount of bad debt relief now claimed".

140. Mr Prosser submitted that the second letter plainly intended to remedy the alleged defect of the first letter by making it clear that BCT had now accounted for VAT on the supplies. The second letter made it clear that BCT must have intended the second letter to be a claim not merely an amendment to an existing flawed claim.

141. Furthermore, in reliance on the *Marks & Spencer* decision Mr Prosser submitted that if the first letter was not a valid claim it could not be amended. It followed that the second letter, which was also a demand for a refund of VAT, could only take effect as a claim in its own right.

142. Mr Mantle argued that the second letter was simply an amendment to the original claim. It related entirely to the subject matter of the original claim (albeit excluding part of it) and there was no extension. The second letter recalculated and reduced the quantum of the original claim by modifying the original methodology.

143. As regards *Marks & Spencer* Mr Mantle argued that it did not follow from the reasoning in that decision that where a claimant has made a claim which does not comply with the statutory requirements that something which, viewed objectively, was an amendment to an existing claim was to be treated as a new claim on the basis that the first claim was a "nothing". The second letter was in reality an amendment to the original claim made by the first letter.

Discussion of the claim issue

144. We have carefully considered the arguments raised in respect of the claim issue. We have reached the clear conclusion that HMRC's arguments on this issue are without merit.

145. We consider the logic behind Mr Prosser's argument based on *Marks & Spencer* to be unassailable. HMRC had argued, in relation to the first letter, that BCT's claim could not be accepted because it did not, in their view, meet the statutory criteria, viz that the Regulation 38 adjustment and the Section 36 bad debt relief claim could only be validly made if BCT had accounted for the original supplies in its VAT account. In effect, HMRC were stating that BCT had made an invalid claim. To the extent that

HMRC were in substance repeating the submission made in *Marks & Spencer* that the first letter was a valid claim but was a claim which did not give rise to an entitlement to relief that seems to us a distinction without a difference or, as the tribunal said in that case, it was a proposition devoid of logic. If it was an invalid claim then either it was not a valid claim at all or the second letter, which satisfied the statutory requirements, was a valid claim in its own right and was not an amendment to a flawed claim.

146. The second letter acknowledged the defect in the first letter (albeit in effect on a without prejudice basis). The second letter then claimed the two reliefs and made it clear that BCT had adjusted its VAT account to account for the original HP transactions. This was not merely an amendment to an existing claim but, rather, a claim on a different basis. It is true that the subject matter of the claim was the same (subject to minor amendments) but the legal basis on which the claim was made was different. It was not merely a matter of arithmetical amendments or provisional claims pending documentation or information. Instead, it was a claim made on the basis that an essential statutory condition, which HMRC had previously maintained had not been met, had now been satisfied (albeit that in relation to Regulation 38 BCT continued to argue that accounting for VAT was not strictly necessary).

147. Furthermore, we are inclined to agree with Mr Prosser's characterisation of HMRC's eleventh hour submissions on the claim issue as a "snakes and ladders" point.

148. Put in more judicial language, it seems to us that the rights conferred by Article 90 of the Directive reflect fundamental principles which underlie the working of the VAT system. In other words, VAT is only to be charged on the actual consideration eventually paid for the relevant supply, subject to the right of Member States to impose conditions which enable them to monitor and ensure compliance (see *Goldsmiths* and *EC Commission v Germany*) as discussed above. HMRC's "claim/amendment to claim" argument seemed to pay scant regard to this fundamental right.

149. The relevant "condition" imposed by the UK in this case was the need for the trader to reflect the original supplies in its VAT account. It seems to us, however, that such a fundamental principle - that VAT should only be charged on the actual consideration (as increased or decreased), a principle enshrined in Article 90 - should not be undermined by procedural requirements that go further than the need to monitor and ensure compliance. In this case, there is no suggestion that BCT failed to pay the VAT that was required of it in respect of the original transactions. Those transactions produced a net zero result in VAT terms, with input tax equalling output tax. No tax has been lost and at no stage has HMRC suggested that tax has been lost. HMRC have accepted that if BCT had made what are, effectively, self-cancelling entries in its VAT account then at the outset it would have been entitled to the reliefs claimed. We have held that HMRC, in accordance with Regulation 38 and Section 36, could require that BCT entered these self-cancelling (in VAT terms) transactions in its VAT account in order to ensure compliance so that HMRC is not placed in a position of having to refund VAT which it cannot ascertain has previously been accounted for

appropriately. To go further and require that BCT satisfy the requirements for relief before claiming and, then, once they have satisfied the requirements for relief to deny them that relief because they have already claimed unsuccessfully seems to us more akin to the application of some of the finer points of Mediaeval theology than giving effect to a fundamental principle of the VAT Directive. For this reason also, we cannot accept HMRC's argument.

150. Finally, we have taken account of the recent decision of this tribunal in *Bratt Auto Services Ltd & Bratt Auto Contracts Ltd v HMRC* [2014] UKFTT 676 (TC) (Judge Berner) which was published after the hearing and do not consider that it affects the conclusions we have reached. In particular, BCT's Regulation 38 claim appears fully to satisfy the requirements for a claim under Section 80 VATA in accordance with Regulation 37 of the Regulations, as interpreted in that decision.

Decision

151. In summary, we have decided:

(1) that the supply to BCT of specialist repossession services and legal services in relation to repossession were received by BCT for the purposes of selling the vehicles at auction (excluding those exceptional instances in which a vehicle was scrapped on repossession) and was therefore directly attributable to taxable supplies;

(2) that for the purposes of Regulation 38 and Section 36 it was necessary in order for BCT to make, respectively, a valid adjustment and claim that it should have entered the original purchase and sale of the vehicles in its VAT account. Accordingly, HMRC were right to reject BCT's claim for relief in the first letter.

(3) Finally, once BCT had entered the above transactions in its VAT account, its claim for an adjustment under Regulation 38 and for bad debt relief under Section 36 was a valid claim and was not an amendment to an existing claim. Therefore the claims to relief under Regulation 38 and Section 36 contained in the second letter should have been allowed.

152. We therefore allow this appeal.

153. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision 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.

GUY BRANNAN

TRIBUNAL JUDGE
RELEASE DATE: 1 August 2014