HMRC entitlement to set-off against “GMAC” refunds, and vehicles sold "in the same condition"

Masterlease Ltd [2010] UKFTT 339 (TC)

This case concerns two issues arising from 'GMAC' claims for refunds of output VAT on termination of hire purchase agreements. HMRC sought to offset amounts which it considered to have been underdeclared in respect of vehicles which the Appellant had 'desupplied' as being sold on 'in the same condition', even though HMRC would have been out of time to raise an assessment in respect of those amounts in the normal course of events. The First Tier Tribunal was therefore asked to consider whether HMRC could set the amounts off and, if so, against which criteria should the 'same condition' test be determined.

Following the GMAC decision concerning VAT adjustments in respect of sales of motor cars on hire purchase terms, the Appellant submitted claims for VAT refunds on the basis that it was entitled to reduce its output VAT in respect of cars which were returned part way through the hire purchase contract, giving rise to reductions in consideration. (The adjustments were due under Reg 38 VAT Regulations 1995 which provided that they should be made in the VAT periods when the cars were returned but, as the Appellant had been unaware of this entitlement until the GMAC decision was released, it was required to make the adjustments retrospectively). The Tribunal in GMAC, had held that, where the reg 38 adjustments had not been made in the periods when the cars were returned, claims could be made for VAT overpaid under s80(1)(a) VAT Act 1994, as "an amount that was not output tax due".

HMRC accepted that the Appellant's GMAC claims were valid, however, HMRC also considered that the Appellant had underdeclared amounts of output VAT due on the subsequent resale of the returned vehicles. In the GMAC case, the returned cars had been deemed to be "repossessed" for the purposes of art 4(1)(a) VAT (Cars) Order 1992 SI 1992/3122, which provides that "the disposal of a used motor car by a person who repossessed it under the terms of a finance agreement, where the motor car is in the same condition as it was when repossessed" is neither a supply of goods or services for VAT purposes. HMRC contended that the Appellant could not show that the 'same condition' criterion was satisfied because the repossessed cars had been subjected to some remedial work by the Appellant after repossession, ranging from mere cleaning and valeting, through replacing minor items such as light bulbs, touching up scratched paintwork, repairing and replacing dented paintwork, tyres etc., to significant mechanical repairs in some cases. HMRC therefore considered that output VAT was due on the full value of the sales of the cars.

Whilst accepting that it was out of time to assess for the majority of the output VAT due under s73 VAT Act 1994, HMRC considered that it was entitled to set-off the VAT underdeclared in respect of the sale of the returned cars against the amounts claimed by the Appellant under s80(1). The result was the reduction of the Appellant's claims from c.£3.3m to c.£225k.

The First Tier Tribunal was therefore asked to consider the two issues of s80(1) set-off and the proper application of the 'same condition' criterion.

S80(1) set-off

HMRC contended that, when quantifying a claim for "an amount that was not output tax due", it was necessary to consider both failure to make reg 38 adjustments on the appropriate returns and the amounts of output tax due on the sales of repossessed cars which had not been brought to account in order to arrive at the correct "amount that was not output tax due". The correct amount

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.

to be adjusted did not depend on the reason why it was to be adjusted, it was necessary to establish the correct amount of output tax due for the period and adjust under s80(1), as the VAT & Duties Tribunal had held in GMAC.

The Appellant argued that s80(1) only applied to tax paid that was not due to HMRC, which was not the case here because the Appellant had, in declaring the output VAT due on the original hire purchase sale, paid the correct amount of output tax. S80(1) was not relevant to a reg 38 adjustment. Reg 38 was a direct implementation of art 90(1) Principal VAT Directive 2006/112/EC, i.e. the right to adjust output tax in the event of partial or total non-payment, and the Tribunal in GMAC had been wrong in its conclusion that a retrospective reg 38 adjustment fell under s80(1), and there was no right for HMRC to set off underdeclared output VAT against a reg 38 adjustment.

The 'same condition' criterion

Although HMRC accepted that there was a 'de minimis' level of work on the cars beneath which they should be considered to be sold in the same condition, for example cleaning and valeting to present the vehicle in order to obtain the best price, but still in the same fundamental condition as when repossessed. Once the work on the cars went beyond cleaning, the condition of the cars was being altered and the subsequent supplies were therefore excluded from art 4(1)(a) and must be taxed. There was no other relief from VAT available in the UK legislation; the margin scheme would make no difference because there was no purchase value to be deducted from the sale value and there was no directly effective relief from VAT for these supplies in the EC legislation.

The Appellant contended that the work was undertaken on the cars in order to maintain them in saleable condition, and that a 'de minimis' level should go beyond cleaning and valeting, suggesting that five hours work or £150 cost would be a reasonable level. It was irrational that the sale of the same vehicle should be taxed twice, and particularly so when the sale would be taxed if the Appellant carried out repairs but not taxed if the original purchaser had repaired it prior to returning it in order to meet his contractual obligation to return it in good condition. Parliament had intended the second sale to be relieved from VAT in order to prevent double taxation. Failing that, the Appellant suggested that the second sale should only be taxed to the extent that value had been added to the car by virtue of the work done on it, by reading art 4(1)(a) as excluding "the disposal of a used motor car by a person who repossessed it under the terms of a finance agreement, insofar as the motor car is in the same condition as it was when repossessed", i.e. only the value of the remedial work would be taxed. Such a reading would be possible adopting the approach of the Court of Appeal in IDT Card Services Ireland Limited [2006] EWCA Civ 29, where the court had chosen to read into the legislation such terms as were necessary to ensure that the legislation achieved the principle of the EC legislation.

Held

S80(1) set–off

The First Tier Tribunal considered that s80(1) applied to the amount of VAT that was entered in Box 1 of the VAT return and was not concerned with the reason why that amount was entered there or with the reason why it might have been incorrect.

Reg 38 was the provision governing adjustments in consideration but it was also mandatory under that regulation for the adjustment to be made in the VAT period when the reduction in consideration took place, in this case when the proceeds of sale of the repossessed cars were

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.

brought into the business accounts. Where the Appellant had not made the adjustment in that VAT period, it had made an overpayment to HMRC and s80(1) was the provision which enabled that adjustment to be made retrospectively.

Consequently, in calculating the amount that had been overpaid in each VAT period for the purposes of s80(1), it was necessary for HMRC to take into account amounts of output tax, if any, which had been underpaid in respect of sales of repossessed cars.

The 'same condition' criterion

The First Tier Tribunal considered that, as art 4(1) VAT (Cars) Order was not an implementation of any EC legislation, it was necessary to consider the intention of Parliament when it had been enacted and construe it in accordance with the ordinary meaning of its wording. It was clear that "same condition" could not be intended to mean "identical condition". Condition would ordinarily change between repossession and sale, e.g. if the car was driven from one place to another or left out in bad weather, or if the car was valeted and cleaned, but the intention of Parliament was clearly not to exclude the car from art 4(1) on that basis.

The intention of Parliament was to prevent taxation of cars which had been repossessed and sold in "substantially" or "materially" the "same condition" and, had the Minister been challenged on this, the response would have been that the provision would be "applied reasonably and with common sense". Therefore there must be an element of judgment applied. For example, the First Tier Tribunal suggested that:

- the repair of a scratch without respraying would not be material but the removal of a dent would be material;
- minor work to make the car roadworthy and compliant with vehicle construction and use legislation, such as replacing defective windscreen wipers or bulbs would not be material;
- inflating a tyre to correct the pressure was not material;
- five hours work excluding valeting (suggested by the Appellant as 'de minimis') would be material;
- one or two hours in addition to valeting and £50 on parts would not be material;
- a minor service to ensure that the car is roadworthy would not be material but a full service or any substantial mechanical work would be material.

Finally, the First Tier Tribunal commented that, had Parliament intended that the second sale should only be taxed to the extent that value had been added to the car by virtue of the work done on it, art 4(1)(a) could have been drafted as the Appellant had suggested but the fact was that it had not been so drafted, and therefore this contention was rejected.

Noting HMRC's submission that the "same condition" criterion would have to be applied individually to each car, but also that the Appellant's records of remedial work over the period of the claims were incomplete, the First Tier Tribunal invited the parties to seek to agree a settlement based on the application of the suggested 'materiality' of the works carried out on the cars, and the appeal was therefore adjourned.

Comment

S80(1) set-off

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.

HMRC will often seek to set off amounts of VAT against retrospective claims, whether those amounts are in respect of underdeclared output VAT or adjustments to input VAT recovered, e.g. where exemption is applied to a supply retrospectively. Businesses should always consider carefully whether there are vires for HMRC to apply such set-offs, as this is a complex area of VAT and the extent to which HMRC is entitled to do so is a matter of some debate. In this particular case, the debate concerned the relationship between reg 38 adjustments and s80(1) claims, a matter considered in the GMAC case, and the Appellant here was effectively seeking to persuade the First Tier Tribunal to set aside its predecessor's decision on that issue. It is possible that the issue will be subsequently appealed to the Upper Tribunal, as it was not one of the matters appealed to the High Court in GMAC.

"Same condition"

The First Tier Tribunal adopted a similar approach in this case as in Buy As You View Ltd which concerned a similar provision, (Article4(1)(a) VAT (Special Provisions) Order 1995 SI 1995/1268), which applies to 'desupply' sales of repossessed goods other than motor cars. The decision as to whether goods are 'materially' or 'substantially' in the same condition is a subjective one and, as all supplies are subject to VAT unless they fall within the scope of a specific relief, businesses should, in the light of these cases, ensure that they keep sufficient records of the extent of work carried out on them, and the principles applied in deciding the VAT treatment, to justify non-taxation.

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.