[2019] UKFTT 144 (TC)

TC07010

Appeal number: TC/2013/06798

VALUE ADDED TAX – bad debt relief (BDR) – when consideration for supply of services received – when consideration due and payable – whether amounts outstanding 6 months after time of supply – whether claims for BDR in time – whether procedural requirements for BDR met including maintenance of refund of bad debts account and writing off of debts to that account – appeals dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

REGENCY FACTORS LTD	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE RICHARD THOMAS

Sitting in public at Alexandra House, Manchester on 30 October 2018

Nigel Gibbon of Nigel Gibbon & Co for the Appellant

Mrs Ann Sinclair, litigator, HM Revenue and Customs, for the Respondents

DECISION

1. This was an appeal by Regency Factors Ltd ("the appellant") against VAT assessments withdrawing bad debt relief included in its returns. The appellant in the course of its business described in more detail below makes only one type of supply on which VAT is chargeable, the supply of factoring services to its clients. It issues a VAT invoice for these services when a client assigns invoices of its own to the appellant which it wished the factor to collect and accounts for the VAT to HMRC on the basis that the time of supply is the issue of the invoice. An important issue in this case is whether it also receives payment of the consideration at the time of the issue of the invoice.

Facts

The witnesses and the documents

2. I had a ring binder of documents containing correspondence between the parties. I also had two witness statements from Mr John Farrell, Group Chief Executive of the appellant, to which were appended two further ring binders of documents. I have no hesitation in accepting Mr Farrell's evidence as truthful and credible, but as is often the case with witnesses so close to the issues there were opinions expressed in the statement relating to the matters which it is the Tribunal's function to decide on and I have ignored those opinions.

3. I also had a witness statement from Ms Tara Munir, a Senior Officer in HMRC's Wealthy/Mid-sized Business Compliance section and who described the HMRC compliance check and exhibited the correspondence. I also accept Ms Munir's evidence which was not in dispute.

Mr Farrell's first witness statement: the appellant's operations

4. So far as the method of operation of the appellant and the basis for its accounting procedures is concerned I draw the following account from Mr Farrell's witness statement and his oral evidence.

5. The appellant was formed in October 1991 and was registered for VAT. It acts both as holding company for the group and as a trading company.

6. The appellant's business is factoring invoices of, and providing funding or finance to, its clients (who are also called in contracts its "suppliers"). The factoring service is "with recourse" which means that the appellant is entitled to require the client to "repurchase" (Mr Farrell's word) the debt from the appellant should the appellant's efforts to collect the debt fail.

7. The basic factoring service provided involves the client "selling" (Mr Farrell's word) invoices issued by it to customers to the appellant. The appellant then takes over the collection of the debt due from the client's customers, including recovery action. The customer is aware of the appellant's role as the invoice bears a notice of assignment to the appellant.

8. Mr Farrell explained the mechanics of the factoring and funding services by way of a chronology of a typical with recourse factoring agreement:

(1) The client enters into the agreement

(2) The client submits schedule of invoices to the appellant with a view to obtaining funding.

(3) The invoices are stamped with a notice of assignment and certain items are selected for verification.

(4) The appellant makes an advance (Mr Farrell puts the words "a loan" in brackets after "advance") "against the value of the invoices less [the appellant's] charges".

(5) In the normal course of its business the appellant collects the invoice value from the customer on the due date.

(6) When a debt is outstanding the appellant carries out its credit control procedures.

(7) When the debt is collected, the balancing sum, ie "the invoice value received, less the initial purchase percentage" is repaid to the client.

9. Mr Farrell also explained the accounting system used by the appellant to record the events at each stage. There are in effect two separate and distinct ledgers maintained by the appellant, the Overall Sales Ledger ("OSL" – my abbreviation) which reflects the client's business with its customers and the Factoring Current Account ("FCA") which reflect the appellant's account with the client. Both the OSL and the FCA are shown on the same client financial screen in the appellant's computerised accounting system, which they call an F15.

10. In addition they maintain a Customer Sales Ledger ("CSL") for each customer of each client. But the FCA shows the cumulative position for all customers of the same client.

11. From Mr Farrell's detailed account of the way the FCA works, illustrated by him with reference to a printout of sample F15s and to a simple example which assumes no other transactions, I find (after making some inferences where his description is unclear or inconsistent) the following facts.

(1) Every time a client submits a batch of invoices the OSL amount increases and each CSL increases.

(2) Such an increase also increases the amount available of funding.

(3) Once the information from the invoices had been input and the invoices themselves scanned and selected invoices verified with the customer, the system applies charges to the FCA. In Mr Farrell's example the charge is 3% of invoice value.

(4) The charges are shown under the heading "Commissions/fees" and because they are VATable the applicable VAT at the standard rate is added under the heading "VAT".

(5) The available funding is calculated. Typically the system calculates it as 80% of the approved debt (some debt eg old debts may not be approved as backing funding and there may be overall limits) less the charges including VAT. Thus on the example of one invoice for £1,000 acquired, the available funds are calculated as £1,000 x 80% - £36 (3% of £1,000 plus 20% VAT) ie £764.

(6) If the client wished to drawdown this facility they will receive an advance of £764 and the FCA will be debited.

(7) The appellant then carries out its normal collection procedures including calling the customers, issuing dunning letters and sending statements.

(8) The final step in the normal collection procedure is to allocate the funds collected. They are allocated on two separate ledgers. The first is CSL where the fund are allocated to the relevant invoice. The second is the OSL for the customer concerned. Where the £1,000 is collected, the OSL is reduced by £1,000 and the approved funded figure reduced by £800. The FCA with the customer would then stand at -£200 (£764 + £30 + £6 - £1,000) and the approved funds become £200. That amount represents the "retention" due to the client, £800 having been used to repay the £764 and the charges of £30 plus VAT. (Mr Farrell's statement uses the word "repaid" in respect of all the amounts).

12. Mr Farrell adds, "for the avoidance of doubt" that what has happened is that the client has issued an invoice to its customer for £1,000 and has received two payments, £764 being the initial advance and £200 the "retention payment". The difference between £1,000 and £964 is the charge for services plus VAT.

13. In a further analysis of the FCA Mr Farrell says that:

> "it is clear however that within the [FCA] there is no allocation of funds against particular invoices. Instead when invoices are received (as part of a schedule) then an advance will be made to the client (a lend) that sum is debited to the [FCA].
>
> Likewise on receipt of an invoice schedule a charge is applied to the Current Account in respect of [the appellant's] service charge. As the service charge attracts VAT Regency likewise applies the VAT element to the Current Account.
>
> Accordingly if no collections are received from the Customers then there is an outstanding balance to [the appellant] which represents the total outstanding balance due under the factoring agreement (without any early termination fees and the like."

14. Subsequently in his witness statement Mr Farrell considered various examples of failures to collect the full amount with a view to establishing that the amounts the appellant claimed as bad debt relief ("BDR") are accurate. In his first example a sum of £52,473 has been allocated as charges to the FCA excluding VAT, which is £9,135.52. Advances made were £458,990 and collections £500,480. Thus, says Mr Farrell, as the appellant had collected more that it paid the client:

> "we *must have therefore* recovered our capital. The resulting balance of £19,718 *must therefore* be in respect of our charges and the VAT on those charges".

(My emphasis – I do not, at this stage, find it as a fact that it necessarily follows that in this example all capital had been recovered and that the shortfall is therefore attributable to the charges after recovery of capital).

15. He further makes the point that:

> "As set out above the [FCA] is a running account balance accordingly there is an admixture of funds and it is impossible to apportion credits to particular invoices submitted by a client and receipts from their Customer. Instead the [FCA] can only be made up of
>
> Current Account = Payments to Client + Commission (Factoring Fee and Re-Factoring) + Disbursements + VAT – Collections.
>
> Applying the concept of *pari passu* that is apportionment of the 'loss' on the items that are debited and credited to the [FCA] we are able to calculate the VAT element that could be claimed under BDR, that is as follows

All		**Ratio**	**Credit**	**Balance**
Factoring charge	23324	0.38	-15859	7465
Retrospective charge	645	0.1	-439	207
Refactoring charge	19868	0.32	-13509	6359
Disbursement	8634	0.14	-5871	2764
VAT	9135	0.15	-6212	2923
	61609		**-41890**	**19719**
Diff between Pay & Col	-41890			
FCA balance	19719			

16. Thus in this example the claim for BDR would be £2,923.

17. After setting out the facts and this type of calculation for two more examples, Mr Farrell states his opinion that there is only one way to allocate the funds, ie on the basis of the examples using the *pari passu* concept. That is a matter for the Tribunal to decide if necessary and so I find as a fact only that the examples show how the appellant calculated the amount of BDR in a case where there has not been full collection of the invoices.

18. Finally Mr Farrell applied the concepts he described to all the cases where the appellant has claimed BDR.

19. I hope that in this account I have done justice to what Mr Farrell set out in his witness statement. I have to say I found the statement tough going as there are

numerous inconsistencies of terminology and a lot of jargon, and the statement is interspersed with Mr Farrell's opinions, all of which are predicated on the assumption that the charges are not paid until collections exceed the sums advanced, and that is the main issue in this appeal.

Mr Farrell's second witness statement: the appellant's contracts

20. I next turn to the contractual position, which was referred to in Mr Farrell's second witness statement. He exhibited two contracts for two of the clients in relation to whom BDR was claimed, each made in 2002 ("the 2002 agreement").

21. The details set out below are from one of them between the appellant ("the Factor") and The Hire Shop Ltd (called "the Supplier" in the contract) and is dated 4 April 2002.

22. The preamble says that the appellant has agreed to provide to the supplier a factoring service to include the assignment to the factor of those debts which the factor wishes to have assigned.

23. The relevant definitions in the Interpretation clause are:

> ""Approved Debt" means all Debts owing to the Supplier upon which the Factor may agree to make an initial advance …
>
> "Factoring Fee" means 6.50 (per centum) of the gross value of each Approved Debt purchased by the Factor plus in addition [a discretionary fee of £6]
>
> "Initial Advance" means 75.00% of the gross value of each Approved Debt.
>
> "Minimum Annual Factoring Fee" means the factoring fee applied to the Minimum Actual Factoring Turnover
>
> "Minimum Actual Factoring Turnover" means the sum of £75,000.00 per annum being the total Approved Debt purchased by the Factor for which it receives payment within the year.
>
> "Sales Ledger" shall mean a record of all sales effected by the Supplier in respect of which Approved Debts have been purchased by the Factor."

24. Clause 2 describes the terms of the "Purchase of Debts" under which the Supplier "sells" the debts, and Clause 3 the scope of the "Factoring Service".

25. Clause 4 is headed "Payments" and says:

> "In consideration of the factoring services supplied by the Factor to the Supplier, the Supplier shall pay to the factor on demand:-
>
> 4.1 Forthwith upon the signing hereof the Setting Up Fee; and
>
> 4.2 Forthwith the Minimum Annual Factoring Fee upon period review hereof if the Supplier shall have failed to achieve the Minimum Factoring Turnover for the period under such review or such sum as shall represent the due proportion of shortfall for that period.

> 4.3 The Supplier acknowledges that the Factoring Fee … in relation to each Approved Debt purchased by the Factor shall be due and payable to the Factor forthwith upon the factoring of each Approved Debt … and shall be deducted at the Factor's discretion from such sums as may be payable by the Factor to the Supplier pursuant to the terms of this agreement from time to time.
>
> 4.4 Value Added Tax … at the rate current from time to time shall be payable on all sums pursuant to this agreement which are subject to Value Added Tax
>
> 4.5 All sums due and shall [*sic*] be payable forthwith by the Supplier to the Factor and may at the direction of the factor be deducted from any amounts held by the Factor from moneys paid in respect of Debts from time to time."

26. Clause 12 Deals with "Payments and Disapproval". It provides

> "12.3 If no notice of rejection of a Debt is sent within 15 business days an Initial Advance will made against such debt less any Minimum Annual factoring Fee/ or other fee whatever payable to the Factor by the Supplier according to the terms of this agreement; and/or [*sic*]
>
> 12.4 The Factor shall pay to the Supplier monthly the balance payments due in respect of Debts on which an Initial Advance(s) [*sic*] has been made after receiving the full amount due under the Invoices from a Debtor, subject to the deduction therefrom of any sums or fees due (or contingently due) on any other accounts to the Factor."

27. Clause 20 is headed "Set-off". It says

> "The Factor shall be entitled, but not obliged, at any time to set-off against any sum payable to the Supplier the amount of any liability of the supplier to the factor whether under this agreement or otherwise, whether existing future or contingent and whether by way of Debt, damages or restitution."

28. And finally there is Clause 30 "Entire Agreement":

> "This Agreement (together with any documents referred to herein) constitutes the whole and entire agreement between the parties hereto and it is expressly agreed that no variations hereof shall be effective unless made in writing. The Supplier confirms it has not relied upon any representations whatsoever from the Factor prior to the date hereof."

29. The other 2002 agreement is in material terms identical save that the factoring fee is 5%, the initial advance is 70% and the minimum turnover is £50,000. Mr Farrell says the form of these contracts had been introduced in 2002 and was also the form of the agreements signed by the other clients whose accounts are the subject of the BDR claims.

30. The first witness statement was made in July 2014. In his second witness statement dated June 2018 Mr Farrell says that the agreement used by the appellant changed in 2006 and it was this later agreement which was shown to HMRC during the enquiry initiated in 2011. Mr Farrell then exhibited to his second statement a copy of

the agreement dated 2011 ("the 2011 agreement") given to HMRC in 2012. I add that Mr Farrell's dating is a bit awry here.

31. I cover the 2011 agreement here even though it is not an agreement relevant to the BDR claims, because HMRC have obviously based much of their case on the 2011 agreement, and it may be necessary to see whether there are material differences.

32. Clause 3 is headed "Consideration payable in respect of approved debts" and provides:

> "3.1 The Purchase Price in respect of each Approved Debt shall be the Notified Value of each Approved Debt less
>
> (a) any, deduction, set off, or abatement claimed by any Debtor; and
>
> (b) any prompt settlement or analogous discount available to the Debtor; and
>
> (c) the discount charge, and
>
> (d) all or any fees and /or charges payable to the Factor;
>
> (e) all and any monies due to the Factor from the Supplier."

33. The capitalised terms are ones defined in Schedule 1 – Definitions. These relevantly are:

> ""Purchase Price" means the price payable by the Factor for an Approved Debt calculated in accordance with Clause 3.1.
>
> "Notified Value" means the face value of any Debt, Notified by the Supplier to the Factor.
>
> An uncapitalised term in Clause 3.1 "discount charges" is also defined in Schedule 1 notwithstanding Clause 1.1 which says that they aren't. In Schedule 1 "discount charges" means the charge which is calculated and debited to the Current Account in total each month by applying the daily rate to the debit balance on the current account as shown in our records at the end of each day.
>
> "Daily Rate" means 3% over Lloyds TSB's base rate."

34. Clause 6 – Payments – says:

> "In consideration of the purchase of debts and the supply of the factoring services by the Factor, the Supplier shall pay to the factor on demand free from any counterclaim, set off or withholding all and any fees, expenses, costs charges and interest that may be payable from the Supplier to the Factor from time to time, as more particularly set out in schedule 2. All such sums shall be payable by the Supplier to the Factor immediately upon their falling due in accordance with the terms of this clause 6 (*sic*) and may constitute a Deduction or at the discretion of the Factor be deducted from any Initial Advance otherwise payable in respect of Approved Debts or set-off against Remittances from Debtors from time to time."

35. Schedule 2 provides that the Supplier is liable to pay the following charges including:

> "immediately upon entry into the agreement, the setting up fee
>
> the Factoring Fee in relation to any Approved Debt, which is payable forthwith upon the vesting of each Approved Debt, and may be deducted at the Factor's discretion from such sums as may be payable by the Factor to the Supplier or otherwise applied to the Current Account.
>
> Value Added Tax on all sums pursuant to this agreement which are subject to that tax."

36. The equivalent of Clause 12 of the 2002 agreement is clause 6 "Payment and Disapproval":

> "The Factor, may in its discretion, at the time of recipient of a Notification [a schedule of invoices given by the supplier/client] or later:
>
> 14.1 Categorise any Debt as an Unapproved Debt by reason of age, dispute, credit limit or otherwise; and/or
>
> 14.2 subsequently re-categorise any Debt as an Approved Debt which has previously been categorised as an Unapproved Debt; and/or
>
> 14.3 allow the Supplier to draw an Initial Advance against such Debt less any deduction according to the terms of this Agreement provided that no notice is given by the Factor to the Supplier that a debt had been categorised as an unapproved debt within 15 business days of Notification; and/or
>
> 14.4 the Factor shall from time to time pay to the Supplier the balance payments due in respect of Debts on which an Initial Advance(s) has been made after receiving a Remittance for the full amount due under the Invoice from a Debtor subject to any deduction therefrom."

37. "Initial Advance" is defined as "a payment on account of the full purchase price of each approved debt calculated by applying the Advance Rate to it but subject always to any Deductions". The "Advance rate" is defined as 80% of the gross value of each Approved Debt.

38. On an initial reading of this contract I dismissed the importance of clause 14.3 as I took "such" Debt to be a reference back to the immediately preceding mention of a debt, namely an Unapproved Debt, but that could not be right. It could then, I thought, be a misplaced reference to 14.1, to an Approved Debt which had been recategorised, which makes more sense. But that was likely to be a small percentage of the total debts. On a third reading I wondered if, because of the use of that ugly expression "and/or", it was a reference back to both 14.2 and 14.1, but that makes no sense in relation to a debt categorised as unapproved. On a fourth reading I came to the conclusion that what the parties meant to agree was that an initial advance would be made against all Approved Debts unless within 15 days of notification they were recategorised as unapproved.

39. The contract seems to be silent as to the time when the supplier/client may draw down the initial advance, but it is unlikely that it could be any time earlier than the fifteenth day after notification.

40. I also need, because of the way the appeal has been framed, to refer to clause 30 and Schedule 9. Clause 30 is the entire agreement clause and also refers specifically to the agreement including, without limitation, the Offer Letter set out in Schedule 9. A copy of such a letter in the bundle confirms the principal details of the appellant's offer to the client. These include:

> (1) That the agreement is a with recourse factoring agreement with an initial advance of "up to" 80% of approved existing debtors and further advance "at" 80% of succeeding invoices.
>
> (2) The factoring fee is 1.75%
>
> (3) Operationally you will send us the original invoices together with all supporting paperwork.
>
> (4) A payment will be made the day after receipt of the invoices representing 80% (less our charges) to your business bank account.
>
> (5) Upon receipt we will pay the resultant availability (? – my question mark)

41. It is abundantly clear from HMRC's statement of case created on 3 March 2014 that references in both the appellant's grounds of appeal and HMRC's contentions to clauses of agreements are to the 2011 agreement.

42. On 8 February 2017 the appellant filed an amended Notice of Appeal which made no mention of any contracts or terms of them.

43. On 7 April 2017 HMRC filed an amended statement of case which at (22) XVIII, XX, XXI and XXIII is worded in such a way as only to be a reference to the 2011 contracts.

44. On 5 May 2017 the appellant served a request for further and better particulars of HMRC's case asking how their case was compatible with clause 12(4) of the agreement in force at the time of the supply (the 2002 agreement), an agreement which had been supplied to HMRC on 21 May 2012 and to the terms of which HMRC were referring to in other paragraphs of their statement of case. In response HMRC refer both to paragraph 12.4 of the 2002 agreement and to para 3.1 of 2011 agreement relied upon by the decision maker in 2011.

Mr Farrell's second witness statement: the appellant's invoices

45. One further matter which I need to cover is the invoices issued by the appellant to the clients. Mr Farrell's second witness statement deals with VAT calculations and exhibits a number of invoices for the appellant's services.

46. Taking one at random on page 407 of the witness statement bundle there is what is called a "Client Statement and VAT Invoice" ("CSVI") for a company called

Gateway. It is for the month of March 2009 and shows at the top "Tax Point: 31 March 2009". The "client account" shows:

Opening balance 1/3/09		25758
Debts purchased less allowances		93429 +
Pre-payments made to you		86141 -
Fees	3627	
Refactoring	69	
Disbursements	220	
VAT @ 15.0%	587	
Total charges		4503 -
Closing balance 31/3/10		28542

No payment terms are shown.

47. At page 349 is a schedule of clients with four columns being the four items shown in the CSVI which are part of the "total charges". The figure of £587 is shown for Gateway under VAT.

48. At page 348 is a total company summary as at 31 March 2009 which contains a part in the same format as the CSVI with the totalled figures from page 349.

49. At page 347 is what is in form an invoice from Regency Factors plc to "C3 Charges" and giving an invoice number and invoice date (31/3/2009). The description on the invoice is of the total of the four columns and shows a total "unit price" £55,121 VAT% as 15.00 and VAT as £8268.18. At the foot is "Payment terms: 30 days".

50. Mr Farrell's witness statement refers to the document at page 348 as a "C3 Total Company report" and to the document at p 347 as a "summary invoice". I find that this is a purely internal accounting document of no significance to this appeal.

51. There is no dispute that the appellant accounted for VAT on the basis that the individual invoices were issued on the closing date, the end of the month whose figures they contained, and I so find.

HMRC's compliance check

52. Finally I turn to the compliance check carried out by HMRC, but I mention only those aspects which seem to be relevant to the appeals as formulated in statements of case and skeletons.

53. The first item is a letter from HMRC dated 23 April 2011 mentioning that the BDR claim covered the periods 07/07 to 01/10, and informing the appellant that BDR was not due as was confirmed by paragraph 5.7 of VAT Notice 701/49 if the BDR relates to client accounts and not to the appellant's own debts.

54. On 7 July 2011 HMRC refer to the "standard factor agreement you have produced" and to paragraph 3.1 in particular (this must be a reference to the 2011 agreement). HMRC gave notice of their intention to raise assessments to recover the BDR.

55. On 11 July 2011 an assessment was apparently made and notified charging £164,932 in VAT for periods 07/07, 01/08, 04/08, 07/08 and 01/09. I say "apparently" because they are not in the bundle.

56. On 6 August 2011 Jim Dunlop of Queo VAT Consultancy Ltd appealed on behalf of the appellant and requested a review.

57. On 30 September 2011 Jim Dunlop rowed back on some of the BDR claims which he said related to unpaid invoices by customers of the clients, and so the claim was, provisionally, limited to the question of whether the appellant's fees were unpaid. Information about the possible inconsistency in the 2011 agreement and how it should be reconciled was given. The claim was reduced to an amount of £45,737.17.

58. On 21 May 2012 Jim Dunlop apologised for the fact that the 2011 agreements given to HMRC were not the same as the agreement in force with the clients in relation to whose payments due to the appellant were in issue for BDR. The 2002 agreements were supplied and contentions made in respect of them. A number of reports and papers by Mr Farrell were supplied.

59. On 18 February 2013 HMRC reaffirmed their position.

60. On 28 August 2013 the conclusions of the review requested on 6 August 2011 were given. The conclusion letter raised issues relating to the BDR Regulations and whether the record keeping requirements, procedures and time limits had been met. It is also clear to me that discussion of the terms of the 2011 agreement was still thought to be relevant even though the review officer also referred to a 2002 agreement and an offer letter related to that. She also said that there was no attachment to Schedule 9 of the 2011 agreement which was blank. The assessments were upheld.

61. On 2 October 2013 the appellant now acting through Nigel Gibbon & Co (who had been in the background for some time) appealed to the Tribunal in respect of the total VAT of £164,932.

Law

62. By art 73 of the Principal VAT Directive (2006/112/EC) ("PVD") consolidating art 11A(1)(a) of the sixth VAT Directive (77/388/EEC) which was in effect at the time of most or all of the supplies in this case:

> "In respect of the supply of goods or services … 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."

63. By art 90 PVD which was in force at the time of the claims to BDR:

> "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.

2. In the case of total or partial non-payment, Member States may derogate from paragraph 1."

64. This is a case of total or partial non-payment. Art 90, so far as referring to total and partial non-payment, has been transposed in UK law as s 36 Value Added Tax Act 1994 ("VATA") and regulations made under the vires in that section.

65. Section 36, so far as relevant provides:

"(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.

(3) In subsection (2) above "the outstanding amount" means—

(a) if at the time of the claim no part of the consideration written off in the claimant's accounts as a bad debt has been received, an amount equal to the amount of the consideration so written off;

(b) if at that time any part of the consideration so written off has been received, an amount by which that part is exceeded by the amount of the consideration written off;

and in this subsection "received" means received either by the claimant or by a person to whom has been assigned a right to receive the whole or any part of the consideration written off.

(3A) For the purposes of this section, where the whole or any part of the consideration for the supply does not consist of money, the amount in money that shall be taken to represent any non-monetary part of the consideration shall be so much of the amount made up of—

(a) the value of the supply, and

(b) the VAT charged on the supply,

as is attributable to the non-monetary consideration in question.

(4) A person shall not be entitled to a refund under subsection (2) above unless—

(a) the value of the supply is equal to or less than its open market value, ...

(5) Regulations under this section may—

(a) require a claim to be made at such time and in such form and manner as may be specified by or under the regulations;

(b) require a claim to be evidenced and quantified by reference to such records and other documents as may be so specified;

(c) require the claimant to keep, for such period and in such form and manner as may be so specified, those records and documents and a record of such information relating to the claim and to anything subsequently received by way of consideration as may be so specified;

(d) require the repayment of a refund allowed under this section where any requirement of the regulations is not complied with;

(e) require the repayment of the whole or, as the case may be, an appropriate part of a refund allowed under this section where any part (or further part) of the consideration written off in the claimant's accounts as a bad debt is subsequently received either by the claimant or, except in such circumstances as may be prescribed, by a person to whom has been assigned a right to receive the whole or any part of that consideration;

(g) make different provision for different circumstances.

(6) The provisions which may be included in regulations by virtue of subsection (5)(f) above may include rules for ascertaining—

(a) whether, when and to what extent consideration is to be taken to have been written off in accounts as a bad debt;

(b) whether anything received is to be taken as received by way of consideration for a particular supply;

(c) whether, and to what extent, anything received is to be taken as received by way of consideration written off in accounts as a bad debt.

(7) The provisions which may be included in regulations by virtue of subsection (5)(f) above may include rules dealing with particular cases, such as those involving receipt of part of the consideration or mutual debts; and in particular such rules may vary the way in which the following amounts are to be calculated—

(a) the outstanding amount mentioned in subsection (2) above, and

(b) the amount of any repayment where a refund has been allowed under this section.

(8) Section 6 shall apply for determining the time when a supply is to be treated as taking place for the purposes of construing this section."

66. Section 6 VATA so far as relevant to this case provides:

"(1) The provisions of this section shall apply … for determining the time when a supply of … services is to be treated as taking place for the purposes of the charge to VAT.

(3) Subject to subsections (4) to (14) below, a supply of services shall be treated as taking place at the time when the services are performed.

(4) If, before the time applicable under subsection … (3) above, the person making the supply issues a VAT invoice in respect of it or if,

before the time applicable under subsection … (3) above, he receives a payment in respect of it, the supply shall, to the extent covered by the invoice or payment, be treated as taking place at the time the invoice is issued or the payment is received.

(5) If, within 14 days after the time applicable under subsection … (3) above, the person making the supply issues a VAT invoice in respect of it, then, unless he has notified the Commissioners in writing that he elects not to avail himself of this subsection, the supply shall (to the extent that it is not treated as taking place at the time mentioned in subsection (4) above) be treated as taking place at the time the invoice is issued."

67. The relevant regulations in force at the time of the claims are in Part 19 of the Value Added Tax Regulations 1995 (SI 1995/2518) ("the VAT Regulations"):

"PART XIX

BAD DEBT RELIEF (THE NEW SCHEME)

165 Interpretation of Part XIX

In this Part--

"claim" means a claim in accordance with regulations 166 and 167 for a refund of VAT to which a person is entitled by virtue of section 36 of the Act and "claimant" shall be construed accordingly;

"payment" means any payment or part-payment which is made by any person . . . by way of consideration for a supply regardless of whether such payment extinguishes the purchaser's debt to the claimant or not;

"purchaser" means a person to whom the claimant made a relevant supply;

"refunds for bad debts account" has the meaning given in regulation 168;

"relevant supply" means any taxable supply upon which a claim is based;

"return" means the return which the claimant is required to make in accordance with regulation 25 …;

"security" means--

(a) in relation to England, Wales and Northern Ireland, any mortgage, charge, lien or other security, …

…

165A Time within which a claim must be made

(1) … A claim shall be made within the period of 3 years and 6 months* following the later of—

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

(b) the date of the supply.

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

…

** With effect from 1 April 2009 the words "3 years and 6 months" were replaced by "4 years and 6 months" (art 10 SI 2009/586)*

166 The making of a claim to the Commissioners

(1) Save as the Commissioners may otherwise allow or direct, the claimant shall make a claim to the Commissioners by including the correct amount of the refund in the box opposite the legend "VAT reclaimed in this period on purchases and other inputs" on his return or the prescribed accounting period in which he becomes entitled to make the claim or, subject to regulation 165A, any later return.

(2) If at a time the claimant becomes entitled to a refund he is no longer required to make returns to the Commissioners he shall make a claim to the Commissioners in such form and manner as they may direct.

166A Notice to purchaser of claim

Where the purchaser is a taxable person, and the relevant supply was made before 1st January 2003, the claimant shall not before, but within 7 days from, the day he makes a claim give to the purchaser a notice in writing containing the following information—

(a) the date of issue of the notice;

(b) the date of the claim;

(c) the date and number of any VAT invoice issued in relation to each relevant supply;

(d) the amount of the consideration for each relevant supply which the claimant has written off as a bad debt;

(e) the amount of the claim.

167 Evidence required of the claimant in support of the claim

Save as the Commissioners may otherwise allow, the claimant, before he makes a claim, shall hold in respect of each relevant supply--

(a) either—

(i) a copy of any VAT invoice which was provided in accordance with Part III of these Regulations, or

(ii) where there was no obligation to provide a VAT invoice, a document which shows the time, nature and purchaser of the relevant goods and services, and the consideration therefor,

(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.

168 Records required to be kept by the claimant

(1) Any person who makes a claim to the Commissioners shall keep a record of that claim.

(2) Save as the Commissioners may otherwise allow, the record referred to in paragraph (1) above shall consist of the following information in respect of each claim made—

(a) in respect of each relevant supply for that claim—

(i) the amount of VAT chargeable,

(ii) the prescribed accounting period in which the VAT chargeable was accounted for and paid to the Commissioners,

(iii) the date and number of any invoice issued in relation thereto or, where there is no such invoice, such information as is necessary to identify the time, nature and purchaser thereof, and

(iv) any payment received therefor,

(b) the outstanding amount to which the claim relates,

(c) the amount of the claim, . . .

(d) the prescribed accounting period in which the claim was made, and

(e) a copy of the notice required to be given in accordance with regulation 166A.

(3) Any records created in pursuance of this regulation shall be kept in a single account to be known as the "refunds for bad debts account".

169 Preservation of documents and records and duty to produce

(1) Save as the Commissioners may otherwise allow, the claimant shall preserve the documents, invoices and records which he holds in accordance with regulations 167 and 168 for a period of 4 years from the date of the making of the claim.

(2) Upon demand made by an authorised person the claimant shall produce or cause to be produced any such documents, invoices and records for inspection by the authorised person and permit him to remove them at a reasonable time and for a reasonable period.

170 Attribution of payments

(1) Where—

(a) the claimant made more than one supply (whether taxable or otherwise) to the purchaser, and

(b) a payment is received in relation to those supplies,

the payment shall be attributed to each such supply in accordance with the rules set out in paragraphs (2) and (3) below.

(2) The payment shall be attributed to the supply which is the earliest in time and, if not wholly attributed to that supply, thereafter to supplies in the order of the dates on which they were made, except that attribution under this paragraph shall not be made to any supply if the payment was allocated to that supply by the purchaser at the time of payment and the consideration for that supply was paid in full.

(3) Where—

(a) the earliest supply and other supplies to which the whole of the payment could be attributed under this regulation occur on one day, or

(b) the supplies to which the balance of the payment could be attributed under this regulation occur on one day,

the payment shall be attributed to those supplies by multiplying, for each such supply, the payment received by a fraction of which the numerator is the outstanding consideration for that supply and the denominator is the total outstanding consideration for those supplies.

172 Writing off debts

(1) This regulation shall apply for the purpose of ascertaining whether, and to what extent, the consideration is to be taken to have been written off as a bad debt.

(1A) Neither the whole nor any part of the consideration for a supply shall be taken to have been written off in accounts as a bad debt until a period of not less than six months has elapsed from the time when such whole or part first became due and payable to or to the order of the person who made the relevant supply.

(2) Subject to paragraph (1A) the whole or any part of the consideration for a relevant supply shall be taken to have been written off as a bad debt when an entry is made in relation to that supply in the refunds for bad debt account in accordance with regulation 168.

(3) Where the claimant owes an amount of money to the purchaser which can be set off, the consideration written off in the accounts shall be reduced by the amount so owed.

(4) Where the claimant holds in relation to the purchaser an enforceable security, the consideration written off in the accounts of the claimant shall be reduced by the value of that security."

The issues

68. Mr Gibbon in his skeleton identified three issues for my determination:

(1) In respect of each claim for BDR, was there a debt in respect of which BDR might be claimed?

(2) If so, were the claims made within the statutory time limit?

(3) If so, did the appellant's satisfy the record keeping requirements?

69. This is essentially how HMRC put the issues, though they regarded (2) and (3) as subheads of the same issue, ie whether the procedural requirements of the regulations were met.

70. As to the first issue identified by Mr Gibbon, I do not think it is necessary to consider each claim separately. I do think that the formulation of the issue is not very clear. Since by section 36(2) and (3) VATA no relief can arise if all the consideration for a supply has been received so that the "outstanding amount" is nil, it seems to me that the issue is better expressed as:

> (1) Did the appellant receive consideration for the supply by it of factoring services when they made an initial advance to the client/supplier?

71. If the answer is yes, that is an end of the case as there was nothing totally or partially unpaid in respect of the supply of services at any relevant later date. If the answer is no, then the further issues identified by Mr Gibbon arise. I would characterise those issues as:

> (2) Did each of the claims made by the appellant meet the requirements of s 36 VATA and Part 19 of the VAT regulations?

The parties' submissions

Issue (1) - Did the appellant receive consideration for the supply by it of factoring services when they made an initial advance to the client/supplier?

72. The appellant says that in relation to this issue that at the time of the purchase of the debts by the appellant from the client and the issue of the invoice for fees for factoring services, no money moved *from* the client *to* the appellant: the only movement of money was the initial advance f*rom* the appellant to *the* client.

73. The 2002 agreement provides at 12.4 that:

> "12.4 The Factor shall pay to the Supplier monthly the balance [of] payments due in respect of Debts on which an Initial Advance has been made after receiving the full amount due under the Invoices from a Debtor, subject to the deduction therefrom of any sums or fees due (or contingently due) …"

74. The appellant says that it is clear from this clause that the appellant will pay to the client/supplier the amount of any debts collected from the customers upon which an advance has been made. Thus the appellant has contracted to pay 100% of the value of the invoices issued to the customers, not a lower percentage.

75. Clause 4.3 then says that charges:

> "shall be deducted at the Factor's discretion from such sums as may be payable by the Factor to the Supplier pursuant to the terms of this agreement from time to time"

and clause 4.5 says:

> "All sums due … may at the discretion of the Factor be deducted from any amounts held by the Factor from moneys paid in respect of Debts from time to time."

76. In support of their contentions as to the time that the debt for factoring services is paid, the appellant quotes from a press release issued by the Department for Business, Energy and Industrial Strategy ("DBEIS") of 10 September 2018 describing the factoring process:

> "Invoice finance allows a business to raise funds by assigning their right to be paid (known as 'receivables') to a finance provider in exchange for funds, typically representing 80% of the value of the invoices. The initial advance is received within a few days and the balancing 20% (less fees and charges) is paid when the customer settles the invoice. Invoice financing is not borrowing, because the supplier is receiving an advance against future payment."

77. That analysis, says the appellant, mirrors the agreement between the appellant and its clients. It is the factoring process which provides for debts to be collected from clients which will be sufficient to cover the advance and the charges. In that situation the charges are paid and there is no bad debt.

78. But the problem arises when the amounts collected are insufficient to cover the advance and the charges. Here there can be a bad debt.

79. HMRC's submissions are, Mr Gibbon says, based on a fundamental misunderstanding of the concept of consideration. As their Manual correctly says, consideration means everything which is received by a supplier (ie the appellant, not the clients) in return for their services. That means something must move from the client to the appellant which is capable of being consideration. The only consideration paid is by the client's customers when they pay the invoices assigned to the appellant at which point the value of the charges are offset against the money owed to the client.

80. HMRC put their case by pointing out that the date of supply of services is when they are performed, but this can be overridden by s 6(4) VATA by the issue of an invoice or by receiving payment. In this case the appellant issues a monthly invoice for its factoring services which HMRC say is a valid invoice.

81. The appellant also makes an advance to the client, an agreed percentage of the value of the invoices. This is also recorded on the invoice and is made to the appellant net of the charges.

82. Because the appellant's payments to its clients are limited by clearly defined amounts equivalent to its fees and charges plus VAT, this reduction in the value of the payments for the clients' debts, the advance, represents consideration for the appellant's factoring services and, as a consequence there cannot be a bad debt.

83. In accordance with the ECJ decision in *Tolsma* there is a direct link between the reduction in the advance and the factoring services.

84. Regulation 165 of the VAT Regulations is relevant in that it specifies what payment means in relation to a BDR claim. It means any payment or part payment which is made by a person by way of consideration for a supply regardless of whether such payment extinguishes the debt or not. In this case the appellant receives consideration by the reduction in the value of the payment available for the client's debt.

85. As the appellant was not entitled to claim BDR, the assessments under s 73 VATA are justified and should be upheld.

Issue (2) Did each of the claims made by the appellant meet the requirements of s 36 VATA and Part 19 of the VAT regulations?

86. HMRC make two main points about procedural issues. The first is that regulation 165A of the VAT Regulations is relevant to the appeal in that the time of supply of factoring services is when the invoice is issued (by virtue of s 6 VATA as applied by s 36(8) VATA). In relation to periods before 1 April 2009 the time limit for submitting a claim was three years and six months from the time of supply, and all the appellant's claims fall in periods before 1 April 2009.

87. They point out that the appellant had suggested that only £45,737.15 of the claims are within the time limits, but HMRC have not tested the accuracy of that assertion. Seemingly they are putting the appellant to proof that their claims are not out of time.

88. The second procedural point is that during visits to the appellant's premises the appellant did not produce its single account known as a "refund for bad debts account". This brings into play both s 36(5)(c) VATA and regulation 168(3) of the VAT Regulations as they require a claimant for BDR to keep the specified records and documents and a record of information relating to the claim. The appellant has therefore, they say, not produced sufficient evidence from its business records to show that the factoring charges remain unpaid and so the claims must fail and the appeals must be dismissed.

89. The appellant's response on the time limit issue is that under regulation 165A(1) the claims are to be made within 3 years and 6 months of the later of the time of supply (which they agree is the invoice date) and the date that the consideration that was written off because "due and payable". The charges only become due and payable when collection of debts has failed to cover more than the advances made and when the appellant reverts to the client and demands payment for the outstanding invoices. It may happen that after the invoice becomes due and payable, collection continues and claims to BDR are not made until all collection processes have been conceded.

90. They seek to meet an argument from HMRC based on Schedule 2 to the 2011 contract that the charges become due and payable "forthwith" on entering into the agreement. They say that the contract allows for that provision to be overridden, or in the alternative if the charges do contractually become due and payable on entering into the agreement the parties' conduct had the effect of changing the terms of the agreement in that respect, and they cite the decision of the Court of Appeal (Moore-Bick, Beatson

and Underhill LJJ) in *Globe Motors Inc & ors v TRW Lucas Varity Electric Steering Ltd & anor* [2016] EWCA Civ 396 ("*Globe Motors*").

91. The appellant implies but does not state that all the claims to BDR are in time on that basis.

92. As to record keeping they refer to each sub-paragraph of regulation 168(2) of the VAT Regulations and point to where the relevant record is kept.

93. They say that the appellant does not create any records in pursuance of regulation 168. Records required to evidence a BDR claim are created in the course of normal business activity, including the "bad debt write off account" referred to and exhibited with Mr Farrell's second witness statement. The records therefore comply with regulation 168.

Discussion

94. The first issue is, it seems to me a matter of determining what the relevant contracts mean and applying that meaning to the facts. Neither party has suggested that economic substance plays any part in this dispute. I need to make it clear that the contract I am interpreting is the 2002 contract because that was the one that the relevant clients entered into with the appellant at the relevant times. The 2011 contract has muddied the waters somewhat, as HMRC, even after obtaining the 2002 contracts in 2012, continued to argue by reference to terms of the 2011 contracts and the appellant responded likewise. Any such arguments and responses are relevant to my decision only if the particular terms in question in the 2011 contract were, for practical purposes, identical to those in the 2002 contract and so the arguments could also have been made in the same terms by reference to the 2002 contract. In the event I have not needed to consider the 2011 agreement as I consider the 2002 agreement is clear.

95. Adopting Mr Farrell's simple example, the crucial issue then is whether the 2002 agreement provided only for an initial advance on acquiring invoices of £764 or an initial advance of £800 and an application of £36 of that amount towards the charges. It is not in dispute that there would be, in this simple situation, only one movement of funds, from the appellant to the client in the amount of £764.

96. Clause 12.3 of the 2002 agreement provides for the initial advance in these terms:

> "… an Initial Advance will made against such debt less any … fee whatever payable to the factor by the Supplier according to the terms of this agreement".

97. Clause 4.3 says:

> "4.3 The Supplier acknowledges that the Factoring Fee … in relation to each Approved Debt purchased by the Factor shall be due and payable to the Factor forthwith upon the factoring of each Approved Debt … and shall be deducted at the Factor's discretion from such sums as may be payable by the Factor to the Supplier pursuant to the terms of this agreement from time to time."

98. Reading these two subclauses together it seems to me clear that the factoring fee is "due and payable" to the appellant at the time of the assignment of the debt, and that when the appellant pays £764 to the client the fee of £36 has been deducted from the initial advance of £800 (£800 being how the initial advance would be calculated by virtue of the definition in Clause 1).

99. This interpretation is supported by clause 20:

> "The Factor shall be entitled, but not obliged, at any time to set-off against any sum payable to the Supplier the amount of any liability of the supplier to the factor whether under this agreement or otherwise, whether existing future or contingent and whether by way of Debt, damages or restitution."

100. It seems to me artificial to say that when £764 is paid that is simply the payment of the advance contracted for. What would also have been artificial would have been for the appellant to transfer £800 to the client and simultaneously for the client to transfer £36 to the appellant. In this regard see the remarks of Lord Walker of Gestingthorpe in *Burton (Collector of Taxes) v Mellham Ltd* [2006] UKHL 6 for example at [27].

101. As the satisfaction of a debt by way of set off is valid satisfaction, consideration for the supply of factoring services has been received by the appellant at the time of making the advance. Mr Gibbon says that "monies" have to pass from a client to appellant for there to be consideration. If by this he means a transfer of funds from an account of the client to the appellant I disagree. He cited no authority for this proposition. It is also clear from both EU and UK legislation that non-monetary consideration is still consideration, and the meeting of a debt by a third party may also be consideration (indeed in this case the appellant says that the consideration for the supply of services is the receipt of funds from the customers once it had reached a particular percentage of the factored invoice amounts).

102. I also think that clause 12.4 on which Mr Gibbon relied does not help the appellant. This the more so when the complete sub-clause is examined, not just the part quoted by Mr Gibbon in his skeleton. Clause 12.4 says in full:

> "12.4 The Factor shall pay to the Supplier monthly the balance payments due in respect of Debts on which an Initial Advance(s) [*sic*] has been made after receiving the full amount due under the Invoices from a Debtor, subject to the deduction therefrom of any sums or fees due (or contingently due) *on any other accounts to the Factor.*"

103. The words I have italicised are missing from Mr Gibbon's quotation of the sub-clause, but in my view those words show that clause 12.4 has no relevance to the issue. Nor do I think that the DBEIS document adds anything: it is far too general to be of any assistance in determining wheat the agreements provide for in this specific case.

104. My conclusion on the first issue is that no claim can be made for BDR in relation to the factoring charges as they are paid within six months of the time of supply. I should say again that I have not considered the 2011 contract in any depth. At first

glance clause 3 of it might provide some support for what the appellant argued in relation to the 2002 contract, but I am not going to make any decision about it.

105. This makes the second issue moot, as it is put by HMRC. But I will set out the conclusions I have reached as they were fully argued and the point may arise in relation to later claims.

106. The first sub-issue is the question whether the claims were in time. There is a time limit of 3 years and 6 months in the periods concerned, and the appellant points out that it runs from the later of two events:

> (1) the date on which the consideration … which has been written off as a bad debt becomes due and payable to … the person who made the relevant supply; and
>
> (2) the date of the supply.

107. The date of the supply is the date the invoice is issued. To consider the first date I have to assume counterfactually that the consideration became payable at the time the appellant contended for, and that was the time when the appellant took action to seek payment of the invoice from the client. Had I not found as I did, then I would have needed to go into the details of the claims to establish whether the time limit was met. It seems likely that it would have been because it would have needed the appellant to continue collection without writing off the debt as bad for another 42 months for the time limit to act as a bar to BDR.

108. The appellant seems to have anticipated that the Tribunal might find that contractually the charges became due and payable when the advance was made. I have not actually needed to make such a finding as the crucial date in my view was the date of receipt of the consideration. But I think it must follow that by virtue of clause 4.3 the due and payable date is the date of actual receipt. Recognising that the above analysis might commend itself to the Tribunal, Mr Gibbon argued that the 2002 contract did not govern the conduct of the parties. He said:

> "… the practice between the appellant and its clients was that its charges were not due and payable until amounts had been collected from a client's customers."

109. If that was the practice it is very difficult to see then why the amount paid to the client on the assignment of the invoices was not £800. The appellant does not say that in practice £800, not £764, would have been advanced.

110. In relation to this argument I note first that the 2002 contract contains a "no variations unless written" clause (30 – see §28) to the effect that any variation must be in writing, and that no evidence had been supplied that there was any such written variation. *Globe Motors*, cited by Mr Gibbon in support of this argument, does suggest that variation by conduct may override a clause such as clause 30. However at the time of the hearing of this appeal, *Globe Motors* and the cases relied on in it had been held to be wrong by the Supreme Court in *Rock Advertising Ltd v MWB Business Exchange*

Centres Ltd [2018] UKSC 24 ("*Rock*") where Lord Sumption JSC said in clear terms at [10]:

> " In my opinion the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation."

111. Lord Briggs JSC concurred as to the result and the other Justices agreed with Lord Sumption.

112. It follows from *Rock* that any variation of the 2002 agreement by conduct is ineffective. But an important point made in *Globe Motors* is that any person seeking to show that conduct or an oral variation overrode a "no variation unless written" clause may have an uphill task to produce convincing evidence for the variation. What evidence there was here did not persuade me that the parties, and the appellant in particular, had not acted entirely in conformity with the 2002 contract and in particular clauses 4 and 12.

113. I add here that I was surprised that I was not informed that *Globe Motors* had been overruled by *Rock*, but it may be that I jumped in, figuratively brandishing *Rock*, before Mr Gibbon had a chance to explain.

114. I now turn to the other procedural issues. First I examine what a BDR claimant must do for the claim to be accepted by HMRC.

115. Section 36(1) VATA lays down three conditions, the first and third of which were clearly met (a supply on which VAT has been accounted for – subsection (1)(a) - and paid and the elapsing of six months from the date of supply, in this case the date of the invoice – subsection (1)(c)). The second condition in subsection (1)(b) is that:

> "the whole or any part of the consideration for the supply has been written off in his accounts as a bad debt"

116. Regulation 172 of the VAT Regulations deals with writing off. Paragraph (2) provides that:

> "the whole or any part of the consideration for a relevant supply shall be taken to have been written off as a bad debt when an entry is made in relation to that supply in the refunds for bad debt account in accordance with regulation 168."

117. Regulation 169 requires a company which claims BDR to keep certain records as set out in regulation 168(2). The appellant says it does so, and I have no reason to doubt that it keeps the records as listed. But s 168(3) requires them to be kept "in a single account", to be known as "the refunds for bad debts account". It is in this single account that the writing off must be recorded. But the appellant says it does not have a single account. It has a "Bad Debts Write Off Account" which Mr Farrell refers to in his second witness statement. In my view the record keeping by the appellant is insufficient to comply with regulation 168 and particularly paragraph (3). The purpose of having a single refunds for bad debts account in which write offs are shown is to establish an audit trail that HMRC investigators can easily check.

118. This failure to keep a single account for bad debt refunds is possibly a consequence of the way the appellant accounts for its business. A passage at [39] of Mr Farrell's first witness statement is particularly telling:

> "As set out above the Current Account is a running account balance accordingly there is an admixture of funds and it is impossible to apportion credits to particular invoices submitted by a client and receipts from their Customer…"

119. And in that same witness statement where Mr Farrell gives information about particular clients in relation to whom the appellant has claimed BDR he says that the claims made to BDR are not the amounts shown on his analyses (as in §15): they may be higher or lower. HMRC had already pointed these discrepancies out. Thus in the absence of a refunds for bad debt account as required by regulation 168 it is impossible to say whether the necessary conditions for BDR have been met.

120. Thus had I not found against the appellant in relation to issue 1, it would have failed on issue 2.

Decision

121. The appeals are dismissed.

122. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 28 FEBRUARY 2019