[2020] UKUT 0357 (TCC)

Appeal number: UT/2019/0092

VALUE ADDED TAX – bad debt relief – s 36 VATA 1994, reg 168 VAT Regulations 1995, Articles 73 and 90 Principal VAT Directive – factoring services – when is the consideration received – requirement in reg 168 for a "refunds for bad debts account"

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

REGENCY FACTORS PLC **Appellant**

-and-

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

TRIBUNAL: **THE HONOURABLE MRS JUSTICE BACON**
JUDGE JONATHAN CANNAN

Sitting in public by way of remote video hearing on 13 November 2020

Mr Michael Ripley instructed by Nigel Gibbon & Co for the Appellant

Ms Suzanne Lambert instructed by Her Majesty's Revenue & Customs Solicitor's Office and Legal Services for the Respondents

DECISION

Introduction

1. The appellant company, Regency Factors Plc ("Regency") appeals, with permission from the Upper Tribunal, against a decision of the First-tier Tribunal (Tax Chamber) ("the FTT") released on 28 February 2019 ("the Decision"). The FTT dismissed Regency's appeal against VAT assessments made by HMRC to withdraw bad debt relief which Regency had claimed in its VAT returns for various accounting periods between July 2007 and January 2010.

2. Regency provides a factoring service to its clients and in consideration for that service it is paid certain fees. VAT invoices for those fees are issued to clients when the invoices which are being factored are assigned to Regency for collection. In outline, Regency contended before the FTT and on this appeal that it is entitled to bad debt relief pursuant to section 36 Value Added Tax Act 1994 ("VATA 1994") for the VAT element on the fees that were unpaid by its clients. HMRC contend that Regency is not entitled to bad debt relief because the consideration for the supply was received by Regency and there was no bad debt to write off. Alternatively, HMRC say that Regency did not in any event comply with the requirements of regulation 168 of the Value Added Tax Regulations 1995 ("the Regulations"), and that in consequence HMRC were entitled to make the disputed VAT assessments.

VAT bad debt relief

3. The issues in this case involve identifying the taxable amount of Regency's supplies for VAT purposes, the time when that taxable amount is paid and the circumstances in which the taxable amount can be reduced after a supply has taken place. These matters are dealt with by provisions of the Principal VAT Directive ("PVD") (2006/112/EC) which are introduced into UK domestic legislation by VATA 1994 and the Regulations.

4. The following provisions of the PVD are relevant to define the taxable amount and to make provision for a reduction in the taxable amount after the time of supply:

> Article 73
>
> In respect of the supply of goods or services, other than as referred to in Articles 74 to 77, 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.
>
> Article 90
>
> 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.

5. A basic principle of the VAT system was described by the CJEU in *Elida Gibbs Ltd v Customs and Excise Commissioners* Case C-317/94:

> 19. The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.

6. The issue in the present appeal concerns when the consideration is "actually paid" and consequently when consideration remains unpaid for the purposes of bad debt relief. It was common ground between the parties that the term "consideration" is an autonomous concept of EU law, and is not defined by reference to the concept of consideration for the purposes of domestic contract law.

7. The conditions for bad debt relief are set out in section 36 VATA 1994 which in so far as relevant provides as follows:

> 36(1) Subsection (2) below applies where —
>
> *(a)* a person has supplied goods or services and has accounted for and paid VAT on the supply,
>
> *(b)* the whole or any part of the consideration for the supply has been written off in his accounts as a bad debt, and
>
> *(c)* a period of 6 months (beginning with the date of the supply) has elapsed.
>
> (2) Subject to the following provisions of this section and to regulations under it the person shall be entitled, on making a claim to the Commissioners, to a refund of the amount of VAT chargeable by reference to the outstanding amount.
>
> (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.
> …
>
> (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;
…

8. Bad debt relief is given by reference to VAT on the "outstanding amount", which is defined by reference to the amount of the consideration which has been received by the trader. Both parties agreed that in the context of bad debt relief, a sum that was not paid for the purposes of Article 90 was a sum that was not received for the purposes of section 36.

9. The following provisions of the Regulations are relevant. They are made pursuant to section 36(5) and set out how a claim is to be made, the evidence required to be held at the time of a claim, the records to be kept by a claimant and the circumstances in which a refund that has been received shall be repaid to HMRC.

165A Time within which a claim must be made

(1) … A claim shall be made within the period of 3 years and 6 months [4 years and 6 months from 1 April 2009] 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.

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 for 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.

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 therefore,

(*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 regulations 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) Subject to regulation 170A below, 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.

171 Repayment of a refund

(1) Where a claimant —

(*a*) has received a refund upon a claim, and
(*b*) either—

(i) a payment for the relevant supply is subsequently received, or
(ii) a payment is, by virtue of regulation 170 or 170A, treated as attributed to the relevant supply, or
(iii) the consideration for any relevant supply upon which the claim to refund is based is reduced after the claim is made,

he shall repay to the Commissioners such an amount as equals the amount of the refund, or the balance thereof, multiplied by a fraction of which the numerator is the amount so received or attributed, and the denominator is the amount of the outstanding consideration, or such an amount as is equal to the negative entry made in the VAT allowable portion of his VAT account as provided for in regulation 38.

(2) The claimant shall repay to the Commissioners the amount referred to in paragraph (1) above by including that amount in the box opposite the legend "VAT due in this period on sales and other outputs" on his return for the prescribed accounting period in which the payment is received.

(3) Save as the Commissioners may otherwise allow, where the claimant fails to comply with the requirements of regulation 167, 168, 169, 170 or 170A he shall repay to the Commissioners the amount of the refund obtained by the claim to which the failure to comply relates; and he shall repay the amount by including that amount in the box opposite the legend "VAT due in this period on sales and other outputs" on his

return for the prescribed accounting period which the Commissioners shall designate for that purpose.

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.

10. By way of outline at this stage it can be seen that where a trader wishes to obtain bad debt relief, section 36 requires the trader to have accounted for and paid VAT on the supply and to have written off the whole or part of the consideration or taxable amount as a bad debt. The date on which a debt is written off, which may be relevant for the time limit in regulation 165A, is taken to be the date on which an entry is made in the "refunds for bad debts account". A period of 6 months must also have elapsed from the date of the supply. The claim is to a refund of VAT on the amount of VAT chargeable by reference to the outstanding amount, which is effectively that part of the consideration for the supply which has not been received.

11. The Regulations provide for the claim to be made by including the amount of the refund in the VAT return for the period in which the trader becomes entitled to make the claim or a later return, subject to an overall time limit. The amount of the claim is simply included with other sums for which input tax credit is being reclaimed in that return.

12. We refer in our discussion below to the evidence a trader must hold before a claim can be made, the records a trader is required to keep, and the circumstances in which a trader must repay a sum claimed by way of refund.

The FTT's Decision

13. The FTT made its findings of fact based on witness evidence from Mr John Farrell, Group Chief Executive of Regency and Ms Tara Munir, a Senior Officer of HMRC. The FTT's findings as to the nature of Regency's business and its accounting procedures are at [4] – [19] of the Decision. It appears that the FTT found it difficult to understand and make findings in relation to certain aspects of Mr Farrell's evidence. Hence, at [19] it said as follows:

> "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."

14. Be that as it may, there was no real factual dispute before the FTT, or in this tribunal What follows is our summary of the facts based on the FTT's findings and explanations given to us by counsel during the hearing.

15. Regency was formed in October 1991 and was registered for VAT. It is in the business of factoring invoices and providing funding or finance to its clients. The factoring service provided by Regency involves the client assigning invoice debts to Regency. Regency then takes over the collection of invoice debts due from the client's customers, including where necessary any recovery action. The customer is aware of Regency's role because the invoice issued to the customer includes a notice of assignment to Regency. The factoring service is "with recourse", which means that Regency is entitled to recover from its clients any sums paid to those clients in relation to invoice debts that Regency is ultimately unable to collect.

16. To a large extent Regency's appeal to the FTT and its case on this appeal turns on the precise terms and construction of the written agreements it enters into with its clients. We deal with those agreements in more detail below. The FTT described the way in which the agreements operated as follows:

> (1) Clients submit schedules of invoices to Regency with a view to obtaining funding.
>
> (2) The invoices are stamped with a notice of assignment and certain invoices are selected for verification by Regency.
>
> (3) Regency makes an advance against a proportion of the value of the invoices.
>
> (4) In the ordinary course, Regency collects the invoice value from the customer on the due date.
>
> (5) If a debt is outstanding, Regency carries out certain credit control procedures.
>
> (6) When the debt is collected, the balancing sum due in relation to the invoice is paid to the client.

17. The FTT described Regency's accounting systems by reference to various ledgers which it maintained:

> (1) An Overall Sales Ledger ("OSL") which reflects the client's business with its customers.
>
> (2) A Customer Sales Ledger ("CSL") for each customer of each client.
>
> (3) A Factoring Current Account ("FCA") which reflects Regency's account with its client at any one time.

18. The FTT found the following facts in relation to Regency's accounting system:

> (1) Every time a client submits a schedule of invoices, the balance on the OSL and each CSL increases.
>
> (2) Those increases have the effect of increasing the amount of funding available to the client which is shown in the FCA.
>
> (3) Factoring fees and other charges are shown in the FCA under a heading "Commissions/fees". In most cases those fees are subject to VAT, and VAT at the standard rate is shown.
>
> (4) The FCA shows the amount of funding available to the client. It is typically calculated as 80% of the approved debt less the charges including VAT. The FTT used the following figures to illustrate the approved funding by reference to a single invoice of £1,000. The available funds would be calculated as £1,000 x 80% - £36 (3% of £1,000 plus 20% VAT), that is £764.
>
> (5) If the client wished to drawdown this facility they would receive an advance of £764 and the FCA would be debited. Typically, clients would withdraw the full amount of £764.
>
> (6) Once Regency collects funds from a customer they are allocated to the OSL and to the relevant invoice in the CSL. If an invoice of £1,000 is collected, the OSL is reduced by £1,000. The available funds shown in the FCA would then stand at minus £200 (£764 + £30 + £6 - £1,000) which represents the balance of £200 due to the client, £800 having been used to pay the advance of £764 and the charges of £30 plus VAT.

19. There is no allocation of funds against particular invoices in the FCA. Instead the FCA operates as a running account balance made up of payments made to the client, factoring and other fees plus VAT, disbursements relating to the collection of debts and sums collected from customers.

20. Regency issues monthly statements to clients in a document called a "Client Statement and VAT Invoice". The client statement is a sales ledger control account and shows a balance of factored debts brought forward, new debts factored, any debts reassigned to the client, and cash received by Regency from customers. The document also includes a client account summary showing an opening balance reflecting sums due to the client if all factored debts are collected, debts factored in the period, advances

made to the client, charges to the client with VAT separately identified and a closing balance. A separate document shows the funding available to the client at any one time.

21. It was common ground before the FTT and before us that these monthly statements were VAT invoices satisfying the requirements of regulation 14 of the Regulations. The date on which the statements were issued was the time of supply or tax point for VAT purposes, which meant that Regency accounted for the VAT identified in the VAT invoice in its VAT return covering that date.

22. Where debts were not collected in full from customers, either directly or by virtue of the right of recourse, Regency claimed bad debt relief for the VAT on fees that it treated as unpaid. The amount of unpaid VAT was calculated on what Mr Farrell called a *pari passu* basis. It appears from the FTT's findings of fact that this involved identifying the balance on the FCA that represented the final sum owed by the client to Regency. Assuming the sums recovered over the lifetime of a client relationship exceeded the sums paid out to a client, the balance was treated as relating to Regency's charges, disbursements and VAT which had been charged to the client. The outstanding amount was then apportioned between Regency's charges, disbursements and VAT and the sums apportioned to VAT was the subject of a bad debt relief claim.

23. The FTT described at [14] to [17] of the Decision an example of this process which had been given by Mr Farrell. In the example, during the course of a factoring relationship Regency was entitled to charge fees and disbursements of £52,473 plus VAT of £9,135.52. Advances made to the client amounted to £458,990 whilst collections from customers amounted to £500,480. Thus, there was a contribution towards Regency's fees and VAT of £41,890 and a shortfall of £19,719. The VAT amounted to 14.83% of the fees, disbursements and VAT due and therefore the unpaid VAT was treated as being 14.83% of the shortfall, which was £2,923.

24. The FTT recorded the following from Mr Farrell's evidence as to this calculation of the bad debt relief:

> 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.

25. That is how the FCA operates within Regency's accounting system. During the hearing before us Mr Ripley confirmed to us on instructions that it was possible to match payments from customers to specific invoices. That is consistent with the FTT's findings at [11(8)] as to the allocation of funds received to the relevant invoices in the CSL.

26. Regency entered into written contracts with its clients setting out the basis on which it provided a factoring service and charged fees for that service. It was common ground before the FTT that the terms of those contracts at all material times were those set out in a "Factoring Agreement" between Regency and The Hire Shop Limited dated 4 April 2002 ("the Agreement"). Regency was described in the Agreement as "the Factor" and The Hire Shop Limited was described as "the Supplier".

27. The way in which the Agreement worked was that the Supplier periodically provided Regency with schedules of debts which it wished to factor. Regency would have an opportunity to disapprove any debts. Debts which were not disapproved were treated as "Approved Debts" and in respect of Approved Debts Regency would make an "Initial Advance" to the Supplier amounting to 80% of the value of those debts. The Agreement provided for Regency to "purchase" those debts, but it was common ground that in reality Regency took an assignment of the debts simply in order to collect the debts. Regency would maintain a sales ledger for the Supplier and would take steps necessary to collect the Approved Debts. It was entitled to recover from the Supplier the costs of collection which were treated as disbursements.

28. The Agreement made provision for Regency to charge various fees for its factoring service. There was a factoring fee, which was a percentage of the gross value of each Approved Debt together with a fixed fee per purchased invoice. There was also a refactoring charge, which related to debts which had been factored but which Regency subsequently disapproved. The refactoring charge was a percentage per month of the gross value of a debt, chargeable from three days after the debt was disapproved until payment was received, either from the customer or the Supplier.

29. The Agreement contained provision for the Supplier to be liable to Regency in respect of any debts which were not paid by customers within the relevant credit period. Regency would also generally take security and guarantees in respect of that liability.

30. The following clauses in the Agreement are particularly relevant to the issues before us, either directly or by way of context:

> **3 Factoring Service**
>
> The Factor will during the continuance of this agreement perform factoring services for the Supplier including:
>
> 3.1 the maintenance of a Sales Ledger;
>
> 3.2 the collection from Debtors in respect of Approved Debts (in relation to which Invoices shall have been supplied by the Supplier to the Factor) PROVIDED that the Factor shall be under no liability to the Supplier if such sums are not paid by Debtors; and
>
> 3.3 the taking of whatever steps the Factor in its absolute discretion shall consider necessary to recover payment of Approved Debts (and in relation to which Invoices have been delivered by the Supplier to the Factor).
>
> **4 Payments**
>
> 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 the Setting Up Fee; and
>
> 4.2 Forthwith the Minimum Annual Factoring Fee upon periodic review hereof if the Supplier shall have failed to achieve the Minimum Factoring Turnover for the period under review or such sum as shall represent the due proportion of shortfall for that period; and

4.3 The Supplier acknowledges that the Factoring Fee and Refactoring Charge (if any) 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 (or monthly anniversary thereof in relation to any Refactoring Charge) 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; and

4.4 Value Added Tax (or any successor duty or similar fiscal impost) 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 (or such successor duty as aforesaid).

4.5 All sums due and [*sic*] shall 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.

12 Payment and Disapproval

The Factor may at the time of notification or later by written notice to the Supplier:-

12.1 disapprove any Debt by reason of age, dispute, credit limit or otherwise; or

12.2 at the Factor's discretion subsequently approve any disapproved or Unapproved Debt and/or

12.3 if no notice of rejection of a Debt is sent within 15 business days an Initial Advance will be 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

12.4 the Factor shall pay to the Supplier monthly the balance payments due in respect of Debts on which an Initial Advance(s) 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; and/or

12.5 in respect of each Debt or part thereof which remains unpaid on the expiry of 90 days after the date of the invoice, the Factor may in addition to any other rights it may have under this Agreement, make a Refactoring Charge in respect of that Debt or such part thereof until paid; …

20 Set-Off

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.

31. The FTT also referred to a later form of contract which Regency used in 2011. We do not consider the later contract assists in construing the 2002 contract which the parties agreed was in use at all material times.

32. The FTT identified the issues it had to decide at [70] and [71] of the Decision. Those issues may be described as follows:

(1) Did Regency receive consideration for the supply by it of factoring services when it made an Initial Advance to the client/supplier? If so, then the appeal would fail because there was no unpaid consideration.

(2) If not, did each of the claims made by the appellant meet the requirements of section 36 VATA 1994 and Part 19 of the Regulations?

33. In relation to the first issue, it was HMRC's case that the factoring fees were paid when they were deducted by way of set off from the Initial Advance paid by Regency to its clients. Regency's case was that the fees were only paid once it had collected from customers all sums sufficient to cover advances made to its client and its own fees and charges.

34. The FTT said this in relation to the first issue:

> 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…

35. In relation to the second issue, it was HMRC's case that Regency's claims were out of time by virtue of regulation 165A and in any event Regency did not create a single "refund for bad debts account" as required by regulation 168(3). Regency took issue with both those contentions. The FTT said nothing more about the time limit issue or regulation 165A and neither party has sought to revive that issue on this appeal. In the circumstances, we say no more about it.

36. The decision to assess Regency did not, so far as we can see, rely upon any alleged breach of regulation 168, despite the fact that HMRC clearly had serious concerns about the adequacy of Regency's records and whether they were sufficient to establish entitlement to bad debt relief. However, it is clear that regulation 168 was in issue by the time of the FTT hearing and it was addressed in Regency's skeleton argument prior to that hearing.

37. The FTT construed the Agreement and held that Regency had received consideration at the time the Initial Advances were paid to clients. It did so in the following terms:

> 98. Reading these two subclauses together [4.3 and 12.3] 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).
>
> …
>
> 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…

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).

38. The result of the FTT's conclusion on the first issue was that Regency would not be entitled to bad debt relief because the consideration for its services was paid at the time of the Initial Advance and there was no outstanding amount for the purposes of section 36 VATA 1994.

39. The FTT went on to briefly consider the second issue as follows:

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.

40. Both issues were therefore decided in favour of HMRC and Regency's appeal was therefore dismissed.

The grounds of appeal

41. Regency appeals with permission from the Upper Tribunal granted on 23 October 2019. Permission was granted on the following four grounds:

(1) The FTT erred in its interpretation of the contractual arrangements.

(2) The FTT erroneously disregarded the economic reality.

(3) The FTT's reasoning does not apply to all of the disputed claims, including in particular charges or disbursements which arise after the Initial Advance and any charge payable by a client to whom no advances have been made.

(4) The FTT misinterpreted the requirements of the Regulations.

42. Mr Ripley who appeared on behalf of Regency dealt with grounds 1 and 2 together and we shall do the same.

Grounds 1 and 2 – interpretation of the contract and economic reality

43. It is well established and common ground between the parties that in analysing a transaction for the purposes of VAT the contractual arrangements are not determinative, but they are the starting point. It is first necessary to ascertain the contractual terms and then to consider whether those terms reflect economic and commercial reality. That approach is most often applied in the context of identifying what has been supplied, by who and to whom. It is illustrated by numerous cases before the Court of Justice of the European Union and UK domestic courts. The approach was described by the CJEU in *HM Revenue & Customs v Newey* (Case C-653/11) EU:C:2013:409, [2013] STC 2432:

> 42. As regards in particular the importance of contractual terms in categorising a transaction as a taxable transaction, it is necessary to bear in mind the case law of the court according to which consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT …
>
> 43. Given that the contractual position normally reflects the economic and commercial reality of the transactions and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' transaction within the meaning of arts 2(1) and 6(1) of the Sixth Directive have to be identified.
>
> 44. It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.
>
> 45. That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.

44. We were referred to a recent decision of the CJEU to illustrate this approach in *KrakVet Marek Batko* (Case C-276/18) EU:C:2020:485, [2020] STC 1489 at [65] – [68].

45. The approach was also applied by the Upper Tribunal in *Inventive Tax Strategies Ltd (in Liquidation) and Others v HMRC* [2019] UKUT 221 (TCC) in the context of establishing the taxable amount for a supply and whether the taxable amount had been reduced. We refer to that decision in more detail below once we have considered the terms of the Agreement in more detail.

46. In our view this is not a case where the meaning of the contract is clear, but the economic or commercial reality requires a different analysis from a VAT perspective. It is about construing a commercial contract taking into account its commercial context and business common sense. Once the contractual terms concerning consideration are properly construed, it is necessary to address the question of when the consideration is actually paid for the purposes of Article 90 and section 36.

47. It is common ground that the consideration to be received by Regency for its supply of factoring services is principally the payment of factoring fees, refactoring charges and disbursements. There is no issue as to the VAT treatment of the consideration. The assignment of debts by clients to Regency is not consideration for Regency's services and the payment of cash advances by Regency to clients is not consideration for the assignment of debts. Regency and its clients are engaged in a financing and debt collection arrangement for which Regency charges fees. The assignment of debts by clients to Regency is simply a step which enables Regency to provide its factoring services to clients (see the discussion in *MBNA Europe v HM Revenue & Customs* [2006] EWHC 2326 (Ch) at [18] – [22] and of Advocate General Jääskinen in *Finanzamt Essen-NordOst* (Case C-93/10) EU:C:2011:486 at [93] – [103]).

48. Ms Lambert who appeared for HMRC submitted that the FTT was right to conclude that the consideration was paid when it was set off against the Initial Advance. At that stage the charges were "secure and ring-fenced".

49. Mr Ripley submitted that the FTT erred in law in construing the contract as providing for payment of the consideration by way of set off against the Initial Advance. He acknowledged that clause 4.3 provides for Regency's charges to be due and payable forthwith upon the factoring of an approved debt and for those charges to be deducted from sums payable by Regency to clients such as the Initial Advance. However, he submitted that this was subject to two provisions:

> (1) the opening words of clause 4, which provide for the charges to be payable on demand, and
>
> (2) clause 4.3 itself which gives Regency a discretion as to whether it will deduct its charges from sums payable by Regency to clients.

50. Mr Ripley submitted that in the absence of a demand and any exercise of discretion, clause 12.3 was simply concerned with calculating the amount of the Initial Advance. On the figures used by the FTT, the Initial Advance was £764 and the charges were only paid when the debt was collected from the customer at which stage a sum of £200 was paid to the client after deduction of the charges of £36.

51. As to the requirement for a demand, Ms Lambert submitted that the monthly VAT invoices amounted to a demand for these purposes. Mr Ripley submitted that Regency did not demand payment of its charges until the debt collection process had ended, either following collection of the debt or when it became clear that the debt could not be collected.

52. It is true that the VAT invoices identified amongst other things the charges due from clients to Regency in the period covered by the invoice. Those charges are shown as a deduction from the amount due to clients on collection of all factored debts but there is no demand for payment as such. We do not accept that the VAT invoice is a demand for payment.

53. In fact, it became apparent during the hearing that Regency could not point to any demand to clients for payment of its fees and charges, and that no document which could be described as a demand existed in the materials before us. In the absence of any demand, Mr Ripley submitted that Regency's case was that the consideration was only paid when the factoring relationship came to an end, which he acknowledged could take many years. In our view that submission demonstrates a lack of commercial reality in Regency's case. It cannot be the case that fees and charges are only paid when the factoring relationship comes to an end.

54. The reference to payment being made "on demand" in the opening words of clause 4, does not in our view require Regency to make a formal demand for its factoring fees or refactoring charges before it is entitled to exercise the set off provisions in clauses 4.3, 4.5, 12.3, 12.4 and 20. Rather, the words "on demand" refer to the position where Regency requires actual payment of charges by the client instead of operating a set off. In practical terms, that situation might arise in relation to the setting up fee and the minimum annual factoring fee referred to in clauses 4.1 and 4.2, where there might not be a sufficient sum due from Regency to the client against which it could set off those fees.

55. Clause 4.3 provides that the factoring fee and the refactoring charge are payable forthwith on the factoring of each approved debt and may be set off against sums due from Regency to the client. It is to be read together with clause 12.3 which requires payment of the Initial Advance less any fees payable by the client and clause 12.4 which makes provision for monthly payments of the balance due over and above the Initial Advance once the debt has been collected, again subject to Regency's right of set off. It is also to be read together with clause 20 which makes provision for a general right of set off. Those provisions indicate that the right of set off exists independently of any formal demand.

56. Further, clauses 4.3 to 4.5 do not naturally fall to be read together with the requirement for a demand in the opening words of clause 4. Clause 4.3 is an acknowledgment of when the factoring fee and refactoring charge become due and payable, clause 4.4 makes provision for VAT to be payable on all sums subject to VAT and clause 4.5 provides for set off. We do not consider that they are subject to any requirement for a demand.

57. As to the discretion of Regency to exercise a set off, Mr Ripley submitted that the reference to a discretion in clauses 4.3 and 4.5 was reinforced by the terms of clause 20, which provided that Regency was "entitled, but not obliged" to set off against sums payable to a client by Regency, any liability of the client to Regency. He submitted that the FTT was wrong to treat that set off as occurring automatically. Further, whilst clause 12.3 seemed to envisage automatic payment of an Initial Advance and automatic set

off, that did not reflect what happened in practice. Regency did not make automatic payments of the Initial Advance. Instead an amount was credited to the FCA which was then available for drawdown by a client but not necessarily drawn down. The FTT made a finding to this effect as identified above.

58. Ms Lambert accepted that the contract did not expressly provide for automatic set-off, but submitted that as a matter of commercial and economic reality the set off did apply automatically. By issuing monthly VAT invoices showing the set off, Regency was exercising its discretion to apply the set off. When the set off was applied, that amounted to payment by the client to Regency of the consideration for its factoring service. Even if the debt is not collected, Regency had received its consideration in full and was not therefore entitled to bad debt relief.

59. It is clear that clause 4 gives Regency a discretion to demand a separate payment of fees and charges or to exercise its right of set off for fees and charges against sums due to clients under the Agreement. Clause 12.3 on the other hand makes provision for an automatic set off as against an Initial Advance which itself is automatically payable to clients. However, it still remains necessary to consider when the consideration is actually paid for the purposes of Article 90 and section 36.

60. In *Inventive Tax Strategies*, the taxpayers supplied advice in connection with SDLT avoidance schemes. Schemes were sold on the basis of an undertaking to refund fees charged to customers if the underlying scheme was unsuccessful. The schemes were not successful and, faced with the prospect of having to make significant refunds to customers the taxpayers went into liquidation or administration. The taxpayers then issued credit notes to customers as evidence of each customer's entitlement to a refund of the fee charged for the schemes. However, no amount was ever actually repaid to customers. The taxpayers considered that there had been a 'decrease in consideration' for the purposes of Article 90 PVD.

61. The Upper Tribunal (Mann J and Judge Richards) considered the relationship between Article 73 and Article 90 as follows:

> 22. … we accept Ms McCarthy's submission [for HMRC] that, as a general proposition, the definition of 'taxable amount' in art 73 is focusing on the 'consideration actually received' for the supply (a concept that is further expanded by the 'subjective value principle' discussed in the next section). In *International Bingo Technology SA v Tribunal Económico-Administrativo Regional de Cataluña* (Case C-377/11) EU:C:2012:503, [2013] STC 661 the CJEU said:
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> > '25. Next, it must be borne in mind that it is settled case law that that provision [ie art 11A(1)(a) of the Sixth VAT Directive, now art 73 of the PVD] must be interpreted as meaning that the taxable amount for a supply of services is represented by the consideration actually received for that supply (see, inter alia, *Boots Co plc v Customs and Excise Comrs* (Case C-126/88) [1990] STC 387, [1990] ECR I-1235, para 19, and *Town and County Factors*, para 27).'
>
> 23. Moreover, the CJEU's decision in *International Bingo Technology* demonstrates that where a supplier receives payment in cash, that can only be treated as having been

> 'actually received' for these purposes where it is freely at the supplier's disposal (see para 29 of the judgment) …

62. The Upper Tribunal went on to hold that whilst there was a price reduction in that case in the sense that the taxpayers' customers had a contractual entitlement to repayment, the commercial reality was that there had not been any refund, nor would there be. That meant there was no reduction in price for the purposes of Article 90. The purported reduction was just a paper one with no commercial substance. The Upper Tribunal stated as follows in its discussion of the issue:

> 58. We have already observed at [21] that considerations of economic and commercial reality are of particular importance in a case such as this. Therefore, we consider that the task is, as the CJEU put it in *Grattan*, to identify whether, because of a reduction in price, part or all of the consideration has not been received by the taxpayers. That formulation requires a little adjustment when considering a post-contract and post-payment agreement to reduce the price, but it indicates that what one is looking for are the relevant circumstances which result in a recipient receiving, and a payer paying, a lower amount with an eye to the commercial realities.
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> …
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> 60. … Speaking generally, it could be said that there is a price reduction in the sense that the appellants' customers have a contractual entitlement to repayment. But what are the commercial realities? The commercial realities, in this case, are that the appellants have made no actual refunds (see [36] of the Decision). Moreover, there will in fact be no repayment of the price, or at least it cannot be demonstrated that there will be. ...
>
> 61. The commercial reality, therefore, is that there neither has been, nor will be, any refund of the price, or at least that it cannot presently be demonstrated that there will be any such refund. We consider that that means that there is no reduction in price for the purposes of art 90. The purported reduction is just a paper one in the circumstances with no commercial substance. That means that no adjustment falls to be made under art 90.

63. *Inventive Tax Strategies* therefore makes clear that a contractual right does not engage Article 90 in considering whether there has been repayment of part of the consideration. We respectfully agree with that conclusion, and by the same reasoning a contractual entitlement to receive payment does not amount to payment of the consideration. If the contractual entitlement to receive payment does not materialise into actual payment, then as a matter of economic and commercial reality no consideration has been paid or received.

64. Applying that to the present case, at the point where Regency makes the Initial Advance to the Supplier in respect of an Approved Debt, with a deduction for charges shown on the VAT invoice, Regency obtains a contractual entitlement to set off its charges against sums collected from the customer. At that stage, the consideration is "to be obtained" using the words of Article 73. But no consideration has been "actually received". The Initial Advance is, rather, a financing arrangement, effectively in the form of a loan. Thus while the deduction of fees serves to reduce the amount of the

Initial Advance to the client, at that point in time Regency does not have the consideration in the form of its charges freely at its disposal – in other words deduction of fees from the Initial Advance does not put cash into the hands of Regency.

65. Regency only has those charges at its disposal once collections for a debt have exceeded the sums advanced to the client. At that point it can deduct its charges from sums due to the client, pursuant to clauses 4.5 and 12.4 of the Agreement. It is that which puts cash into Regency's hands.

66. In the case of a single factored debt, therefore, if an advance is made but no recovery is made from the customer, in no real sense can it be said that the fee has been paid by the client merely because it has been deducted from the Initial Advance.

67. In practice, however, as explained above Regency operated a running account for each client, i.e. the FCA. Ms Lambert submitted that in these circumstances it was difficult to separate each debt from the current account so as to look at the advances and collections on individual factored invoices.

68. We do not consider that the operation of a running account changes the analysis. It is clear that bad debt relief operates by reference to individual supplies; it is therefore necessary to look at each supply separately. A trader must establish that VAT has been accounted for in relation to a specific supply and that the consideration for that supply has not been received and has been written off at least 6 months after the date of the supply. In the context of Regency's supplies, we are concerned with individual debts factored by Regency for which it charges fees to its clients, and as we have noted above Mr Ripley confirmed that it is possible for Regency to match customer payments to specific invoices. Even if that were not the case, regulation 170(2) would be engaged to attribute receipts to specific supplies.

69. In our view, therefore, the way in which Regency operates its client records is simply a matter of accounting, which cannot govern entitlement to bad debt relief pursuant to section 36. Having said that, the operation of a running account may have implications in terms of establishing a right to bad debt relief and in terms of the record keeping requirements, which is the subject of Ground 4.

70. For these reasons we consider that the FTT was wrong to find at [101] that consideration for the supplies was received by Regency at the time it made the Initial Advance to its client.

Ground 3 – charges and disbursements not deducted from an Initial Advance

71. Regency contends that the FTT's reasoning for finding that the consideration was paid at the time of an Initial Advance applied only to fees charged in cases where an Initial Advance was made. However, in some cases there would be no Initial Advance and in other cases charges such as refactoring charges and disbursements would become payable only after an Initial Advance had been made.

72. Ms Lambert argued that whether or not there was an Initial Advance, the funding available to the client was reduced by the charges and so the analysis as to when the

consideration was paid would be the same. In any event, there was no evidence before the FTT that this was a common occurrence and Mr Ripley accepted that it was rare for there to be no Initial Advance. In relation to charges payable after an Initial Advance, Ms Lambert initially submitted that such charges were set off against sums available to the client in the FCA which was in the nature of a running account. Those charges had also been set off and should be treated as paid. During the course of the hearing and on instructions Ms Lambert conceded that charges such as refactoring charges incurred after an Initial Advance had been made could in principle be the subject of a bad debt relief claim, but she said that the treatment of such charges had not been highlighted by Regency before the FTT.

73. In relation to both situations, Ms Lambert submitted that there was no evidence before the FTT as to the extent to which the bad debt claims related to such charges.

74. It can be seen from the FTT's decision that Regency put its case before the FTT on the basis that the issues had to be determined in relation to each individual claim to bad debt relief, which presumably was a reference to the charges incurred in relation to each factored invoice. However, it is not clear to us whether or to what extent Regency identified the different circumstances and different types of charges for which bad debt relief had been claimed. Nor do we know the extent to which submissions were made by reference to those different circumstances and types of charges. We do know that the FTT at [70] decided that it was not necessary to consider each claim separately and formulated the issue to be determined in general terms by reference to cases where there was an Initial Advance.

75. In the circumstances, we are not satisfied that the FTT made any error of law in approaching the issue as it did. However, in light of our analysis above in relation to Grounds 1 and 2, in our view there is no reason to treat refactoring charges or disbursements, or fees charged in cases where there has not been an Initial Advance, any differently to factoring fees where there is an Initial Advance. Those charges will be paid when Regency obtains recovery of the underlying debts from customers and sets the charges off against the sums which it is required to pay the client. In both cases, Regency only has freely available funds when it makes a recovery of the underlying debt.

Ground 4 – the Regulations

76. As a preliminary point, Mr Ripley observed that HMRC had not utilised the procedure in regulation 171(3) to recover relief which had been claimed and paid in circumstances where there was a breach of regulation 168. Instead of designating a return for a prescribed accounting period for Regency to repay the relief, HMRC had made assessments to claw back the relief. Mr Ripley also pointed out the discretion given to HMRC by regulations 168(2) and 171(3) as to the content of the records required to be kept and whether to require the trader to account for relief claimed in breach of regulation 168.

77. There was no challenge by Regency before the FTT as to the means by which HMRC had sought to recover the bad debt relief claimed by Regency. Nor was there any challenge to HMRC's failure to exercise its discretion to allow bad debt relief in

the absence of compliance with regulation 168(3). Nor does Regency have permission to appeal the FTT's decision on the basis of such challenges. The only question that arises under Ground 4 is therefore whether the FTT's decision as to the application of regulation 168 in this case was correct.

78. As to that, Regency contends that it complied with all the regulatory requirements for bad debt relief. In particular, it contends that its records contain all the records required to be kept as detailed in regulation 168(2). It did not create those records for the purposes of regulation 168, but it did create them for its general record keeping purposes. Therefore, there was no requirement to keep the records in a single account. The requirement to keep records in a single account in regulation 168(3) was limited to records "created in pursuance of this regulation".

79. In support of that construction, Mr Ripley relied on the judgment of the CJEU in *Tratave v Autoridade Tributária e Aduaneira* (Case C–672/17) EU:C:2018:989. He relied on *Tratave* for a proposition that the formalities required by Member States in relation to relief under Article 90 were subject to strict limitations and regulation 168 must be construed in a way that is consistent with those limitations.

80. Mr Ripley acknowledged that the onus was on Regency to establish its entitlement to claim bad debt relief in relation to each supply, arguing that it could do that by reference to the various records which it kept. Mr Ripley also acknowledged that Regency's records containing the information required by regulation 168(2) was in different files and records, and the reference in regulation 168(3) to a single account suggested a single ledger or spreadsheet. However, he submitted that Regency's records were not created for the purposes of regulation 168 and therefore there was no need for a single ledger or spreadsheet.

81. In *Tratave*, the CJEU was concerned with a domestic provision in Portugal which required the trader to give prior notice to a customer of its intention to cancel the VAT which it had charged but not recovered from that customer. The issue was whether the principle of neutrality and Article 90 precluded such a provision. The CJEU also referred to Article 273 PVD which provides as follows:

> Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

82. The CJEU found that the principle of neutrality and Articles 90 and 273 did not preclude the Portuguese domestic provision. At [34] the CJEU stated as follows:

> 34. … [T]he formalities to be complied with by taxable persons in order to exercise, vis-à-vis the tax authorities, the right to reduce the taxable amount for VAT, must be limited to those which make it possible to provide proof that, after the transaction has been concluded, part or all of the consideration will definitely not be received. In that regard, it is for the national courts to ascertain whether that is true of the formalities

> required by the Member State concerned (judgments of 15 May 2014, *Almos Agrárkülkereskedelmi*, C-337/13, EU:C:2014:328, paragraph 39, and of 12 October 2017, *Lombard Ingatlan Lízing*, C-404/16, EU:C:2017:759, paragraph 44).

83. In other words, the conditions may require proof but must not prevent a trader from establishing entitlement to make a claim.

84. The CJEU drew considerably from its previous judgment in *Minister Finansów v Kraft Foods Polska* (C-588/10) EU:C:2012:40. That case was concerned with a domestic provision in Poland which required a trader to be in possession of an acknowledgment of receipt of a correcting invoice from the purchaser in order to reduce the consideration under Article 90. The CJEU said as follows:

> 23. Given that Articles 90(1) and 273 of the VAT Directive do not, outside the limits laid down therein, specify either the conditions or the obligations which the Member States may impose, it must be held that those provisions give the Member States a margin of discretion, inter alia as to the formalities to be complied with by taxable persons vis-à-vis the tax authorities of those States in order to ensure that, where the price is reduced after the supply has taken place, the taxable amount is reduced accordingly.
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> …
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> 28. It is also apparent from case-law that measures to prevent tax evasion or avoidance may not, in principle, derogate from the basis for charging VAT except within the limits strictly necessary for achieving that specific aim. They must have as little effect as possible on the objectives and principles of the VAT Directive and may not therefore be used in such a way that they would have the effect of undermining VAT neutrality, which is a fundamental principle of the common system of VAT established by the relevant European Union legislation (see, to that effect, *Goldsmiths*, paragraph 21; Case C-566/07 *Stadeco* [2009] ECR I-5295, paragraph 39 and the case-law cited: and Case C-489/09 *Vandoorne* [2011] ECR I-0000, paragraph 27).
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> 29. Consequently, if reimbursement of the VAT becomes impossible or excessively difficult as a result of the conditions under which applications for reimbursement of tax may be made, those principles may require that the Member States provide for the instruments and the detailed procedural rules necessary to enable the taxable person to recover the unduly invoiced tax (*Stadeco*, paragraph 40 and the case-law cited).
>
> …
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> 33. The requirement at issue in the main proceedings may, in principle, contribute not only to ensuring the correct collection of VAT and preventing evasion but also to eliminating the risk of loss of tax revenue. It follows that the Republic of Poland is fully entitled to submit that that requirement pursues the legitimate objectives set out in Articles 90(1) and 273 of the VAT Directive.

85. The CJEU in *Kraft Foods* then answered the question as follows at [42]:

> [T]he principles of VAT neutrality and proportionality do not, in principle, preclude such a requirement. However, where it is impossible or excessively difficult for the taxable person who is a supplier of goods or services to obtain such acknowledgment

> of receipt within a reasonable period of time, he cannot be denied the opportunity of establishing, by other means, before the national tax authorities, first, that he has taken all the steps necessary in the circumstances of the case to satisfy himself that the purchaser of the goods or services is in possession of the correcting invoice and is aware of it and, second, that the transaction in question was in fact carried out in accordance with the conditions set out in the correcting invoice.

86. Mr Ripley submitted that we must give regulation 168 an interpretation which conformed with these EU law principles or in so far as necessary disapply the regulation. HMRC's justification for requiring a single account was simply a matter of administrative convenience which was not a permissible purpose. Alternatively, if the required information is not contained in a single account but is available elsewhere in Regency's records then HMRC must exercise the discretion which they have in regulation 171(3) not to require repayment of the bad debt relief.

87. Mr Ripley submitted that there was no issue that the requirements of section 36 had been met. Regency had accounted for VAT on the charges, it had written off those charges in its accounts and more than 6 months had elapsed since the date of the supply, which for present purposes was the date of the VAT invoice. Further. The FTT found at [117] that there was no reason to doubt that Regency kept the records listed in regulation 168(2). In those circumstances, he submitted that the FTT was wrong to find at [119] that in the absence of a refunds for bad debts account it was impossible to say that the requirements for bad debt relief had been satisfied.

88. We do not accept those submissions. At [117] of its decision the FTT took the view that the reason regulation 168(3) required records to be kept in a single account was to establish an audit trail that HMRC investigators can easily check. Mr Ripley accepted that this was indeed the purpose of the provision. Looking at the regime as a whole, we agree that was parliament's intention in requiring records to be kept in a single account. We also note that a claim for bad debt relief is simply made by including an amount as part of the input tax deduction made on the VAT return. There is no prescribed form of claim and therefore no specific details required to be included on any claim form. This can be contrasted with claims for overpaid tax under section 80 VATA 1994 where there is a prescribed form which must state the amount of the claim and the method by which it was calculated.

89. Regulation 168 clearly provides that a trader who makes a claim for bad debt relief must keep a record of the information required by regulation 168(2). Regulation 168(3) requires that information to be kept in a single account to be known as a "refunds for bad debts account". Regulation 172(2) also provides that the time when consideration is taken to have been written off is when an entry is made in that account. It is common ground that the information required to be kept has not been kept in a single record or spreadsheet. Regency was obliged to keep such records in a single account. That is a clear failure to comply with regulation 168(3). Regulation 168(3) cannot be read as being inapplicable in every case where the trader has the records stored separately from the single account. The language of the regulation is plain, and Mr Ripley's contrary construction would entirely undermine the purpose of Regulation 168.

90. We do not consider that the CJEU decision in *Tratave* assists Regency. Whilst there are limitations on the conditions and requirements that Member States can impose, such restrictions are engaged where the conditions for relief go beyond the margin of discretion and make the claiming of relief impossible or excessively difficult. The requirement for a single account is to provide an easily verifiable audit trail for HMRC, including identifying the date when consideration is written off. Such a condition plainly falls within the margin of discretion afforded to Member States. The requirements of regulation 168 contribute to ensuring the correct collection of VAT, preventing evasion and eliminating the risk of loss of tax revenue. They are not unduly onerous. Regency did not make out any case that the requirements made it impossible or excessively difficult to claim relief. In any event, the requirements are subject to the discretion of HMRC to allow less information to be contained in the single account. As mentioned above, there has been no challenge to HMRC's exercise of discretion.

91. Further, we do not accept that the FTT made any finding at [117] that Regency had kept a record of all the information required by regulation 168(2). In the light of what the FTT said at [119], the FTT simply assumed that to be the case in favour of Regency in circumstances where there was in any event a breach of regulation 168(3). The FTT found and Mr Ripley confirmed that receipts from customers could be allocated to specific invoices in the CSL. As such, the fact that Regency did not keep a single refunds for bad debts account was simply a matter of administrative convenience for Regency. Regency is not being penalised for its business model, as suggested by Mr Ripley. It has been denied relief because of deficiencies in its record keeping.

92. For the reasons given above, we do not consider that the FTT misinterpreted or made any error of law in its application of the Regulations.

Disposition

93. Given our findings on Ground 4, the appeal must be dismissed.

Signed on original

MRS JUSTICE BACON
JUDGE JONATHAN CANNAN

RELEASE DATE: 14 December 2020