



HM Revenue
& Customs

Extra-statutory concessions – technical consultation on draft legislation

ESC 3.20 VAT: Bad Debt Relief
and insolvent businesses:
revocation of clawback

Consultation document

Publication date: 4 November 2015

Closing date for comments: 16 December
2015

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| Subject of this consultation: | Consultation on draft legislation to preserve the effect of one HM Revenue and Customs (HMRC) extra-statutory concession (ESC). |
| Scope of this consultation: | Draft legislation designed to preserve the effect of one VAT ESC – 3.20: Bad Debt Relief and insolvent businesses: revocation of clawback |
| Who should read this: | Businesses and other taxpayers who currently benefit from the ESC and their advisors, including the insolvency profession. |
| Duration: | 4 November 2015 - 16 December 2015. |
| | This is a technical consultation on secondary legislation preserving an existing policy and hence does not implement a significant change or implement significant new obligations. HMRC is therefore consulting for six weeks in accordance with the Tax Consultation Framework. |
| Lead official: | Stephanie Allistone, HMRC. |
| How to respond or enquire about this consultation: | Responses to the consultation and queries about the content or scope of the consultation, requests for hard copies etc. should be sent to: Stephanie Allistone, HMRC Central Policy, Room 1C/06, 100 Parliament Street, London SW1A 2BQ. Telephone 03000 586496 e-mail: tap@hmrc.gsi.gov.uk . |
| Additional ways to be involved: | This is a technical issue with specialist interests so the consultation will involve only written responses. Where there are known representative bodies HMRC will contact them regarding this consultation. HMRC will also contact respondents to the earlier consultations to alert them to the publication of this further draft legislation |
| After the consultation: | The draft legislation will be updated to reflect any comments received where appropriate, and the legislation will be enacted to replace the concession in due course. |
| Getting to this stage: | Following the House of Lords judgment in the Wilkinson case HMRC has been reviewing its ESCs. This is a further consultation on legislation to be made under the power provided at section 160 Finance Act (FA) 2008 |
| Previous engagement: | Explanatory notes on section 160 FA 2008, which provides the vires to enact existing concessions by Treasury Order, can be found on the HM Treasury website. Previous consultations on ESCs can be found on the gov.uk website. https://www.gov.uk/ |

Contents

| | | |
|---|--------------------------------------|----|
| 1 | Introduction | 4 |
| 2 | Text of ESC and draft legislation | 6 |
| 3 | Consultation Process: How to Respond | 12 |

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1. Introduction

Background

1.1 ESCs have been a feature of the UK's tax system for decades and will continue to be made and withdrawn as necessary. For this purpose the term 'extra-statutory concession' refers to any published concession that departs from the statutory tax treatment. It is not limited to ESCs published in the former Inland Revenue booklet IR1¹ and the former HM Customs and Excise booklet Notice 48².

1.2 The House of Lords' decision in the Wilkinson case clarified the scope of HMRC's administrative discretion to make ESCs that depart from the strict statutory position.

1.3 In light of that decision, HMRC began reviewing its ESCs. Most ESCs can continue in their current form as they are within the scope of HMRC's administrative discretion. But where an existing ESC exceeds the scope of HMRC's discretion its effect will be maintained by putting it on to a legislative basis where it is appropriate to do so.

1.4 Section 160 FA 2008³ provides an enabling power which allows the tax treatment afforded by existing ESCs to be legislated by Treasury Order. This enabling power has been used to legislate a number of ESCs, most recently those included in statutory instrument number 211 of 2014 (SI 2014/211).

Scope of this consultation

1.5 The purpose of this consultation is to expose for comment draft legislation needed to enact the existing tax treatment of one VAT ESC. The consultation, which is of a technical nature, is designed to ensure that the legislation as drafted will ensure that HMRC maintains the purpose and effect of the existing ESC. HMRC welcomes comments on whether the draft legislation will achieve that aim (including whether it covers all required "insolvency procedures"). A Treasury Order giving effect to this and two other concessions consulted on last year (D40: non-resident trusts: definition of participator and F15: woodlands) is expected to be laid in 2016.

1.6 ESC 3.20 is designed to ensure insolvency practitioners do not become liable for clawback of input tax on bad debts where the supply took place prior to the insolvency of the business for which they act.

¹ [Former Inland Revenue booklet IR1](#)

² [Public Notice 48](#)

³ [Section 160 Finance Act 2008](#)

Impact of the proposed changes

1.8 As the primary intention is to do no more than ensure that the existing concessionary tax treatment is put on a statutory basis, there should be no, or only a negligible, impact as a result of the proposed legislation.

Way forward

1.9 The review by HMRC of its ESCs has identified the need to legislate the VAT concession included in this technical consultation. As the review continues we expect further such consultations on other ESCs that appear to exceed the scope of HMRC's discretion. In each case, we will consult on the draft legislation to ensure it gives effect to the existing concessionary tax treatment.

1.10 This document sets out:

- (a) The text of the existing ESC;
- (b) Draft legislation needed to give legislative effect to the tax treatment afforded by the ESC; and
- (c) An outline explanation of the draft legislation.

| <u>ESC to be legislated by order under section 160 FA 2008</u> | Tax/Duty | Page |
|--|-----------------|-------------|
| ESC 3.20: Bad Debt Relief and insolvent businesses: revocation of clawback | VAT | 6 |

2. Text of ESC and draft legislation

ESC 3.20: Bad Debt Relief and insolvent businesses: revocation of clawback

ESC text

3.20 VAT: disapplication of Repayment of Input Tax (Value Added Tax Act 1994 Section 36 (4) A and the VAT Regulations 1995, SI 2518 (as amended by the VAT (Amendment) Regulations 1997 SI 1086)

1. Subject to paragraphs 3 and 4 below, section 36 (4A) of the VAT Act 1994 will not apply to any person where:

(a) an insolvency procedure has commenced in relation to that person under section 81 (4B), (4C), and (5) of the VAT Act 1994

(b) the claimant's notification of his claim for bad debt relief in accordance with regulation 166A of the Value Added Tax Regulations 1995 (SI 1995 No 2518), is received after the insolvency procedure has commenced, and

(c) each relevant supply upon which the claim for bad debt relief is based, was made prior to the commencement of the insolvency procedure.

2. Paragraph 1 above applies whether or not the business of the person who is the subject of the insolvency procedure continues to be carried on.

3. Paragraph 1 above does not apply unless the Commissioners have received notification on [Form VAT 769: notification of insolvency details](#), or such other notification as the Commissioners may require, in respect of the insolvency procedure referred to in that paragraph.

4. Paragraph 1 above does not apply in circumstances where its application would give rise to tax avoidance.

The insolvency procedures to which the extra-statutory concession applies

The insolvency procedures included in section 81 of the Value Added Tax Act 1994 for the purposes of this concession are:

- bankruptcy
- compulsory liquidation (winding up)
- creditors' voluntary liquidation (voluntary winding up)
- members' voluntary liquidation (voluntary winding up)
- Administrative Receivership
- Administrative Order
- Individual Voluntary Arrangement
- Company Voluntary Arrangement

- Scottish Trust Deed, and
- Deed of Arrangement

After further consultations with representatives of insolvency practitioners, and colleagues within Customs who deal with insolvency policy, it has been agreed that the application of this concession should be extended to a number of other types of insolvencies that are not included in the strict application of section 81 of the Value Added Tax Act 1994. Accordingly this concession will apply to the following types of insolvency that are not included in section 81.

- Partnership Voluntary Arrangement. (Insolvent Partnerships Order 1994).(Insolvent Partnerships Order (Northern Ireland) 1995)
- Partnership Liquidation.(Insolvent Partnerships Order 1994).(Insolvent Partnerships Order (Northern Ireland) 1995)
- Partnership Administration Order (Insolvent Partnerships Order 1994). (Insolvent Partnerships Order (Northern Ireland) 1995)
- Sequestration.(Bankruptcy (Scotland) Act 1985).(Bankruptcy (Scotland) Act 1993).
- County Court Administration Order. (County Court Act 1984). Scheme of Arrangement.(Companies Act 1985)
- Deceased Persons Administration Order (Administration of Insolvent Estates of Deceased Persons Order 1986). (Administration of Insolvent Estates of Deceased Persons Order (Northern Ireland) 1991)

Application of extra-statutory concession.

The effective date for the application of the concession will be the date of Customs claim in the insolvency. This will be the relevant date of the insolvency and the insolvency meeting date (if applicable).

In Administration Order cases the effective date will be the date of the Administration Order.

Where there is a subsequent insolvency the concession will also apply to that subsequent insolvency.

If an insolvency arrangement fails the insolvency is annulled and the requirement to account for clawback will be reinstated.

The concession will only apply to a provisional liquidation if it is followed by a permanent liquidation. In these circumstances the clawback concession will take effect from the date of the provisional liquidation.

Draft Legislation

Citation and commencement

1. This Order may be cited as the Enactment of Extra-Statutory Concessions Order 2016 and comes into force on the day after the day on which it is made.

Disapplication of disallowance of input tax in insolvency where consideration not paid

2.—(1) Part 1 of the Value Added Tax Act 1994^(a) is amended as follows.

After subsection (1) of section 26A (disallowance of input tax where consideration not paid) insert—

“(1A) Subsection (1) is subject to section 26AA (disapplication of disallowance under section 26A in insolvency).”

After section 26A insert—

“26AA Disapplication of disallowance under section 26A in insolvency

(1) Section 26A(1) does not apply to a person in relation to credit for input tax which relates to a supply where—

- (a) at the time of the supply, no insolvency procedure had effect in relation to the person,
- (b) at any time during the relevant period, an insolvency procedure had effect in relation to that person (“the insolvent person”), and
- (c) the Commissioners have been notified in writing of the matter mentioned in paragraph (b) by or on behalf of a person authorised to deal with the insolvent person’s affairs.

(2) But where the insolvency procedure mentioned in subsection (1)(b) is a bankruptcy order or a voluntary arrangement and that bankruptcy order is annulled or that voluntary arrangement has come to an end prematurely—

- (a) the disapplication of section 26A(1) by subsection (1) above ceases to have effect, and
- (b) the person to which the bankruptcy order or voluntary arrangement relates is to be taken for the purposes of section 26A(1) as not being entitled to the credit for the input tax concerned as from whichever is the later of—
 - (i) the end of the relevant period, and
 - (ii) the date on which the bankruptcy order was annulled or the voluntary arrangement has come to an end prematurely.

(3) Where the person mentioned in section 26A(1) is entitled, as a member of a partnership, to credit for input tax this section has effect as if—

- (a) the references in subsections (1)(a) and (b) above to “the person” and “that person” were references to the partnership,
- (b) the reference in subsection (1)(c) above to “the insolvent person’s affairs” were a reference to the insolvent partnership’s affairs, and
- (c) the reference in subsection (2)(b) above to “the person to which the bankruptcy order or voluntary arrangement relates” were a reference to the person who is a member of the partnership to which the bankruptcy order or voluntary arrangement relates.

(4) Subsection (1) does not apply where the insolvency procedure referred to in subsection (1)(b) has effect as part of, or as a consequence of, arrangements where the main purpose, or one of the main purposes, of those arrangements is to obtain a tax advantage by the operation of this section.

(5) Regulations may make such supplementary, incidental, consequential or transitional provisions as appear to the Commissioners to be necessary or expedient for the purposes of this section.

^(a) 1994 c. 23; section 26A was inserted by section 22(1) and (3) of the Finance Act 2002 (c. 23).

(6) For the purposes of this section “the relevant period”, in relation to a supply, is the period beginning immediately after the supply took place and ending six months after—

- (a) the date of that supply; or
- (b) if later, the date on which the relevant part of the consideration for the supply is payable.

(7) For the purposes of subsection (6) the relevant part of the consideration is the part of the consideration which is referable to the credit for input tax which would (ignoring the effect of this section) be disallowed under section 26A(1).

(8) For the purposes of this section, an insolvency procedure has effect in relation to a person at a time when any of the following apply—

- (a) a bankruptcy order or award of sequestration has been made which has not been discharged in relation to a person, a winding-up order has been made under Chapter 6 of Part 4 of the Insolvency Act 1986^(b) in relation to that person and that person has not been dissolved and the winding-up order has not been stayed or sisted, or that person is in administration for the purposes of Schedule B1 of the Insolvency Act 1986^(c) or Schedule B1 of the Insolvency (Northern Ireland) Order 1989^(d);
- (b) an appointment of an administrative receiver is in force in relation to that person disregarding any temporary vacancy in the office of receiver;
- (c) an appointment of a liquidator is in force as a consequence of a voluntary winding up under the Insolvency Act 1986 in relation to that person disregarding any temporary vacancy in the office of liquidator;
- (d) a voluntary arrangement has been approved in accordance with Part 1 or Part 8 of the Insolvency Act 1986 or Part 2 or Chapter 2 of Part 8 of the Insolvency (Northern Ireland) Order 1989 in relation to that person and that voluntary arrangement has not been fully implemented or has not otherwise ceased to take effect;
- (e) a deed of arrangement has been registered in accordance with Chapter 1 of Part 8 of the Insolvency (Northern Ireland) Order 1989 in relation to that person and that deed of arrangement has not been fully implemented or has not otherwise ceased to take effect;
- (f) a county court administration order has been made under Part 6 of the County Courts Act 1984^(e) in relation to that person and has not ceased to take effect;
- (g) a compromise or arrangement, sanctioned by the court and delivered to the registrar in accordance with section 899 of the Companies Act 2006^(f), is in place in relation to that person;
- (h) that person’s estate is vested in any other person as that person’s trustee under a trust deed;
- (i) that person has died and an insolvency administration order has been made which has not been discharged in respect of that person’s estate in accordance with an order under section 421 of the Insolvency Act 1986 or article 365 of the Insolvency (Northern Ireland) Order 1989;
- (j) a voluntary arrangement has been approved in accordance with Part 1 of the Insolvency Act 1986 as applied by Part 2 of the Insolvent Partnerships Order 1994^(g), or Part 2 of the Insolvency (Northern Ireland) Order 1989 as applied by Part 2 of the Insolvent Partnerships

^(b) 1986 c. 45.

^(c) 1986 c. 45; Schedule B1 was inserted by Schedule 16 to the Enterprise Act 2002 (c. 40) and amended by paragraph 299 of Schedule 8 to the Courts Act 2003 (c. 39) and article 2 of S.I. 2003/2096.

^(d) S.I. 1989/2405 (N.I.19); relevant amending instruments are S.R. & O. (NI) 2002 No 3152 and 2005 No 1455; S.R. (NI) 2002 No 334, 2004 No 307, 2006 No 61, 2006 No 370 and 2006 No 377; S.I. 2007/2194, 2008/948 and 2009/1941.

^(e) 1984 c. 28; section 112 was amended by section 220 of the Insolvency Act 1985 (c. 65), paragraph 2 of Schedule 2 to the Civil Procedure Act 1997 (c. 12) and paragraph 10 of Schedule 9 to the Crime and Courts Act 2013 (c. 22).

^(f) 2006 c. 46; Section 899 was amended by paragraph 250 of Schedule 1 to S.I. 2008/948 and article 28 of S.I. 2011/1265 and was applied with modifications by regulation 45 of S.I. 2009/1804.

^(g) S.I. 1994/2421; relevant amending instruments are S.I. 1996/1308, 2002/1308, 2002/2708, 2005/1516 and 2006/622.

Order (Northern Ireland) 1995^(h), in relation to that person and that voluntary arrangement has not been fully implemented or has not otherwise ceased to take effect;

- (k) an appointment of a liquidator is in force as a consequence of a voluntary winding up under the Insolvency Act 1986 as applied by Parts 4 and 5 of the Insolvent Partnerships Order 1994, or the Insolvency (Northern Ireland) Order 1989 as applied by Parts 4 and 5 of the Insolvent Partnerships Order (Northern Ireland) 1995, in relation to that person disregarding any temporary vacancy in the office of liquidator;
- (l) that person is in administration for the purposes of Schedule B1 of the Insolvency Act 1986 as applied by Part 3 of the Insolvent Partnerships Order 1994 or Schedule B1 of the Insolvency (Northern Ireland) Order 1989 as applied by Part 3 of the Insolvent Partnerships Order (Northern Ireland) 1995.

(9) (a) In this section—

“administrative receiver” means an administrative receiver within the meaning of section 251 of the Insolvency Act 1986 or article 5(1) of the Insolvency (Northern Ireland) Order 1989;

“tax advantage” has the same meaning as in Schedule 11A; and

“trust deed” has the same meaning as in the Bankruptcy (Scotland) Act 1985⁽ⁱ⁾.

- (b) In this section a voluntary arrangement comes to an end prematurely if it would be regarded as having come to an end prematurely under section 7B or section 262C of the Insolvency Act 1986^(j).

(10) Section 6 applies for determining the time when a supply is to be treated as taking place for the purposes of construing this section.”

3.—(1) In Part 19B of the Value Added Tax Regulations 1995^(k), regulation 172H (repayment of input tax) is amended as follows.

In paragraph (1) for “paragraph (5)” substitute “paragraphs (5) and (6)”.

After paragraph (5) insert—

“(6) This regulation does not apply in so far as a person is entitled under section 26AA of the Act^(l) to credit for input tax in relation to the supply.”

4.—(1) For the purposes of section 26AA of the Value Added Tax Act 1994 (as inserted by article 2(3) above) an insolvency procedure also has effect in relation to a person if—

- (a) that person executed a deed of arrangement which was registered under section 5 of the Deeds of Arrangement Act 1914^(m) before 1st October 2015, and
- (b) that person’s estate has not been finally wound up.

5. This Order has effect in relation to supplies made on or after the date on which this Order comes into force.

^(h) S.R. (NI) 1995 No 225; relevant amending instruments are S.R. (NI) 1996 No 472, 2003 No 144, 2003 No 550 and 2006 No 515.

⁽ⁱ⁾ 1985 c. 66.

^(j) 1986 c. 45; sections 7B and 262C were inserted by sections 2 and 3, paragraph 10 of Part 1 of Schedule 2 and paragraph 12 of Schedule 3 of the Insolvency Act 2000 (c. 39).

^(k) S.I. 1995/2518, amended by S.I. 2002/3027; there are other amending instruments but none is relevant.

^(l) Paragraph (1) of regulation 2 of the Value Added Tax Regulations 1995 provides that “the Act” means the Value Added Tax Act 1994.

^(m) 1914 c. 47; section 5 was amended by section 22(2) and Schedule 5 of the Administration of Justice Act 1925 (c. 28) and Part 5 of Schedule 11 of the Finance Act 1949 (c. 47) and has been repealed but with savings by Part 1 of Schedule 6 of the Deregulation Act 2015 (c. 20).

Explanation

ESC 3.20 is concerned with disapplying the clawback of input tax where no payment, or only part payment, has been made for the supply but the business has entered insolvency proceedings. It has had effect since 26 November 1996 and relieves an insolvent business from making an adjustment providing the supply took place before the insolvency and the clawback becomes due after the insolvency.

When introduced by section 36(4A) of the Value Added Tax Act 1994 (“VATA”) clawback was aimed at combating avoidance and evasion schemes based on the Bad Debt Relief provisions. However, an unintended consequence was the impact it had on insolvent businesses and insolvency practitioners. Clawback would create a liability for VAT against the insolvency practitioner which the practitioner would be required to settle in preference to other debts. It was accepted that as clawback resulted from the actions of the business prior to liquidation the insolvency practitioner should not be liable for the clawback.

Since 1 January 2003 clawback has been due under section 26A. The ESC was not amended to reflect this change but it has continued to have effect as before.

This draft legislation is intended to have the same effect by inserting section 26AA into VATA. Article 2 of the draft amends s26A and inserts a new section, section 26AA, to provide that the disallowance of credit for input tax (clawback) provided for in section 26A will not apply where:

- one of the listed insolvency procedures applies after the time of the relevant supply, and
- clawback falls due after the application of the insolvency procedure,
- the commissioners have been notified of the insolvency procedure, and
- that insolvency procedure has not been annulled or ended prematurely.

Article 3 amends regulation 172H of the VAT Regulations (repayment of input tax) to provide that the obligation to reduce the VAT deduction will not apply where a person is entitled to a credit for input tax where the new section 26AA disapplies section 26A of VATA. Article 4 is a saving provision and provides that deeds of arrangement, registered before 1st October 2015, under the Deeds of Arrangement Act 1914 (c. 47), which was repealed from 1st October 2015, are included as an insolvency procedure for the purposes of the section 26AA of VATA.

3. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 3 of the process. The purpose of the consultation is to seek views on draft legislation in order to confirm, as far as possible, that it will achieve the intended policy effect with no unintended effects.

How to respond

Responses should be sent by 16 December 2015, by:

e-mail to tap@hmrc.gsi.gov.uk

or by post to: Stephanie Allistone, HMRC Central Policy, Room 1C/06, 100 Parliament Street, London SW1A 2BQ.

Telephone enquiries 03000 586496 (from a text phone prefix this number with 18001)

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles. [If you wish to explain your choice of consultation period, this is the place. Also, if you are holding additional meetings or using alternative means of engaging, please mention this here].

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.