David Bowden urges UK asset lenders to “get good VAT advice at the beginning” in the light of a recent court case

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A recent VAT case from the First Tier Tribunal will be of interest to asset finance providers.

In a reserved decision dated August 1, 2014 of Judge Guy Brannan and Julian Stafford, the tribunal had to rule on the recoverability of VAT made by a finance house on hire purchase transactions.

British Credit Trust (BCT), following a review of its business by Deloitte LLP (Deloittes), submitted a claim to HM Revenue and Customs (HMRC) for an adjustment to its VAT account and to reclaim output VAT over-declared in the total sum of £1.3 million plus interest.

The claim for repayment was rejected by HMRC.

VAT costs after repossession

BCT is a well known motor finance company that buys new or used vehicles. The company then provides finance to end-user consumers under hire purchase (HP) agreements regulated by the Consumer Credit Act 1974. The tax supply of the vehicle to BCT by the car dealer is VAT neutral.

Where customers default in payment under these HP agreements, BCT use the services of a repossession agent, who delivers these repossessed vehicles to one of 60 or so sites of its preferred auctioneer (Scottish Motor Auctions) for sale. The repossession agent charges BCT £175 + VAT to recover each vehicle.

If an end-user had paid over one-third of the total price, the BCT instructs a firm of solicitors to obtain a court order for its return (where a customer will not agree to voluntarily surrender it). These solicitors charge BCT a fee for this service and these fees also attract VAT.

BCT’s pre-contract information document, which precedes the HP agreement, makes it clear that a customer will be liable for repossession costs and solicitor’s charges in these circumstances.

The auctioneers charge BCT a fee for selling the repossessed vehicles. This fee also attracts VAT which BCT is liable to pay. Some repossessed vehicles are worthless and are scrapped.

BCT had not accounted for VAT in its books properly. It made a claim for 11 quarters from January 2007 to September 2010 for over payment of the VAT it had neglected to reclaim in its regular quarterly VAT returns.

There were four issues that the Tax Tribunal had to decide – and whilst BCT lost on two of these issues – it won on the two issues that mattered - meaning that its claim for a hefty VAT refund was upheld in full.

Issue 1: Repossession

In 2007-10 BCT had incurred VAT on its repossession agent’s costs totaling £552k.

The company claimed it was entitled to offset the input tax on this against its output tax – and the Tax Tribunal agreed.

BCT put its case on this issue in three different ways. However the Tribunal rejected two of these arguments. BCT did however succeed on its argument that there was a "direct link" between the repossession services it received and its onward taxable supply of the vehicle.

The Tribunal applied the Court of Appeal ruling in the 2004 Dial-a-phone case (where mobile phones were supplied with three months free insurance) and thus there was a mixture of exempt and taxable supplies. Lord Justice Parker agreed there was a mixed supply but found that it did not matter for VAT purposes "provided that a sufficient 'direct and immediate link' exists between them and the marketing and advertising costs".

The Tribunal applied this principle and held that BCT's witness evidence (which was not challenged in cross-examination by HMRC at the tribunal hearing) established a clear, direct and immediate link between the supply of the services by the repossession agent and the sale of the vehicle by BCT at auction.

Similarly the Tribunal found a similar direct and immediate link to the supply of legal services to BCT to obtain a return of goods order.

On this first issue, the Tribunal found that none of the VAT on repossession agent's and solicitor's costs should be attributed to BCT's exempt supplies but rather to its taxable supplies of the sale of the vehicles at auction.

Issue 2: Adjustment not made in same quarter but in January 2012

It was only when BCT engaged Deloittes that it made the correct claim for VAT repayment which is set out in Deloittes' letter to HMRC dated January 31, 2012.

Regulation 38(5) of the VAT Regulations 1995 provides that VAT entries should be made in a VAT account which "relates to the prescribed accounting period". There was much detailed correspondence between Deloittes and HMRC on this.

Article 90 of the relevant EU VAT Directive provides for the "adjustment" of VAT where the price is reduced. HMRC argued that "adjust" meant making a change to an existing entry in BCT's accounts – and that this did not apply as BCT had not made any entries at all.

BCT said HMRC's argument led to absurd consequences. In the end whilst the Tribunal considered the matter to be "finely balanced" it ruled in favour of HMRC on this issue. However, this did not mean BCT's claim for a VAT repayment failed.

Issue 3: bad debt relief

BCT had a claim for bad debt relief in the total sum of £749k. Section 36 of the VAT Act 1994 provides that where a tax payer has supplied goods or services and "has accounted for" and paid VAT on the supply, after six months, it can make a claim for a refund of that VAT to HMRC.

BCT argued that to give this sense, these statutory words should be qualified by "insofar as VAT was payable". The Tribunal disagreed and rejected BCT's claim for bad debt relief as originally formulated. Again – this still did not mean that BCT's claim for its £1.3m refund failed.

Issue 4: Is accountant's letter a valid claim?

BCT submitted that the letter Deloittes wrote on its behalf dated 31 January 2012 constituted a valid "claim" for VAT repayment. BCT said in the end its accountants had sorted its accounts out for these 4 years and had presented HMRC with the correct VAT position.

HMRC said BCT was not making a claim for a VAT refund – but an amendment of an earlier claim. BCT categorised this as a “snakes and ladders” argument. BCT said HMRC’s position that it did not have a valid claim was “artificial and unreasonable”.

BCT relied on two earlier tax cases concerning Marks & Spencer and Reed Employment in this regard. In Reed, Roth J in the Upper Tribunal held that “claim”: • should be given its ordinary meaning;

• was a demand for repayment of overpaid tax;

• what is an overpayment is a question of fact and degree; and

• the issue was one of substance rather than of labels.

The Tribunal was emphatic on this issue: “We have reached the clear conclusion that HMRC’s arguments on this issue are without merit”.

It found the logic of BCT’s arguments to be “unassailable”. The Tribunal found that no tax had been lost and that HMRC had not suggested this either. HMRC accepted that if BCT had made self-cancelling entries in its VAT account at the outset, it would have been entitled to the relief claimed.

The Tribunal castigated HMRC’s arguments as “more akin to the application of some of the finer points of medieval theology”!

On issue 4 the Tribunal found for BCT with the result that BCT’s claim to recover £1.3m VAT succeeded.

Comments

Given the careful analysis and the undisputed facts, this does not look like a good case for HMRC to appeal to the Upper Tribunal (or beyond).

A clear lesson for asset finance providers to get good VAT advice at the beginning. If not there is expensive and prolonged dialogue with HMRC which involves accountants, solicitors and barristers trying to unpick this later.

Although BCT succeeded, it would have to meet its own costs before the Tribunal.

Although this case concerns hire purchase and motor vehicles, the principles are equally applicable to lease or finance transactions for other assets.

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