

**EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2007**

2007 No. 313

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

- 2. Description**

2.1 These Regulations amend the Value Added Tax Regulations 1995 (“the principal Regulations”). They provide a new method of attributing payments between interest and capital for those wishing to claim bad debt relief on supplies made under certain types of credit agreement.

- 3. Matters of special interest to the Select Committee on Statutory Instruments**

3.1 The Committee will note that, although the instrument comes into force on 1st March 2007, the amendments made by this instrument will apply to supplies made on or after 1st September 2006. The instrument will not, however, apply to any claim for bad debt relief arising before 1st March 2007. This is because, by virtue of section 36(1)(c) of the Value Added Tax Act 1994 (c.23), a claim for bad debt relief will only arise, at the earliest, six months after the supply to which that claim relates has taken place.

- 4. Legislative Background**

4.1 This instrument amends the law relating to bad debt relief for VAT following anomalies in the operation of the relief identified by two High Court decisions.

4.2 In Commissioners of Customs and Excise v General Motors Acceptance Corporation (UK) Plc¹ the High Court identified a potential loophole in the law relating to goods sold under certain types of credit agreement. The problem arises where a customer fails to make all the payments due under the agreement and the finance company sells the goods a second time. The High Court found that, because of the operation of two separate legal provisions, finance companies could obtain VAT relief on both the first and second sale. As a result, an element of consumption via finance agreements was going untaxed. This particular loophole was closed in Budget 2006 by the Value

¹ [2004] STC 577

Added Tax (Cars) (Amendment) Order 2006 and the Value Added Tax (Special Provisions) (Amendment) (No.2) Order 2006.

4.3 The decision caused the Commissioners to reconsider the whole subject of bad debt relief in relation to certain types of finance agreement. During the course of the proceedings in Commissioners of Customs and Excise v Abbey National Plc², a case in which the Commissioners were successful, it became apparent that the current method of calculating bad debt relief did not reflect commercial accounting methods. This instrument introduces a new method of calculating bad debt relief which is intended to more accurately reflect commercial practice.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary law, no statement is required.

7. Policy Background

7.1 The Abbey National high court case highlighted an anomaly in the way the amount of relief can be calculated under existing legislation in respect of terminated agreements. When a finance company repossesses goods the relief provided on the first sale is often a combination of an adjustment to the original price and bad debt relief, but the calculations provided for under each approach are different. The reduction in price rules allow a 'fair and reasonable' test to be used, which means that businesses can allocate payments made, between the taxable (goods) and exempt (finance) elements, in line with their accounting practices. The bad debt relief rules currently require a specific allocation based upon the total amounts due under the finance agreement at the outset, ignoring any subsequent reductions or rebates. The changes made by this instrument are intended to reflect the commercial position and provide a calculation which produces a fairer and more accurate result for businesses.

7.2 HMRC has liaised with the relevant trade bodies, the Finance Leasing Association and the British Vehicle Rental and Leasing Association, who expressed a desire to be able to choose between the current and new methods of calculation to give them time to update their internal procedures. This instrument allows for a transitional period of 12 months during which time businesses can elect to choose either method in respect of supplies made on or after 1st September 2006 and before 1st September 2007. As bad debt relief claims cannot be made until at least six months after the date of the supply, this means that the transitional period will end on 29 February 2008. After this transitional period has elapsed, the new method will be mandatory.

² [2006] STC 1

7.3 HMRC recognised that it would not be appropriate to use the new method of calculation for those customers who are required to repay an element of their input tax in respect of unpaid consideration, as this would have required those claiming bad debt relief to provide detailed information to their customers. This would have required further legislation and would have placed an unacceptable burden on the claimants. The calculation to be carried out by affected customers is therefore unchanged from the current position.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no significant impact on business, charities or voluntary bodies.

8.2 There is no impact on the public sector.

9. Contact

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