



TC05342

Appeal number: TC/2015/06150

*VAT – bad debt relief – time limit for making claim – cash accounting –
whether adopted – appeal dismissed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

THORNE MOTOR COMPANY

Appellant

- and -

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

**TRIBUNAL: JUDGE JONATHAN CANNAN
DEREK ROBERTSON**

Sitting in public in Leeds on 27 May 2016

Mr Roy Humphries, partner for the Appellant

Mr Bernard Haley of HM Revenue & Customs for the Respondents

DECISION

Background

1. The Appellant is a partnership between Mr Roy Humphries (“Mr Humphries”) and his brother. The appeal concerns a decision by the Respondents to refuse a claim for bad debt relief. The circumstances are not straightforward and we set them out in detail below. Essentially the issue on this appeal is whether a claim for bad debt relief was made outside the statutory time limits. The appeal also raises issues concerning the cash accounting scheme for VAT.

2. In outline, the Appellant has for many years carried on business in Doncaster servicing and repairing motor vehicles. In or about September 2006 the Respondents issued an assessment to output tax in the sum of £40,962 for VAT periods 09/03 to 03/06. Following a review the assessment for period 09/03 was withdrawn as being out of time. The resulting assessment for periods 12/03 to 03/06 totalled £36,953 (“the Assessment”).

3. The Assessment related to output tax on work that had been done but not invoiced to or paid by customers. Over a period of several years the Appellant had failed to invoice customers for up to 2,000 jobs. We set out the reason for that state of affairs below.

4. In 2015 the Appellant appointed Townends, chartered accountants to bring its VAT affairs up to date. Townends submitted a VAT return for period 06/11 on 12 February 2015. By then there were a large number of tax returns outstanding going back to 2011. The 06/11 return included a claim for bad debt relief of £30,681 relating to supplies in periods 12/03 to 03/06. HMRC enquired into the claim and it was refused by letter dated 7 April 2015 on the basis that the claim was out of time. The decision to refuse the claim was upheld in a review letter dated 21 August 2015.

5. Mr Humphries has dealt with HMRC throughout the period giving rise to the present appeal and he appeared before us at the hearing. He lodged an appeal against the decision refusing the claim on 2 October 2015. It was a few days out of time but HMRC did not object to the appeal being made out of time and we extend time accordingly. The grounds of appeal were essentially as follows:

(1) The Assessment should never have been made because the Appellant was entitled to use the cash accounting scheme in the periods covered by the Assessment. On that basis output tax would not have fallen due in relation to work that had been carried out in those periods but was unbilled and unpaid.

(2) Mr Humphries was unaware of the time limit for making a claim to bad debt relief and in his dealings with various HMRC officers in 2006 and 2007 they failed to make him aware that there was a time limit.

6. Mr Humphries gave evidence on behalf of the Appellant. Mr Haley who appeared for the Respondents did not take issue with Mr Humphries evidence and we

set out below our findings of fact. Before doing so we set out some of the relevant provisions in relation to cash accounting and bad debt relief.

Cash Accounting and Bad Debt Relief

7. In general businesses account for output tax and input tax by reference to the date goods or services are supplied or the date an invoice is issued rather than the date payment is received or made. That is subject to:

- (1) provisions for businesses to take advantage of the “Cash Accounting Scheme” pursuant to which output tax and input tax are accounted for at the time payment is received or made; and
- (2) provisions for bad debt relief where output tax has been accounted for but the customer fails to pay for the goods or services in whole or in part.

8. Cash accounting is governed by regulations made pursuant to paragraph 2(7) Schedule 11 Value Added Tax Act 1994 (“VATA 1994”), namely regulations 56-65 Value Added Tax Regulations 1995 (“the Regulations”). Regulation 57 provides that the cash accounting scheme is subject to conditions described in a notice published by the Commissioners, which is Notice 731.

9. Regulation 58 provides that a person is eligible to operate the scheme if, amongst other conditions, he has made all returns and paid all sums due on those returns and on any assessments or has agreed an arrangement for any outstanding sums to be paid in instalments over a specific period. It also provides that a person is not entitled to commence operating the scheme if the Commissioners consider that it is necessary for the protection of the revenue that he should not be so entitled.

10. Notice 731, which in the relevant parts has the force of law, provides for additional record keeping requirements. In particular records must be maintained clearly cross-referencing payments made and received to the corresponding sales and purchase invoices. It also provides that a trader cannot retrospectively use the scheme to account for VAT.

11. Bad debt relief is governed by s.36 VATA 1994 and regulations made under that section. It provides as follows:

“ 36(1) Subsection (2) below applies where -

- (a) a person has supplied goods or services [...] 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.”

12. Relief is given only upon a claim being made. Regulation 165A of the Regulations provides a time limit within which a claim must be made as follows:

“ (1) Subject to paragraph (3) and (4) below, a claim shall be made within the period of 4 years and 6 months following the later of –

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

(b) the date of the supply.

10 (2) A person who is entitled to a refund by virtue of section 36 of the Act, but has not made a claim within the period specified in paragraph (1) shall be regarded for the purposes of this Part as having ceased to be entitled to a refund accordingly.”

13. The period of 4 years and 6 months in regulation 165A(1) applied with effect from 1 April 2009. Prior to 1 April 2009 the time for making a claim was 3 years and 6 months after the latest date specified in (a) and (b). Hence, for a supply in December 15 2003 where the price became due and payable in December 2003 the time limit for making a claim to bad debt relief was June 2007.

Findings of Fact

20 14. The Appellant has been registered for VAT and has carried on business since 1980. The business continues to this day, albeit at a much reduced level. Mr Humphries looks after the administration side of the business. His brother is a “hands on” mechanic and was supposed to fill in a job card for each job setting out the parts used and work done. Mr Humphries used the job cards to bill customers however his 25 brother could not be relied on to properly complete the job cards.

15. Mr Humphries’ mother suffered from multiple sclerosis. She had been housebound for some years and suffered from dementia but Mr Humphries was determined to look after her at home rather than see her go into a nursing home.

30 16. Mr Humphries used a simplex cashbook to keep track of the Appellant’s income. However because of his personal circumstances he found it more and more difficult to keep on top of the invoicing to customers. In particular a large number of invoices were not issued to customers which meant that they did not pay the sums owed.

35 17. The Appellant’s VAT returns for periods 09/03 to 03/06 included claims for input tax credit on parts purchased. Output tax was accounted for on jobs invoiced to customers but only when paid. No account was taken of output tax on supplies which had not been invoiced. The result was that in each of those periods the returns showed a net amount due to the Appellant which was paid by HMRC.

18. In or about September 2006 Mr C Mitchell, a VAT officer made a visit to the Appellant to enquire into the Appellant's VAT records. He identified the reason the Appellant had consistently claimed repayments of VAT. In a letter dated 6 September 2006 he pointed out that "under the normal accounting procedure" adopted by the
5 Appellant output tax became due at the tax point, which in the circumstances was the date the work was done. He also referred to the cash accounting scheme as follows:

10 " ... It would have been open to you to use the cash accounting scheme under which you do not account for VAT until you are yourselves paid by the customer, but this requires the keeping of a proper cash book or similar record in which payments received are cross-referenced to the jobs and invoices to which they relate."

19. Mr Humphries suggested in a letter dated 11 June 2015 that Mr Mitchell had told him at this visit that he would not permit the Appellant to use cash accounting until 1 April 2007. We did not have the benefit of hearing from Mr Mitchell but it seems to us that this is unlikely. Mr Mitchell does not refer to it in his letter dated 6
15 September 2006. Further, as will be seen below the possibility of the Appellant using cash accounting with effect from 1 April 2007 was referred to by Mr Mitchell in his letter dated 12 February 2007. It seems to us that the Appellant's recollection in this regard is unreliable.

20. Mr Mitchell went on to estimate the value of sales in the periods 09/03 to 03/06 from the known value of parts purchased. This gave rise to his original assessment of £40,962, later reduced to £36,953. Mr Mitchell gave Mr Humphries an opportunity to make any further representations before making his assessment but there is no evidence that any representations were made.

21. The Respondents did not challenge Mr Humphries' evidence that it was
25 accounting for output tax by reference to payments received and we accept that was the case. However it is not clear how Mr Humphries accounted for the Appellant's input tax in the periods 09/03 to 03/06. The point had not previously arisen but Mr Humphries told us that a credit was only included in a return if the purchase invoice had been paid. If that is right then the Appellant was operating what in substance was
30 the cash accounting scheme, albeit without maintaining proper records. However Mr Mitchell's letter referred to the Appellant operating the "normal accounting procedure". In the absence of the underlying records or any other documentary evidence we cannot be satisfied how the Appellant accounted for input tax.

22. The correspondence available to us for the period following Mr Mitchell's letter
35 dated 6 September 2006 is not complete. Mr Mitchell made his assessment and we can see that the review followed on 22 January 2007. The review was conducted by Mrs Heather Gibbs. She noted that the assessment for period 09/03 was out of time but otherwise confirmed the Assessment in the reduced figure of £36,953. Mrs Gibbs also considered an associated misdeclaration penalty. She gave full mitigation for the
40 circumstances in which Mr Humphries had been running the business and reduced the penalty to £2,717.

23. Mrs Gibbs' review letter also referred to bad debt relief as follows:

“ I note from your letter of 22 September 2006 that you consider that some of the amounts owing by customers for work done will not be paid.

5 I would point out that, in order to claim relief from VAT on bad debts, certain conditions, set out in paragraph 18.5 of VAT Notice 700 ‘The VAT Guide’, must be met. In brief, such relief may only be claimed on debts which are more than six months old and for which:

- the VAT was paid to HM Revenue and Customs;
- the debt has been written off in your accounts; and
- notification has been sent to the customer.

10 No such relief is immediately available to your business until and unless these conditions are met.”

24. This is the first reference to bad debt relief in the documents we have seen and it appears to have been raised by Mrs Gibbs. The requirement to send notification of a claim for bad debt relief to the customer in fact only applied to supplies made prior to
15 1 January 2003 and where the customer was registered for VAT. Mrs Gibbs did not identify the time limit for making a claim but it was referred to in Notice 700.

25. The letter also set out the Appellant’s right of appeal to the VAT & Duties Tribunal. The Appellant did not appeal the Assessment.

20 26. Mr Mitchell carried out a further visit on 12 February 2007. He wrote on the same date in order to clarify for Mr Humphries what needed to be done in the future regarding record keeping and accounting for VAT. In relation to the periods covered by the Assessment he stated as follows:

25 “... If your customer fails to pay you, then you are eligible for bad debt relief. However, in the circumstances we would expect to be able to distinguish clearly in your records those which had been paid and which had not, and to see some evidence that you had sought and failed to obtain payment. ”

27. Mr Mitchell did not refer to the specific conditions for bad debt relief. That is most likely because he was aware that Mrs Gibbs had already referred Mr Humphries to Notice 700.

30 28. Mr Mitchell noted that since his first visit the Appellant had continued to account for VAT only on work invoiced, although more work appeared to have been invoiced than had previously been the case. He said that he was prepared to allow the returns submitted on that basis for periods 06/06, 09/06 and 12/06 to stand without amendment. However he stated that Mr Humphries should ensure that all work done
35 between 1 April 2006 and 31 March 2007 and not already invoiced should be invoiced, or at least priced, by 31 March 2007 and output tax accounted for in the return for period 01/07. That appears to have been an error and he must have been referring to period 03/07.

29. In relation to cash accounting Mr Mitchell stated as follows:

“We agreed that you could formally commence to use the cash accounting scheme with effect from 1 April 2007.

5 From that date you will need to record the work done in each tax period, showing details of invoicing and payment, and accounting for output tax on the work which has been paid for during the quarter ...”

30. In June 2007 Mr Humphries’ mother died. Shortly afterwards Mr Humphries own health deteriorated. He was diagnosed with emphysema and he had various other medical issues. His brother also became ill and they considered closing the business
10 but his brother wanted to continue being self employed so that he could help with his son, who has cerebral palsy. Later that year Mr Humphries was diagnosed with oesophageal cancer and he underwent chemotherapy.

31. On 25 July 2007 Mr Humphries wrote to HMRC at Dean Clough, Halifax apparently in connection with the VAT then outstanding. In that letter he referred to
15 various payments which he had made totalling £15,000. He hoped to clear the balance within 6 months depending on how soon customers responded to the invoices he was sending out. He added:

20 “Obviously, once all the invoices have been produced we will then know how true the assessment was and any adjustments can then be made. Then after six months there may well be the matter of bad debt relief to consider.”

32. The reference to 6 months must have been a reference to Mrs Gibbs’ letter which in turn appears to be a reference to s.36(1)(c) VATA 1994 quoted above. Mr Humphries appears to have misunderstood the reference because it refers to the
25 condition for bad debt relief that it only applies 6 months after the date of supply which had already passed. Mrs Gibbs’ letter does not appear clear in that regard.

33. In or about November 2008 the Appellant took on an employee working 30 hours per week to help with invoicing customers, including the backlog which existed at that time. The employee tried his best to contact old customers but was generally
30 told that there was no chance the bills would be paid. He did manage to invoice sums including output tax of £6,271 referable to the periods covered by the Assessment.

34. In the period from March 2008 to November 2013 no VAT returns were submitted by the Appellant. We understand that central assessments and default surcharges were issued. In Mr Humphries mind he had more than £30,000 worth of bad debt relief to set off against the liabilities.

35. Mr Humphries wrote to HMRC Debt Management Unit on 8 March 2010. It
35 seems that by that date there was a sum of £12,788 outstanding. Mr Humphries paid £4,000 towards that amount which he said was all he could afford as he had been unable to recover much of the sum outstanding from customers. He added that “ ... much [of this] will have to be reclaimed bad debt relief”.

36. During 2010 and 2011 Mr Humphries spoke with a number of HMRC staff in connection with the sums outstanding and in connection with outstanding returns. Whilst there was no record of these conversations we have no reason to doubt Mr Humphries' evidence that the officers were made aware that there would be a claim to bad debt relief in relation to the Assessment.

37. In early 2015 the Appellant appointed Townends to act in relation to VAT matters. Townends had been the Appellant's accountants since the 1980's although they had not previously been instructed in relation to VAT. Townends submitted the return for 06/11 and it prompted a further VAT visit by Miss Trayer, a Higher Officer of HMRC. Following that visit Townends wrote to Miss Trayer. They referred to what Mr Mitchell had said about accounting for output tax in the period 1 April 2006 to 31 March 2007 in the return for period 03/07. They argued that if Mr Humphries had been able to issue all outstanding invoices by 31 March 2007 then a large number would likely not have been paid and the latest date to claim bad debt relief in relation to those invoices would have been in the 06/11 return. In completing the return for 06/11 they had included a claim for bad debt relief of £30,681 being the amount of the Assessment less the sum invoiced to customers by the new employee of £6,271.

38. Miss Trayer refused to make any adjustment in relation to the Assessment on the basis that it was final, and had not been appealed. She also refused the claim for bad debt relief for which she said the time limit was 4 years 6 months from the basic tax point, which was the date the services were supplied. The bad debts were incurred in relation to supplies which took place in the period July 2003 to March 2006. She considered that the latest date by which a claim could be made in relation to any of those supplies was 30 September 2010.

39. Miss Trayer's decision was upheld in a review letter dated 21 August 2015. Essentially the review officer considered that Mr Humphries ought to have made himself aware from Notice 700 that there was a time limit for making a claim to bad debt relief. The review officer also referred Mr Humphries' correspondence in connection with the review to HMRC's complaints team. The complaint was rejected on the same basis.

Reasons

40. We have no doubt that in submitting the return for period 06/11 including a claim for bad debt relief, Townends were seeking a pragmatic solution to the problem faced by the Appellant. They were seeking to obtain bad debt relief for the output tax included in the Assessment. However we must consider whether, as a matter of law, the Appellant was entitled to make such a claim.

41. In the period following the Assessment Mr Humphries understood that everything would sort itself out when he was able to claim bad debt relief. Unfortunately he was not aware that there was a time limit for making a claim.

42. Mr Humphries criticised Mrs Gibbs and Mr Mitchell for failing to point out in January and February 2007 that there was a time limit for making a claim to bad debt

relief. We do not consider that is a fair criticism. It is true that a claim for bad debt relief in relation to output tax assessed on supplies made in 12/03 would have to be made by June 2007, assuming the consideration had become payable in December 2003. That is the effect of regulation 165A(1). Mr Humphries intended to issue
5 invoices for the unpaid debts, attempt to recover them and then write them off. Mr Mitchell and Mrs Gibbs were not to know that Mr Humphries' personal circumstances would result in him being unable to issue invoices for period 12/03 by June 2007. Mr Humphries himself described these as "unforeseen events". For later periods the time limit would be correspondingly later. Hence for supplies in period 03/04 the time limit
10 for a claim would expire in or about September 2007 and so on.

43. Mrs Gibbs wrote to the Appellant on 22 January 2007 drawing attention to the existence of conditions for bad debt relief and referring Mr Humphries to Notice 700. We consider that there was an onus on Mr Humphries to consult Notice 700 himself or to ask HMRC for a copy. If he had done so then he would have identified the time
15 limit for claiming relief. We can understand that the reason he did not do so was the difficulty he had looking after his mother and administering the business. When Mr Mitchell visited on 12 February 2007 the Appellant had already been referred to Notice 700. It is not clear what discussion there was about bad debt relief at that meeting but in his letter of the same date Mr Mitchell indicated that he would want to
20 see evidence in support of a claim to bad debt relief.

44. Mr Humphries also criticised the officers he spoke with in 2010 and 2011 for not telling him that there was a time limit for making a bad debt relief claim. Those officers were concerned with the unpaid VAT liability and the non-submission of returns. We have not seen any material to suggest that they should be expected to
25 have had sufficient knowledge of the Assessment and its circumstances to alert Mr Humphries to the time limit for making a claim. Indeed by then the time limit had expired for making a claim in relation to most of the supplies in the Assessment.

45. Regulation 165A(2) is clear. Failure to make a claim within the time specified means that the Appellant is to be regarded as having ceased to be entitled to a refund.
30 We have no jurisdiction to waive that provision even though we can sympathise with Mr Humphries' position.

46. Miss Trayer in her letter dated 7 April 2015 drew Townends' attention to the possibility of appealing the Assessment out of time. She did so because they appeared to be challenging the Assessment itself. Townends argued in correspondence that the
35 Assessment was wrong in law because there was no consideration for the supply of the Appellant's services. They relied on s.5(2)(a) VATA 1994 which states that the term "supply" ... includes all forms of supply, but not anything done otherwise than for consideration". We do not consider that argument is tenable. The Appellant provided its services to customers for consideration. It did not do anything otherwise
40 than for consideration. The fact is that the consideration was not paid and in those circumstances the Appellant must rely on bad debt relief but it is now out of time to make a claim.

47. Mr Humphries in his grounds of appeal also appears to challenge the Assessment on the basis that he was operating cash accounting. The parties did not address us on whether time should be extended to appeal against the Assessment. For the reasons stated above we are not satisfied that the Appellant was operating cash accounting in periods 12/03 to 03/06. In particular there was no evidence as to the basis on which it was accounting for input tax on purchases. Further there was no evidence that the Appellant had made any attempt to maintain the records required by the Regulations. Mr Humphries did not suggest that in 2003 to 2006 he was aware of the cash accounting scheme. It seems likely that he was not aware of it. Mr Mitchell made the Assessment on the basis that the Appellant was operating “normal accounting procedure” and Townends did not suggest in their later correspondence that it had been wrong to do so.

48. Against that background we cannot see that the Appellant would have any realistic prospect of challenging the Assessment and we would have refused any application to extend the time for appealing.

49. Finally, it appears that sums owed by the Appellant to HMRC include some £7,000 of default surcharges referable to periods after 2007. During that period Mr Humphries was suffering the personal difficulties briefly described above. The present grounds of appeal do not cover those surcharges. Mr Haley fairly offered to write to the Appellant following the hearing setting out how it should go about appealing those surcharges out of time on the basis of a reasonable excuse.

Conclusion

50. We have considerable sympathy for the position of the Appellant. Throughout the period from January 2007 onwards Mr Humphries intended to claim bad debt relief. It came as a body blow to him when he was told by Miss Trayer in April 2015 that the time limit for making a claim had expired.

51. However, for the reasons given above we are satisfied that the claim was out of time. We regret that in those circumstances we cannot give effect to the claim and we must dismiss the appeal.

52. 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.

**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 24 AUGUST 2016