TC07142

VAT – Bad debt relief – s 11 FA 1990 & s 36 VATA 1994 – historical claim

Appeal number: TC/2014/3875

FIRST-TIER TRIBUNAL
TAX CHAMBER

BETWEEN

SAINT-GOBAIN BUILDING DISTRIBUTION LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE PETER KEMPSTER

Sitting in public at Centre City Tower, Birmingham on 16-19 October 2018

Mr David Southern QC, instructed by Grant Thornton UK LLP, for the Appellant

Ms Eleni Mitrophanous of counsel, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Respondents

DECISION

Introduction

1. In May 2014 the Appellant submitted a claim for VAT bad debt relief ("**BDR**") in respect of supplies made in the period from 1 April 1989 to 18 March 1997 ("**the Claim Period**"). The Respondents ("**HMRC**") rejected that claim in June 2014. The relevant supplies were of building materials, and the customers were mainly builders buying on trade credit terms.

2. The relevant supplies were made by three companies in the VAT group of which the Appellant is the representative member (s 43 VAT Act 1994 refers): Jewson Limited ("**Jewson**"), Harcros Timber and Building Supplies Limited ("**Harcros**"), and Graham Group Limited ("**Graham**") (together "**the Claimant Companies**"). In was previously in dispute whether the Appellant could bring a claim on behalf of the Claimant Companies; however, it has now been agreed (following the Upper Tribunal decision in *RCC v MG Rover Group Ltd & others* [2016] UKUT 434 (TCC)) that the Appellant is eligible to bring claims for Jewson and Harcros for the entire Claim Period, and for Graham for the period from 1 April 1994 to 18 March 1997.

3. The amount in dispute has been varied since the original claim, following discussion between the parties, and the parties agreed that further work would be necessary to finalise the amount if any repayment is found to be due. The claim currently stands at around £9.9 million plus statutory interest. The parties requested and I agreed that a decision in principle should be determined, with leave to revert to the Tribunal, if appropriate and necessary, on quantum.

Law

4. The Claim Period starts almost three decades ago, so it is necessary to refer to historical as well as current legislation.

5. Article 11C(1) Sixth Council Directive 77/388/EEC (now Article 90 Directive 2006/112/EC) states:

> "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.
> However, in the case of total or partial non-payment, Member States may derogate from this rule."

6. The UK legislative enactment providing relief for bad debts was first in s 11 Finance Act 1990, then replaced by s 36 VAT Act 1994. The relevant requirements may be summarized as follows:

(1) A person has supplied goods or services for consideration and has accounted for and paid VAT on the supply (s 11(1)(a) FA 1990, s 36(1)(a) VATA 1994).

(2) That person has written off in his accounts the whole or any part of the consideration as a bad debt (s 11(1)(b)) FA 1990, s 36(1)(b) VATA 1994).

(3) A stipulated period of time has elapsed from the date of the supply – this was originally two years (s 11(1)(c) FA 1990) reduced, from 1991, to one year (s 15 FA 1991) and, from 1994, to six months (s 36(1)(c) VATA 1994).

(4) A claim is made to HMRC for a refund of the amount chargeable in relation to the outstanding amount (ie the unpaid consideration written off) (s 11(2) & (3) FA 1990, s 36(2) & (3) VATA 1994). Regulations required a claim to be made in a particular form and manner; for it to be evidenced and quantified by reference to records; require such records to be retained; and require repayment of refunds in specified cases (s 11(2) & (5) FA 1990, s 36(2) & (5) VATA 1994) – during the Claim Period the relevant regulations were The Value Added Tax (Bad Debt Relief) Regulations 1986, The Value Added Tax (Refunds for Bad Debts) Regulations 1991, and the Value Added Tax Regulations 1995. Regulations 167 & 168 of the VAT Regulations 1995 provide:

> "**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".
> (4) Where regulation 166AA applies, "prescribed accounting period" in this regulation is to be read as "tax period"."

(5) In the case of the supply of goods, the property in the goods has passed to the person to whom they were supplied or to a person deriving title from, through or under that person (s 11(4)(b) FA 1990, s 36(4)(b) VATA 1994) ("**the Property Condition**").

7. In *GMAC UK plc v Revenue and Customs Commissioners* [2017] STC 1247 ("***GMAC***") the Court of Appeal decided (at [83] & [89]) that the Property Condition was not in accordance

with EU law and was disproportionate, and should be disapplied. The Property Condition was repealed from 19 March 1997 – which marks the end of the Claim Period. Following that change, HMRC issued "Revenue and Customs Brief 1 (2017): VAT - historical bad debt relief claims", which it is convenient to set out here:

> **"Purpose of this brief**
> This brief sets out HM Revenue and Customs' (HMRC) position on claims for historical bad debt relief following the Court of Appeal's judgments in British Telecommunications of 11 April 2014 and GMAC UK Plc on 25 October 2016.
>
> **Readership**
> VAT registered businesses that suffered bad debts on supplies they made between 1 January 1978 and 19 March 1997 and that didn't adjust the VAT on such debts.
>
> **Background**
> The UK VAT Bad Debt Relief scheme was introduced in 1978. Since then the conditions of the scheme have changed:
>
> - before 1 April 1989, the scheme required the defaulting customer to be formally insolvent
> - until 19 March 1997, there was also a condition that title in any goods must have passed to the customer
>
> The litigation concerned the bad debt relief legislation that existed between 1978 and 1997 and doesn't affect the current scheme set out in Notice 700/18 Relief from VAT on bad debts.
>
> The Court of Appeal found that the above former conditions were disproportionate. However, it also decided that it was too late to make claims under the scheme that existed before 1 April 1989. The outcome of the litigation is, therefore, that:
>
> - claims relating to bad debt relief on any supplies made prior to 1 April 1989 will be refused
> - claims relating to supplies of goods made between 1 April 1989 and 19 March 1997 will be paid subject to satisfactory evidence that the bad debts occurred and that the VAT hasn't been previously reclaimed - claims not subject to capping
>
> **Evidence**
> In addition to where title in goods passed on supply, between 1989 and 1997, Notice 700/18 made clear that title in goods would pass, and therefore bad debt relief would apply, where either of the following occurred:
>
> - goods in question had been sold on to a third party by the debtor
> - supplier chose to write to their customer and give up title in the goods to them
>
> It's therefore possible that businesses may have previously claimed relief during this period under these terms. HMRC considers this unlikely to be the case in circumstances where businesses routinely repossessed high value goods following default by the customer. It is more likely that VAT bad debt relief may have been claimed where, for example, goods were supplied to customers who purchased the goods for resale.

> To ensure that any businesses making claims in the light of the GMAC case haven't previously claimed relief, claims will need to meet the requirements set out in conditions 1 to 5 in paragraph 2.2 of Notice 700/18.
>
> If a business can't meet these requirements it will need to satisfy HMRC by other means that it didn't previously obtain bad debt relief. HMRC will consider alternative evidence for amount and methodology. The responsibility is on the claimant to show:
>
> - that they suffered bad debts on supplies of goods made under retention of title terms
> - they didn't previously claim relief
> - the amount claimed is correct
>
> Claims already with HMRC will be dealt with in line with this brief although we may need to contact claimants for further information. New claims should be made in writing, quoting Revenue and Customs Brief 1 (2017), and sent with full supporting evidence …"

Witnesses

8. The Tribunal took oral evidence from the following witnesses, who also answered questions from counsel and the Tribunal.

(1) For the Appellant:

(a) Mr Malcolm Ellis is a qualified accountant and is employed by the Appellant as a project director. He adopted and confirmed a formal witness statement dated 4 October 2015.

(b) Mr Leach is the indirect taxes manager of the Appellant's holding company. He adopted and confirmed two formal witness statements dated 6 October 2015 and 11 October 2018 respectively. HMRC objected to the admission of Mr Leach's second witness statement on the grounds that (i) it was delivered late, only one week before the hearing; and (ii) it expressed views which were the opinion of the witness rather than assertions of fact. After hearing from both parties, I determined that the second witness statement should be admitted, and that HMRC would have an opportunity to address me as to relevance when Mr Leach's evidence was heard.

(2) For HMRC, Mr Lunn is the customer compliance manager for the Appellant's group. He adopted and confirmed a formal witness statement dated 10 October 2018.

Mr Ellis's evidence

9. Mr Ellis's evidence included the following points. I found him to be a credible witness on the matters within his personal knowledge, and he was open concerning matters raised that he had no knowledge of.

(1) He joined the Appellant's group – then called Meyer International plc – in 1990, and has held a number of accountant positions, including finance director of a group subsidiary.

(2) Between 1990 and 1996 he was part of an accounting team responsible for producing **the White Book**. This was a half-yearly briefing document prepared for board members, providing additional detail on the half-yearly and annual accounts of the group. Due to the passage of time, a complete set of the White Books for the Claim Period was not available; copies had been found for seven half-year periods, and the years ended March 1996 and March 1997. Accounting information was provided to the team by the various brands and companies.

(3) The White Books set out details of the Appellant's specific provisions for bad debts and bad debts charged to the Profit and Loss account. The specific provisions for bad debts reflect the age profile of debtor balances and the likelihood that some may prove to be uncollectable. The bad debt charges to the Profit and Loss account were a combination of the specific provisions and those debts written off when it was known that payment would not be received by the Appellant. The details were taken directly from the information supplied by the Appellant's various brands and companies. Bad debts charged to Profit and Loss account took into account any recoveries that were made from debtors during the relevant period (for example, dividends received from liquidators or administrators).

(4) The Appellant's group used the Meyer International Accounting Manual ("**the Accounting Manual**"). Paragraphs 6.2 to 6.4 of the Accounting Manual described the accounting for the bad debts provision. Throughout the year, on a monthly basis, a reserve of 0.4% of external credit sales (including VAT) was charged to profit and loss account, against which debts assessed by management as bad or irrecoverable would be charged. At the end of the final month of the accounting year (March) the overall bad debt provision would be allocated to specific debts regarded as irrecoverable and any surplus on the reserve credited to profit and loss account. In other words, the bad debts reported annually constituted an actual figure, not a provision. In the statutory accounts the charge for bad debts would be part of "cost of sales" – per para 16.1 of the Accounting Manual. For the years ended March 1996 and March 1997 the figures for turnover and net profit were the same in the statutory accounts and the White Books for those years.

(5) Mr Ellis was not responsible for preparing the group's statutory accounts. He did not have any involvement in the preparation or filing of the VAT returns for group companies. VAT was accounted for in accordance with SSAP 5: turnover was exclusive of VAT, debtors were inclusive of VAT, and bad debt figures were inclusive of VAT.

(6) Between 1990 and 1997 the standard terms and conditions of the Appellant's businesses included a retention of title clause, entitling the supplier to recover goods from a customer who failed to pay. He could not recall any letters to customers releasing the retention of title clauses.

(7) In response to questions in cross-examination:

> (a) Customers were trading builders who might store the goods for short periods but generally were using them on building projects being undertaken for their own customers.
>
> (b) The credit control team would chase slow payers; if they knew a customer was in financial difficulties then a representative might attend

to try to identify goods before an administrator was appointed, but usually it was too late and Mr Ellis did not know if this ever succeeded.

(c) He did not know if VAT BDR claims were made. He would expect to see this as part of the reporting; it was not covered by the Accounting Manual. By the time the VAT rules changed in 1997 he had changed role within the organisation.

(d) He believed the group had no expectation of recovering VAT on bad debts; it was not a conversation they were having because they understood it was not an option. If it had been possible then he would expect to see it in the White Books somewhere. He was not at that time familiar with the VAT Notices concerning BDR.

Mr Leach's evidence

10. Mr Leach's evidence included the following points. I found him to be a credible witness on the matters within his personal knowledge, and he was open concerning matters raised that he had no knowledge of.

(1) He has over 35 years' experience working in tax, including 18 years specialising in VAT, with large professional firms and commercial organisations. He joined the Appellant's group in 2009. Thus he had not been involved with the Claimant Companies during the Claim Period.

(2) The disputed claim was prompted by discussions with the group's professional advisers following the *GMAC* decision of the Upper Tribunal in 2012, which held that both the Property Condition and the insolvency condition for VAT BDR were not enforceable between April 1989 and March 1997, and that the time limit for making such a claim was not capped.

(3) The large majority of the group's sales are building materials to building businesses of various sizes, usually on credit terms. The standard terms and conditions used in the Claim Period included a retention of title clause which provides that title only passes when the goods are paid for. In practice this was somewhat academic, as the goods (eg bricks) may often have been incorporated into something else (eg a house).

(4) His understanding was that VAT BDR was not available in the Claim Period because of the retention of title clause; *GMAC* had held that restriction was invalid. In correspondence HMRC had said that VAT BDR would have been available if the supplier wrote to the customer to waive the retention of title clause; he was not aware of this practice nor of seeing any suppliers being advised to follow this course of action.

(5) The businesses were asked to review their old records for any evidence of bad debts incurred in the Claim Period, for the terms and conditions used at the time, and any information as to whether or not any VAT BDR claims were in fact made. Due to the passage of time, no VAT returns or other VAT records were available for the Claim Period, and no current employees had been able to comment on VAT return workings relating to the Claim Period; HMRC had confirmed that they also held no such records.

(6) Mr Leach described the methodology he had used to compute the claim; this involved estimates of the percentage of sales that were VAT standard rated, the percentage of sales that were made on credit sales, and the percentage of bad debts. In calculating the claim it had been assumed that at no stage had the Claimant Companies provided statements to insolvency practitioners or others, formally giving up their rights under the retention of title clauses that were in place in relation to these sales. In calculating the claim it had been assumed that no VAT BDR had previously been claimed in relation to these supplies; this appeared consistent with the limitations placed on claiming VAT BDR in the relevant period as reflected in VAT Notice 700/18, and various extracts from Tolley's VAT reference books current during the Claim Period. In the Accounting Manual it was stated:

> "5.3.5 The specific bad debts on line 9270 is the year to date amount incurred based on write-offs due to insolvency or treatment for VAT purposes as irrecoverable, if earlier. The amounts should include value added or sales tax and stated before taking account of credit insurance claims and other recoveries.
>
> 5.3.6 Line 9260 is for the year to date bad debt charge to the profit and loss account including changes in the specific provision and general reserve but excluding credit insurance charges …"

(7) In 1997 the group had acquired Harcros; the purchase agreement contained tax warranties including one concerning any VAT BDR claims made since the balance sheet date (31 December 1996); a disclosure against that warranty stated that BDR claims had been made by Harcros for the March and June 1997 quarters.

(8) In response to questions in cross-examination:

(a) He held no VAT records information concerning whether BDR had been claimed. He had assumed that no BDR could be claimed, or was claimed. He accepted that if a business could claim BDR then it would be expected to do so.

(b) He understood the White Book figures for debtors and bad debts showed figures as including VAT; that was in line with the Accounting Manual. There were no specific references to VAT in the White Books. He accepted that the White Book did not reveal whether BDR had been claimed; he felt that if BDR was claimed then this would have needed an extra column on the bad debts analysis page.

(c) From the tax warranty information on Harcros he had not taken it as implying that BDR claims had been made for earlier periods. In 1997 the VAT BDR rules had been in flux; they may have made a mistake about the start date for the new rules.

(d) Any BDR claim would not be a separate claim to HMRC, just included in the calculations for the VAT return.

Mr Lunn's evidence

11. Mr Lunn's evidence included the following points.

(1) He has been responsible for managing HMRC's relationship with the Appellant's group since April 2017.

(2) HMRC had checked their records for the Appellant's group and could find no specific information to confirm whether the Claimant Companies did or did not include BDR claims in their VAT returns covering the Claim Period. During the Claim Period and up to the present VAT registered businesses who wish to claim BDR are not required to notify HMRC of their claims. Once a business has satisfied itself that the requisite conditions have been met to claim BDR then it is claimed in Box 4 of their VAT return. Box 4 also contains all the input tax claimed by that business in a VAT period so BDR claims are not visible to HMRC. BDR claims will only be visible to HMRC where either a trader chooses to inform HMRC that they have included a BDR claim within their VAT return, or where BDR claims are specifically checked for during a compliance visit.

(3) The Appellant had confirmed that it no longer held the information stipulated by VAT Regulations and public notices to support any BDR claims.

(4) A number of taxpayers had filed VAT BDR claims following the *GMAC* decision, asserting that they had been prevented from claiming BDR on supplies of goods in the Claim Period. One taxpayer ("**Customer One**") was a manufacturer and distributor of products used in the building and automotive sectors; its claim for the period 1978 to 1997 was predicated on the basis that all its contracts contained retention of title clauses, and so it had been prohibited from claiming BDR in that period. On investigation, HMRC established that Customer One had in fact included BDR claims in their VAT returns, that these had been checked in the course of usual compliance checks, and (after some adjustments) had been agreed as valid.

(5) The significance of the Customer One file for Mr Lunn was:

(a) Customer One was also within the construction sector.

(b) Customer One had argued that it made supplies of goods on credit with retention of title clauses, and that this prevented it from claiming BDR during the relevant period, which overlapped with the Claim Period.

(c) Customer One's products would most likely have been incorporated directly into buildings or automobiles by Customer One's own customers, or sold on by those customers down supply chains but ultimately being incorporated into buildings or automobiles by entities further down the supply chain.

(d) In fact Customer One did claim BDR during the relevant periods, despite its assertion that it had made no such claims, for the reasons stated.

(6) In response to questions in cross-examination:

(a) He acknowledged that the available HMRC visit reports for Jewson made no reference to BDR but could not comment on whether any conclusions could be drawn from that.

(b) He believed the explanations given in HMRC Notices and guidance were intended to be an accurate representation of the applicable law, but could not comment further.

Appellant's case

12. Mr Southern submitted as follows for the Appellant.

13. The Appellant's claim on behalf of the Claimant Companies is that:

> (1) The Claimant Companies were barred by UK law from claiming VAT BDR where the supply contracts contained a retention of title clause. The invalidity of that bar having been established (per *GMAC*), the under-claimed VAT is recoverable.
>
> (2) On the balance of probability, the Claimant Companies did not in fact recover the VAT BDR in these cases.
>
> (3) The amount of under-claimed VAT can be accurately calculated.
>
> (4) Statutory interest is payable.

The Property Condition

14. The ordinary rule in VAT is that goods are supplied when they are delivered, not when ownership passes: *Staatssecretaris van Financien v Shipping & Forwarding Enterprise BV* [1991] STC 627. Thus a supply of goods takes place for VAT purposes when possession is transferred, not when title is transferred. During the Claim Period the UK had chosen to impose a restriction on VAT BDR in a manner which was later held to be in breach of EU law. Section 11(4)(b) FA 1990 and s 36(4) VATA 1994 denied a refund unless "in the case of a supply of goods, the property in the goods has passed to the person to whom they were supplied or to a person deriving title from, through or under that person." That Property Condition was held to be a breach of the principle of effectiveness: *GMAC* (at [85-91]); it was thus ineffective *ab initio*: *Deutsche Morgan Grenfell v IRC* [2007] STC 1 (at [23]).

15. In the Claim Period the Claimant Companies suffered commercial bad debts. UK law denied VAT BDR thereon because the Claimant Companies sold to the customers on terms incorporating a retention of title clause; the only reason BDR was not claimed was because of the Property Condition; that was a problem caused by HMRC's incorrect incorporation of the Property Condition into UK law, as found in *GMAC*. The Claimant Companies did not claim BDR at the time; if relief had been claimed then the Appellant would have known this and would not now be making this claim; by the presumption of regularity it can be assumed that the Appellant complied with the (then) legal framework and conditions; also, any contemporaneous claims would have been spotted and disallowed by HMRC (on their then understanding of the Property Condition). The Appellant was a well-run commercial organisation with extant records that are sufficiently clear to enable the amount of VAT to be calculated.

16. The question how the taxpayer might have behaved if the law had been different was purely speculative, and was rejected in *Conde Nast* by the High Court [2005] STC 1327 at [61-63] and by the Court of Appeal [2008] STC 1721 at [48-50]. Citizens must take the law as it is stated, assume it is correct, and abide by it: *Deutsche Morgan Grenfell* at [24-25 & 61].

17. The common law rule is that "no one gives who possesses not" (*nemo dat qui non habet*). In other words, one person with a limited right to property cannot confer on another a superior right to that property. This principle is extensively modified both by statute and decisions of the courts. Section 25 Sale of Goods Act 1979 ("**SOGA**") provides that a buyer in

possession of goods can, if certain conditions are fulfilled, give a good title to a person who acquires the goods from him.

18. Section 17 SOGA provides that property in the goods passes when the parties intend it to pass. Hence the seller of goods will usually protect itself by retaining title under the sale agreement until payment. While the goods are in the possession of the buyer, the seller has the right to retake the goods. As this is a proprietary right, it will survive the buyer's insolvency. However, any attempt to retain a proprietary interest in the products of the goods or in the proceeds of sale of the goods is likely to be characterised as a charge and unenforceable in the absence of registration. The seller's proprietary interest is limited to an interest in the goods themselves.

19. Section 25 SOGA was an exception to the general principle that title only passed on full payment, by allowing a non-owner to pass title to a third party, and must be interpreted strictly. Where goods were incorporated into another form (eg bricks into a house) then the goods ceased to exist as a distinct item and the contract between the customer and the third party was not a contact for the sale of goods – *Benjamin's Sale of Goods* (10th ed) at 7-080.

20. The retention of title clause prevented BDR, unless the goods were sold on by the customer – that was clear from s 11(4)(b) FA 1990, but was of very limited application. A builders' merchant could not know what was done with the goods by its customers. The evidence was that selling-on was unlikely; the goods were more likely to be used by the customer in its building trade. The second limb of s 11(4) cannot apply to use in its trade by a customer (because that was not a supply of goods by the customer); that was not within s 25 SOGA. The only remaining way for the Claimant Companies to avoid the Property Condition was to waive the retention of title clause in specific cases (as suggested in HMRC's Notice 700/18 – which seemed wholly uncommercial) and Mr Ellis's evidence was that he could not recall that ever being done.

21. The defect in UK VAT legislation was that it deferred time of supply to the time when title was transferred, where the contract contained a retention of title clause. For VAT purposes there is no difference between credit sales where the contract contains a reservation of title clause and credit sales where there is no retention of title condition. HMRC were wrong to contend that *GMAC* only concerned the simpler case of cars being sold on hire purchase. The position was succinctly put by Floyd LJ in *GMAC*:

> **"[80]** The property condition does not only have the effect of excluding from relief all bad debts incurred in connection with hire purchase agreements. It goes further and excludes relief in the case of any contract for the supply of goods which contains a *Romalpa* (retention of title) clause (see *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 2 All ER 552, [1976] 1 WLR 676). So the question one has to ask is not, as Mr Beal [HMRC counsel] suggested, whether there is something special about bad debts in the field of hire purchase which justifies their exclusion from the scheme, but whether one can justify the exclusion of all supplies of goods where title is retained."

No prior claims

22. It was accepted that it is for the Appellant to show (on the balance of probabilities) that (i) no prior recovery has been made, and (ii) the overpaid VAT can be quantified with sufficient accuracy.

23. The key factor is that the UK legislation wrongly blocked VAT BDR, by imposing an invalid condition. The only relevant question is: did the statutory wording apply to reservation of title clauses, such as the contractual terms used by the Claimant Companies. The answer is 'Yes'. In that case the argument that, hypothetically, the Claimant Companies could have recovered VAT BDR in the Claim Period, notwithstanding the statutory provision to the contrary (the Property Condition), is irrelevant. The only relevance of HMRC's argument would be if it supported a possibility that, notwithstanding what the law said, taxpayers had in fact recovered VAT BDR. There must be a presumption of regularity, and so non-recovery.

24. It would be inconsistent with the principle of effectiveness for HMRC to block an historical claim by relying on UK procedural law matters. HMRC's guidance on *Fleming* claims provides an important context, where HMRC stated that there is no special relaxed evidential rule for historic VAT claims, but "we will accept estimated claims provided that the assumptions on which the estimates have been based are reasonable and sustainable."

25. Because of the passage of time, the original evidence was no longer available. Alternative evidence was available and although inherently of lesser value, it could be relied upon especially as the absence of the original evidence was because the Property Condition had previously barred BDR claims. Approximation was sufficient, provided it supported the conclusions drawn from it – see the Upper Tribunal in *Lothian NHS Health Board v RCC* [2015] STC 2221 at [21-23].

26. The legal inability to recover BDR, because of the Property Condition, was strongly suggestive of no prior recovery. When one is trying to prove a negative, then the absence of information was itself relevant.

27. The Harcros warranty relates to a short period at the end of the Claim Period. The fact that the Appellant, as purchaser, sought a warranty concerning the absence of BDR claims indicates that the purchaser group was not making such claims at that time. The evidence concerning Harcros's claims was an isolated and inexplicable exception. Harcros would have been operating under the same legal prohibition on claiming BDR as the other group companies; Mr Leach had pointed out that the timing coincided with VAT law changes that may have become confused.

28. Mr Lunn's evidence of another taxpayer, Customer One, related to a different trader in another line of business. The limited evidence of compliance visits to Jewson made no reference to any discussion of BDR claims, indicating that none were in issue because none were being made.

Calculation

29. The method of calculation used was to take the VAT on total turnover and multiply that by (a) the percentage of turnover represented by credit sales; and further (b) the percentage of credit sales bad debts.

Appellant's conclusions on claims

30. The balance of probability is that there had been no previous VAT recovery in the period in which the UK law excluded BDR on a basis not allowed in EU law:

(1) That accords with the evidence of accounting and business practice.

(2) If the law did not allow recovery of VAT by reason of the Property Condition, the reasonable inference is non-recovery. Unless there is evidence to the contrary it must be assumed that Appellant acted in accordance with the law at the time.

(3) It is not consistent for HMRC to both accept that the property condition was an invalid bar to BDR but assert that the Claimant Companies would have reclaimed the VAT notwithstanding that the legislation prevented their doing so, given that the Property Condition was accepted as preventing BDR where retention of title clauses were used.

Interest

31. Interest was payable because the delay in repayment was due to official error – HMRC had legislated an invalid provision. The position was the same as for *Fleming* claims. Thus, also, there was no time limit.

> "**78 Interest in certain cases of official error**
> (1) Where, due to an error on the part of the Commissioners, a person has
> …
> (*c*) (otherwise than in a case falling within paragraph (*a*) or (*b*) above) paid to them by way of VAT an amount that was not VAT due and which they are in consequence liable to repay to him, …
> then, if and to the extent that they would not be liable to do so apart from this section, they shall pay interest to him on that amount for the applicable period, but subject to the following provisions of this section."

32. The Court of Appeal in *British Telecommunications plc v RCC* [2014] STC 1926 (at [125-127]) and *GMAC* (at [134]) confirmed that a BDR claim could not be brought within s 80 VATA. The Appellant's claim was clearly under s 36 VATA.

Respondents' case

33. Ms Mitrophanous submitted as follows for the Respondents.

34. The Appellant cannot properly evidence its claim.

(1) The Appellant has accepted that it cannot satisfy the evidential requirements of regs 167 & 168 VAT Regs 1995 (see [6(4)] above).

(2) The Appellant has produced no evidence showing what BDR claims were made in relation to the Claim Period or that none were made.

(a) Mr Ellis was employed during the Claim Period but confirms that he was not involved in preparing or submitting VAT returns.

(b) Mr Leach, who was not employed by the group during the Claim Period, confirms that no VAT return files or workings have been found for the Claim Period. Mr Leach accepts that he has merely assumed that no VAT BDR relief was claimed by the Claimant Companies in the Claim Period.

35. The facts in the Court of Appeal's decision in *GMAC* were important. There, the taxpayer supplied cars on hire purchase contracts, mainly to final consumers. Where a customer sold on the car to a third party purchaser without notice, property in the goods passed and so the taxpayer *could* claim BDR. The dispute concerned where the taxpayer repossessed

a car and the Property Condition denied BDR – the Court held that the Property Condition must be disapplied. Here, the Claimant Companies sold to builders and it was in the nature of the sale, as reflected in the contractual position, that the builders would sell on the materials for use in building works and property would pass. The Appellant's circumstances are therefore similar to those about which GMAC did *not* complain. As indicated by Mr Leach in his evidence, the retention of title clause was in practice "somewhat academic" in these circumstances. The Appellant is wrong to claim that the very presence of a retention of title clause blocked or barred BDR; in cases where property in the goods would have passed to the customer or to a person deriving title from the customer, the existence of a retention of title clause would have been irrelevant to the Appellant's ability to make a claim for BDR.

36. Further, even in other instances, the ability of the Claimant Companies to cede title would also have meant that the existence of the retention of title clause was no bar to them claiming BDR. Where the goods were of a type likely to be kept by the customer and not sold on (eg boiler suits, hard hats, or tools) and there is no evidence that title was ceded, HMRC accept that BDR would probably not have been claimed – this is not now in issue between the parties and is not now part of the claim in this appeal.

37. If the retention of title clause was ineffective or irrelevant then the Appellant cannot seek to rely on such a clause at all in this appeal. The Appellant should be treated in the same way as any other trader who had no retention of title clause at all, but chose to bring a BDR claim after destroying records relevant to proving any entitlement to BDR. Further, the irrelevance of the retention of title clause also makes it very likely that any BDR claim has already in fact been made; it would of course have been prudent for a business to bring such claims prior to destroying the relevant records given that there was no impediment to its doing so.

38. Even in relation to *Fleming* claims, the Courts have made clear that it is for the claimant to establish its case, including as to whether claims had not previously been made. Merely estimating what its bad debts were in the Claim Period without any evidence relating to the key issue whether such claims had in fact already been made for the relevant Claim Period, cannot meet the burden placed on the Appellant in this appeal.

39. None of the retention of title clauses used by the Claimant Companies would prevent title from passing to customers:

> (1) Property would have passed under the relevant contracts as the Claimant Companies expressly or impliedly permitted their customers to resell the goods such that the type of retention of title clauses involved in effect sought only to provide rights to the proceeds of resale rather than to retention of title: *Benjamin's Sale of Goods* at 5-146. This position is supported by the *Romalpa* case itself: *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676 (at 680 & 689).
>
> (2) Even absent such authorisation, property would have passed in any case pursuant to s 25(1) SOGA which provides that a buyer in possession (the Appellant's customer) can give good title when he/she sells and delivers the goods to any person receiving these in good faith and without notice of any right of the original seller (the Appellant). Given the nature of the Claimant Companies's trades, the customers would have purchased materials as needed and therefore used materials purchased soon after the date of purchase - such resale would have

occurred well within the period in which the Appellant retained the relevant records and indeed probably within days of purchase.

(3) Where there was no permission to resell the relevant goods, such resale would have constituted a conversion of the goods leading to the Appellant's title being in any case extinguished pursuant to s 3(2) Limitation Act 1980 for failure to pursue an action in conversion (*Benjamin's Sale of Goods* at 7-115, *Halsbury's Laws of England*, paragraphs 987-988).

(4) As the relevant goods would have been incorporated in a process of construction or attached to other goods or to premises and could not be easily removed, again the Appellant's property in the goods would have been lost – *Benjamin's Sale of Goods* at 5-151. As is evident from the contractual terms referred to above and the nature of the trade, the only reasonable conclusion is that the parties' intention was not that the Claimant Companies should retain property in the goods once these were used in building works (if at all).

40. That title might have passed on in any event to a third party was recognised in HMRC's Notices in existence during the Claim Period, and a copy of Notice 700/18 (January 1996 version) was provided to the Appellant in February 1997 following a meeting.

41. HMRC are not seeking to rely on the Property Condition in any way or to impose it on the Appellant. The argument is rather that any difficulties presented by the Property Condition were irrelevant to the Appellant, who is in effect in the same position as traders selling goods in the Claim Period without retention of title clauses. Such traders, and therefore the Appellant, cannot opt to bring a claim for BDR decades after the relevant supply and after relevant records have been destroyed and point to the invalidity of the Property Condition as a reason why it should not be required properly to evidence its claim.

42. If the Appellant is contending that it would not know what the customer had done with the goods or when they may have been used or sold to a third party in good faith, then that is a wholly unrealistic contention. As reflected in the terms of the contracts, the Appellant expected its customers to sell the goods and there is no reason to think that by the time that the Appellant came to destroy its records at the very latest this would not have occurred. This not only supports the position that the Appellant cannot complain about the Property Condition, but further shows that it is very likely that the Claimant Companies in fact made BDR claims at the time when it possessed the relevant records. There was the evidence that Customer One, in a similar line of business to the Appellant, did make BDR claims during the Claim Period.

43. The Appellant was mistaken to suggest that the absence of records of BDR claims indicates that there were no such claims. That approach might be sustainable where there were comprehensive VAT records retained and available, none of which revealed BDR claims; but here there were simply *no* VAT records retained, so the lack of BDR information tells one nothing at all. The single piece of documentary evidence making a clear reference to BDR was the Harcros warranty disclosure that Harcros *had* made certain BDR claims.

44. The Appellant's witnesses had honestly admitted that they had no knowledge of whether previous BDR claims had been made.

45. Nothing concerning VAT BDR could be deduced from the White Book extracts put in evidence.

Section 78 interest

46. Section 78 VATA 1994 has no application to BDR:

> (1) The Property Condition was ineffective and any failure by the Appellant to make a claim sooner was not caused by any error by HMRC (see *Avicenna Centre for Chinese Medicine Ltd* [2016] UKFTT 13 (TC) at [27]).
>
> (2) A failure to make a BDR claim is neither an accounting for output tax not due (see Court of Appeal decisions in *British Telecommunications* (at [30] & [125-128]) and *GMAC* (at [134]) rejecting the argument that such claims fall within s 80 VATA 1994), nor a claim for input tax.
>
> (3) That s 78 does not cover BDR is also evident from the fact that there is no relevant commencement date here, and none is identified by the Appellant.

Consideration and Conclusions

Jurisdiction

47. During the hearing I asked both parties for submissions on the nature of the Tribunal's jurisdiction in relation to the matters in dispute; in particular as to whether I was exercising a full appellate jurisdiction, or instead one of a more limited supervisory jurisdiction (for the distinction, see *CEC v Peachtree Enterprises Ltd* [1994] STC 747). Ms Mitrophanous for HMRC helpfully identified three areas for consideration:

> (1) *Whether there was a prior claim to BDR made by the Claimant Companies for the Claim Period.* The parties agreed that on this issue the Tribunal exercised a full appellate jurisdiction. I agree, and I note that a similar conclusion was reached by this Tribunal (Judge Brannan & Mrs Hunter) in *Perenco Holdings* [2015] UKFTT 65 (TC) (at [56-57]) citing the decision of this Tribunal (Judge Raghavan & Mrs Debell) in *Market & Opinion Research International Limited* [2013] UKFTT 779 (TC).
>
> (2) *The exercise of HMRC's discretion to accept evidence alternative to that required by Regs 167-168.* Although the parties held different views on this issue, they agreed that it was not necessary for the Tribunal to express a view or make a determination on this point given the agreements reached between the parties and the manner in which they had advanced their respective cases.
>
> (3) *The methodology and result of quantification of the claims.* The parties agreed that on this issue the Tribunal exercised a full appellate jurisdiction, but that the Tribunal was not being asked now to make a decision on quantum (see [3] above).

The BDR claim

48. The main (but not sole) issue in dispute is, whether there was a prior claim to BDR made by the Claimant Companies for the Claim Period. I shall consider first the correct approach to be taken to that dispute; then summarise and evaluate the available evidence, before reaching a conclusion.

<u>Approach adopted</u>

49. A similar situation has been addressed by this Tribunal and the Upper Tribunal in relation to "*Fleming* claims" – that is to say, claims for repayment of VAT under-declared or

overpaid, potentially going back as far as the inception of VAT in 1973, following the House of Lords decision in *Fleming (t/a Bodycraft) v RCC* [2008] STC 324. *Fleming* concerned the way in which a statutory time limit on making input tax claims had been introduced, and opened the possibility of historical repayment claims. There is therefore a close parallel with the possibility of historical BDR claims following *GMAC*.

50. *WMG Acquisition Co UK Ltd* [2013] UKFTT 215 (TC) concerned a *Fleming* claim by Warner Music to recover historical input tax allegedly incurred by its employees on travel and subsistence costs but not previously reclaimed. This Tribunal (Judge Demack) stated:

> "28. [HMRC's advocate] submitted that WMG had not shown that it was more likely than not that the input tax on the Group's travel and subsistence expenditure had been incurred and not recovered; the information and documentation produced did not support its assertions.
>
> 29. The burden of proving that the two companies have not recovered the input tax on employee's travel and subsistence expenses falls on the taxpayer in appeals such as the present one. And whilst only the civil standard proof is involved, the tribunal cannot be expected to make decisions simply on the basis that a claim covers a period long ago for which a taxpayer cannot be expected to hold any records, so that its claims should be accepted without question and without evidence. It is simply not good enough for the two companies to say to the Commissioners, "You accepted our claims for input tax recovery for the period 1999 on 2002 on the basis of our records for that period. We say that we made no input tax recovery for earlier periods for which we hold no records whatsoever, but for which we say we operated in exactly the same way and made no input tax recovery claims. You must accept our claims and repay the input tax concerned."
>
> 30. The two companies have not satisfied me on the balance of probability that they failed to make claims for the period concerned, and I therefore reject the claims. It follows that I dismiss the appeals."

51. Similarly, in *KDM International Ltd* [2013] UKFTT 315 (TC) this Tribunal (Judge Sadler & Mrs Hunter) stated (at [9]):

> "The issue we have to decide is purely one of fact to be determined from such evidence as there is about matters which occurred twenty or more years ago and the inferences which can be drawn from that evidence. The burden of proof lies on the Appellant, and we are required to determine whether, on the balance of probabilities, it can establish:
> (1) that the input tax in question was not recovered when it was incurred; and (if it was not so recovered)
> (2) that a reliable estimate has been made of the amount of input tax claimed as under-recovered."

52. A similar conclusion was reached by the Upper Tribunal in *Lothian NHS Health Board v RCC* [2015] STC 2221 where Lord Tye stated (at [23]):

> "In all cases the standard of proof remains the balance of probabilities: that applies equally to historic claims for unrecovered input tax. There is no rule of law or procedure restricting the exercise of the right of recovery in such cases; proof by means of estimates, assumptions and extrapolations was open to it as it is in all cases. The problem for the appellant was that the tribunal was not satisfied that the material placed before it was of sufficient

> value to enable any reliable conclusions to be drawn, whether by way of estimation, assumption, extrapolation or otherwise. Section 121 [FA 2008] re-opened entitlement to make repayment claims potentially going back to 1973, but it did not purport to address any of the practical difficulties that might be encountered in attempting to substantiate old claims. Responsibility for such difficulties must ultimately rest with those who, for whatever reasons, failed to make the claims when they first arose."

53. In *NHS Greater Glasgow & Clyde Health Board* [2017] UKUT 0019 (TCC) Lord Doherty (at [27]) approved the above statement in *Lothian* and stated:

> "I am also clear that the FTT did not misdirect itself as to its jurisdiction. It proceeded on the basis that in demonstrating that an amount was due reasonable and sustainable estimation or approximation by the appellant might be legitimate. It approached the appeal - correctly - on the basis that it was for the appellant to satisfy it on the balance of probabilities that the appellant was entitled to repayment of an amount of input tax. In my opinion the FTT correctly identified the jurisdiction conferred on it by s.11(1) TCEA, and it had proper regard to the terms of s.80 VATA and reg. 37 VATR."

54. From the above cases I conclude that the correct approach to be adopted is:

(1) The taxpayer bears the burden of proving, on a balance of probabilities, that:

(a) There were historical bad debts;

(b) BDR was not previously claimed thereon; and

(c) The amount of the BDR claim can now be reasonably and sustainably estimated or approximated by the taxpayer.

(2) Practical difficulties may be encountered in attempting to substantiate historical claims, but the passage of time and consequent lack of records does not absolve the taxpayer from the obligation of proving the above matters.

55. In relation to where the burden of proof lies, this is only important where the application of the normal test of balance of probabilities exceptionally results in a conclusion that there was insufficient evidence to reach a decision. In *Stephens v Cannon* [2005] EWCA Civ 222 (recently quoted with approval by the Upper Tribunal in *Anglian Water Services Limited* [2018] UKUT 0431 (TCC) (at [63])), Wilson J stated:

> "46. From these authorities I derive the following propositions:
>
> (a) The situation in which the court finds itself before it can despatch a disputed issue by resort to the burden of proof has to be exceptional.
>
> (b) Nevertheless the issue does not have to be of any particular type. A legitimate state of agnosticism can logically arise following enquiry into any type of disputed issue. It may be more likely to arise following an enquiry into, for example, the identity of the aggressor in an unwitnessed fight; but it can arise even after an enquiry, aided by good experts, into, for example, the cause of the sinking of a ship.

> (c) The exceptional situation which entitles the court to resort to the burden of proof is that, notwithstanding that it has striven to do so, it cannot reasonably make a finding in relation to a disputed issue.
> …"

The evidence

56. The evidence presented may be categorised as follows:

(1) The retention of title clauses used by the Claimant Companies in the Claim Period.

(2) Mr Ellis's recollection of the Appellant's accounting treatment for bad debts, including the White Books and the Accounting Manual, during the Claim Period.

(3) Mr Leach's calculations of the disputed BDR claim.

(4) Mr Lunn's experience of another taxpayer, Customer One.

(5) The Harcros share purchase VAT warranty.

The retention of title clauses

57. Numerous examples of retention of title clauses used by the Claimant Companies in or around the Claim Period were (quite rightly) included in the hearing bundle, but I understand it is uncontroversial that a typical example is as follows (taken from one used by Jewson):

> "3. The property in the goods shall not pass to the Buyer until the Buyer has paid to the Seller the whole price thereof. If, notwithstanding that the property in the goods has not passed to the Buyer, the Buyer shall sell the goods in such manner as to pass to a third party a valid title to the goods, the Buyer shall hold the proceeds of such sale on trust for the Seller. The Buyer agrees that prior to the payment of the whole price of the goods the Seller may at any time enter upon the Buyer's premises and remove the goods therefrom and that prior to such payment the Buyer shall keep the goods separate and identifiable for this purpose, Nothing herein shall constitute the Buyer the Agent of the Seller for the purpose of any such sub-sale, Notwithstanding that property in the goods shall not pass to the Buyer save as provided above, the goods shall be at the risk of the Buyer from the time of collection by or delivery to him of the goods or after the expiration of any agreed rent-free period whichever is the earlier. Any delay caused by the unreasonable act or default of either party to rail or road transport or craft furnished by the other to be for the account of the party causing the delay. Notwithstanding the preceding provisions of this clause, the Seller may, at his sole option and at any time by notice in writing to the Buyer, transfer the property in the goods to him."

58. From the evidence of Mr Ellis and Mr Leach I make a finding of fact that the trading builder customers of the Claimant Companies were unlikely to acquire purchased goods for resale, in the sense of selling on the goods in the same or similar condition as they were acquired from the Claimant Companies. I further find that it was very likely that those customers would use (probably within a short time of purchase) those goods as materials in the building projects that the builder customers were performing for their own customers.

59. The Appellant contends that in those circumstances the Property Condition barred the Claimant Companies from being able to claim VAT BDR in the Claim Period, because the goods were sold subject to a retention of title clause and property in the goods did not pass if the full price had not been paid:

> "A person shall not be entitled to a refund … unless … in the case of a supply of goods, the property in the goods has passed to the person to whom they were supplied or to a person deriving title from, through or under that person." (s 11(4)(b) FA 1990 and s 36(4)(b) VATA 1994).

60. HMRC contend that in the same circumstances the Property Condition did *not* present a bar to VAT BDR claims; property in the goods would pass to the customer when the goods were incorporated into the customer's building projects – for example, bricks being built into a wall. Thus, HMRC say (i) it is more likely than not that VAT BDR claims *were* made accordingly; and (ii) even if they were not made they *could* have been made, and the Appellant is now out of time to make such a claim (and further the Appellant accepts it is unable to produce the information required by regs 167-168 VAT Regs 1995).

61. Determination of the correct position requires consideration of the legal status of reservation of title clauses. Both parties referred me to *Benjamin's Sale of Goods* (10th Ed) as an authoritative statement of the relevant commercial law principles. Here references to that work are marked "BSG", and for brevity I shall not cite the extensive authorities that are footnoted at the relevant sections of BSG.

62. I note in passing (BSG 5-144): "Since *Romalpa* clauses may take many forms, and since the case law on their validity and interpretation has become progressively complex and refined, this area of the law is, in the words of Staughton J., "presently a maze if not a minefield"."

63. For the current situation – builders incorporating purchased goods into their own building projects – BSG 5-146 states: "… where goods are sold to a manufacturing or trading company, and particularly where a period of credit is allowed, it can scarcely be supposed that the buyer company is meanwhile to have no right to consume the goods in manufacture or to resell the goods in the ordinary course of its business. Accordingly, a term may be implied to that effect in order to give business efficacy to the contract. An implied, or even express, provision of this nature will not, however, invalidate the seller's retention of ownership of the goods until such time as they are so consumed or sold."

64. BSG 5-151 states: "Goods agreed to be sold subject to a reservation of title provision may be incorporated into other goods owned by the buyer or be subjected to the buyer's manufacturing processes to make other products. The effect of such acts on the title of the seller has been considered in a number of cases." BSG 5-151 then explains the two varying lines of cases that have arisen on this topic.

65. On the first line of cases (BSG 5-151): "In *Borden (UK) Ltd v Scottish Timber Products Ltd*, a seller supplied resin for the manufacture of chipboard by the buyer company, reserving ownership of the resin until all goods supplied by him to the buyer company had been paid for in full. The Court of Appeal held that, once the resin was used in the manufacturing process, it ceased to exist, and with it the seller's title thereto; that, once the resin had lost its identity in the chipboard, it could no longer be traced into the chipboard or the proceeds of its sale; and that no term could properly be implied in the contract that the seller should have any interest in or charge over the chipboard."

66. On the second line of cases (BSG 5-151): "On the other hand, in *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd*, diesel engines were sold to the buyer company subject to a retention of title clause and were incorporated into diesel generating sets. The process of incorporation did not in any way alter or destroy the substance of an engine, and it could be removed from the set, if necessary, within several hours. Staughton J. held that the proprietary rights of the seller were not affected by the incorporation: the engines remained engines, albeit connected to other things."

67. Summarising those two lines of cases (BSG 5-151): "These cases move into very difficult and uncertain areas of law relating to the creation of a new product from materials owned by another or the attachment of one person's chattel to that of another. They appear to establish that, in the absence of an express provision to the contrary, the seller's property in the goods will be lost and vest in the buyer if the identity of the goods is destroyed in the manufacturing process or if they are transformed by manufacture into different goods, but may be retained if the goods are in their original state and can easily be removed from the finished product. But other intermediate possibilities exist. The question whether or not goods which are still identifiable, but have to a greater or less extent been worked on by the buyer or incorporated in other articles, remain the property of the seller would seem to depend upon what intention is to be imputed to the parties, having regard to such factors as the nature of the goods, the product, the degree and purpose of incorporation, and the manufacturing or other process applied."

68. While acknowledging the difficulties signposted by BSG, I need to decide the effect of the retention of title clauses used by the Claimant Companies in the Claim Period. From my findings in [58] above I conclude that the builders' merchant's goods supplied by the Claimant Companies to their customers would have been consumed by being incorporated into other goods by the customers, probably within a short time of purchase from the Claimant Companies – for example, goods such as timber, bricks, copper pipe, electric cable and paint would be used on the customers' building projects in such a way that they were incorporated into the buildings and could not easily be removed, and further that the intention of the customers and the suppliers (the Claimant Companies) was that such incorporation was expected and permitted notwithstanding that the purchases had been on credit terms and the full price was still unpaid. On that basis, the title to the goods passed to the customers when they incorporated the goods into their building projects.

69. It follows that I agree with HMRC's analysis as summarized at [60] above. There are two consequences of that. First, it is relevant to the question of whether earlier BDR claims were made. The Appellant maintains that Notice 700/18 was explicit that BDR was prevented by use of retention of title clauses, and would have been relied upon by the Claimant Companies. However, while the Notice does not go into the legal detail to be found in BSG, it does explain that goods could have been passed on even if not paid for. There were several versions of HMRC (then HM Customs & Excise) Notice 700/18 in the Claim Period: issues April 1996, April 1991 and January 1996. They all contain the following statements:

> "You can claim relief from VAT on bad debts for goods or services that you supplied, if all the following conditions are met: … in the case of a supply of goods, ownership has passed to the customer or through him to a third party. You cannot claim bad debt relief if, for example, you supplied the goods under a contract which reserves title until they have been paid for, unless you follow the procedure [below] … If you supplied goods under a contract with a clause reserving title until they have been paid for (a "Romalpa" clause), and the goods have not been passed on, with good title,

> to a third party, you must send to the person in charge of the insolvency a statement formally giving up your rights under the clause."

The possibility of title passing prior to full payment was thus recognized in the Notice, and the explanation was repeated in March 2017 when HMRC published Customs Brief 1 (2017) – see [7] above, especially the paragraph headed "Evidence". Without leaping ahead in the evidence, I would also note that Harcros *did* claim BDR at least at the end of the Claim Period – see [86-90] below.

70. The second consequence is HMRC's contention that even if no BDR claims were made in the Claim Period, such claims were available at the time and the Appellant is thus now doing nothing more than attempting to make a (very) late claim for the Claim Period, and without the requisite documentation. From my findings and conclusions I have to agree that it is the correct analysis.

Mr Ellis's recollection of the Appellant's accounting treatment for bad debts

71. Mr Ellis was employed in the Appellant's group during the Claim Period. He never had any involvement in the VAT reporting function. For most of the Claim Period he was part of a team responsible for the White Books. The White Books now available covered around half the Claim Period (taking together half-year and twelve-month reports).

72. From paragraphs II2.6 6.2-6.4 of the Accounting Manual, as Mr Ellis explained, a general bad debt reserve (of 0.4% of credit sales) was accrued over the year. Those amounts were inclusive of VAT – see paragraph II3.5 5.3.5 of the Accounting Manual – which is in accordance with SSAP 5 (I agree with Mr Ellis that the reference to "net" in one of the columns of the schedules means net of recoveries, not net of VAT). Then at year end specific bad debts would be identified and recognized, with any under/over provision being charged/released to profit and loss account – those amounts would also be VAT-inclusive. The corresponding profit and loss account entry for all these bad debt account items was made to the cost of sales ("**COS**") account – per paragraph II2.16 16.1 of the Accounting Manual.

73. The White Books available were a mix of half-year and full-year versions. Copies of the bad debt schedules from the available White Books were in evidence. With Mr Ellis's helpful explanation, it was possible to see and track the movement on those accounts as described above.

74. The parts of the Accounting Manual and White Books in evidence gave no analysis of the VAT account (ie the ledger account relating to the VAT creditor account for HMRC). The most I can understand from the evidence is that a VAT-inclusive bad debt account was run throughout the year, with corresponding entries to the COS account. I understand that any VAT BDR recovery would be recorded in the White Books by a credit to COS and a corresponding debit to the VAT account. There was no accounting evidence (from the White Books or otherwise) to show whether that was happening, or not, or what amounts were involved.

75. Mr Southern pursued the literary allusion of "the dog that did not bark" but that approach can only work in the context of other reliable evidence. I appreciate the difficulties facing the Appellant in trying to prove a negative but, as Ms Mitrophanous observed, this is not a situation of being required to draw a conclusion from incomplete information, but instead of there being no information to consider.

76. For those reasons, I conclude that the White Books provide no basis for deciding that it is more likely than not that VAT BDR was not claimed in the Claim Period.

Mr Leach's calculations of the BDR claim.

77. I wish to emphasise that nothing I say here should be taken as any criticism of the work performed by Mr Leach. He did not join the Appellant's group until a decade after the end of the Claim Period. He was handed the unenviable task of researching the VAT position back almost three decades, with all the VAT returns, working papers and prime records having (understandably) been destroyed long ago, and with HMRC also having no records going back that far. He and his colleagues have performed the task of accounting archaeology as best as it could be done, given the materials available.

78. Most of Mr Leach's evidence concerned the methodology of calculation of the disputed claim, which I cover (briefly) later. I also cover separately later his evidence concerning the Harcros warranty.

79. I agree with Mr Leach (and Mr Lunn) that any VAT BDR claim would not be made by a separate claim document, but instead would constitute one of the figures that were reflected in the single entry in Box 4 of the relevant quarterly VAT return – see reg 166 VAT Regs 1995, formerly reg 3 VAT (Refunds for Bad Debts) Regs 1991. In the absence of VAT returns and connected working papers there is no evidence here that earlier claims were not made.

80. In oral evidence Mr Leach stated he felt that if VAT BDR had been claimed then this would have needed an extra column on the bad debts analysis page in the White Book. I was not then sufficiently familiar with the documents to explore that comment with him, but it follows from my analysis at [72] above that I do not agree; a successful VAT BDR claim would be reflected in the COS account and the VAT account, not the bad debt account – and I think that also follows from the examples given by Mr Ellis. There is no evidence that such entries were not made during the Claim Period.

81. I have examined carefully the basis for making the disputed claim in May 2014 – in other words, what was the motivation for making the claim? Mr Leach was candid that he had assumed that no VAT BDR claims had been made in the Claim Period; he explained that approach was consistent with the advice given in HMRC Notice 700/18 and in Tolley's practitioner guidebooks. Mr Ellis too was candid that he had no knowledge whether VAT BDR claims had been made in the Claim Period; he explained that he was not familiar with HMRC Notices but he assumed that the group had no expectation of relief at the time; he accepted that if BDR could have been claimed then he expected it would have been claimed. I also had a formal witness statement (dated 9 October 2015) from Mr Michael Sheppard, a tax partner in Grant Thornton now acting for the Appellant in relation to VAT matters, who HMRC confirmed was not required for cross-examination; Mr Sheppard stated "In light of the decision of the [Upper Tribunal in *GMAC*], Grant Thornton UK LLP was instructed to assist, in particular, with the compilation of a VAT bad debt relief claim." In the claim letter dated 23 May 2014 Grant Thornton explain to HMRC:

> "The Property Condition was particularly relevant to the Building Distribution division as, throughout the relevant period, the standard credit terms of its businesses included a clause stipulating that ownership of goods did not pass to customers until the supplier had received payment in cleared funds of all sums due in relation to those goods. As a result, the companies comprising the Building Distribution division were … unable to recover VAT on any unpaid debts relating to supplies made during this period."

That letter contained a representation, "The group can … confirm that, to the best of its knowledge … consistent with VAT legislation and HMRC's published guidance throughout the relevant period, no VAT bad debt relief has previously been claimed in relation to those supplies."

82. Taking all the above together, and without in any way suggesting the above representation was not given in good faith, it does seem to me that everyone on the taxpayer's side has simply assumed that no previous VAT BDR claims could have been made (because of the Property Condition) and so were not made. In the absence of contemporaneous VAT records they then started work on the considerable task of computing what claims they believed could now (post *GMAC*) be made.

83. None of the above provides any basis for deciding that it is more likely than not that VAT BDR was not claimed in the Claim Period.

Mr Lunn's experience of another taxpayer, Customer One.

84. This evidence concerned HMRC's experience of another taxpayer whose name was redacted from all the documents and who was referred to as Customer One in the hearing. The point Mr Lunn was making was:

> (1) Following *GMAC* a number of historical VAT BDR claims were received by HMRC, including from Customer One.
>
> (2) Customer One was a manufacturer and distributor of products used in the building and automotive sectors. It sold goods on credit terms including retention of title clauses.
>
> (3) On examination it became clear that in fact Customer One had claimed BDR during the relevant periods, despite its assertion that it had made no such claims.

85. I have been careful not to place too much weight on this evidence because of the lack of detail consequent on the redactions made to preserve the confidentiality of Customer One's affairs. I note that only "half of [Customer One's] sales come from … products for buildings …", with the remainder relating to automotive products and technical products for the electronics industry and others. It could be that Customer One's BDR claims related to its sales of products that were dissimilar from the building products, and so I conclude that this evidence does not assist me in deciding whether it is more likely than not that VAT BDR was not claimed in the Claim Period.

The Harcros share purchase VAT warranty.

86. This evidence stems from the acquisition of Harcros by Jewson in December 1997. The share purchase agreement contained warranties given by the vendor (Harrisons & Crosfield plc) some of which related to tax matters and one of which stated:

> "No claim has been made since the Balance Sheet Date [defined as 31 December 1996] by any Group Company [defined to include Harcros] for bad debt relief under section 36 VATA 1994."

87. Although the entire agreement was not included in the hearing evidence bundle, I take it that, in accordance with normal commercial law practice with which I am familiar, the warranties would have been given on the basis of "save as disclosed in the disclosure letter, as

defined" or similar. A disclosure letter dated 21 October 1996 made the following disclosure against the above VAT warranty:

> "*Value Added Tax*
>
> Bad debt relief claimed since the Balance Sheet date:
>
> Quarter to 31/03/97 £182,427.78
> Quarter to 30/06/97 £138,847.09"

88. The Appellant accepts, as I understand, that the above information necessitates an adjustment to the calculation of the claim now in dispute – because the past claims disclosed fall within the Claim Period – but not that the disclosure has any wider impact. Mr Leach suggested that the 1997 claims may have been a mistake because of legislative changes around that time. The information in the disclosure letter covers only two quarters near the end of the Claim Period, but that is because of the scope of the warranty against which disclosure is made.

89. Mr Southern submitted that the disclosure strengthened the Appellant's case because it indicated that Jewson (as purchaser) had presumed that no VAT BDR claims were being made and asked for a warranty to that effect, and from that it could be inferred that Jewson was not itself making VAT BDR claims at or around that time. I do not agree with that submission. The tax warranties contain standard matters for this type of transaction; for example, other VAT warranties given were that there had been no group registration, no default surcharges, no land exemption waiver elections, no capital goods scheme acquisitions, and so on. Standard practice (with which I am familiar) is that such warranties are phrased as bald assertions, and it is then up to the warrantor (ie the vendor) to disclose as they consider fit. No inference can be drawn about Jewson's own policy from the fact that a warranty was requested concerning BDR claims made by Harcros.

90. I consider this evidence is far more important that the Appellant is prepared to accept. It is evidence that Harcros as one of the Claimant Companies – and which, unlike Customer One, was in exactly the same line of business as the other Claimant Companies – did make VAT BDR claims during the Claim Period. Accordingly, this is evidence that counts against the Appellant on the question of whether that it is more likely than not that VAT BDR was not claimed in the Claim Period.

<u>Conclusion on the BDR claim</u>

91. The Appellant has not shown that it was more likely than not that no VAT BDR claims were made in the Claim Period. There is no retained contemporaneous documentary evidence. The only witness employed at the relevant time was not involved in the group's VAT affairs. The White Books do not assist. The Appellant has just assumed that no claims were made, because the group used retention of title clauses in its standard terms of business. One of the Claimant Companies (Harcros) did make BDR claims at the end of the Claim Period.

92. The reservation of title clauses did not prevent title passing to customers when the goods were consumed by being incorporated into building projects being undertaken by the customers. Thus the Property Condition did not operate to deny eligibility for VAT BDR claims by the Claimant Companies in the Claim Period. Thus VAT BDR claims were available to the Claimant Companies but were not made (except for the Harcros claims in 1997) and the Appellant is now out of time to make such claims.

93. For those reasons the Appellant's VAT BDR claim fails and the appeal must be dismissed.

Methodology of calculation of claim

94. I record that because (i) the parties requested a decision in principle concerning the BDR claim, and (ii) my conclusion is that the claim fails, I have not considered in depth (either in my deliberations or in this decision notice) the methodology used by the parties to quantify the potential claim. If the dispute should proceed further and result in the need for a quantification then it seems to me that such matters (if not agreed between the parties) should be referred back to this Tribunal for determination; however, any such referral would be a decision for the higher tribunal and courts.

Whether s 78 interest is due

95. I heard only brief submission on this point, which I have summarised at [31-32] and [46] above. Because my conclusion is that the BDR claim fails, I do not consider it necessary to address the matter of s 78 interest.

Decision

96. The appeal is DISMISSED.

Right to apply for permission to appeal

97. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 16 MAY 2019