HMRC - VATSC95700 - Direction Of Supplies: Receivers, Liquidators And Other Insolvency Practitioners: New Arrangements

General

The easement is strictly for the purposes of allowing a measure of relief for VAT on bad debts and depends crucially on HMRC taking a relaxed view of the supply position. Lenders must not extend this treatment more widely in accounting for VAT within their businesses.

The arrangements apply to BDR claims relating to supplies made on or after 1 July 1994. The overall aim is to provide relief to lenders where they suffer sticking tax on the costs of selling property in circumstances where borrowers have defaulted - in effect where the net proceeds of sale are reduced because the VAT element of the costs has not been recovered.

In principle, the easement covers costs incurred by lenders in arranging the sale of repossessed property and also to selling costs incurred when property is sold through a Law of Property Act receiver. It is emphasised that, with the single exception of build-out costs, the arrangements apply only to sale costs, and not to any incurred in relation to letting.

Although the Law of Property Act does not apply in Scotland, there are analogous provisions in Section 27 of the Conveyancing and Feudal Reform (Scotland) Act 1970. The arrangements therefore apply equally in Scotland.

Basic principle

Under the arrangements, lenders can be seen as agents of the borrower in relation to the costs of sale whether or not the mortgage deed specifies such a relationship. As an agent, the lender may treat the selling costs incurred as supplies made to them and by them under s47(3) of the VAT Act 1994. The order of attribution of the sale proceeds in the BDR regulations can then be applied and bad debt relief claimed as appropriate in accordance with normal rules.

These arrangements apply only to costs relating directly to the sale of property, which would ordinarily have been incurred by the borrower had he arranged the sale himself. Examples of such costs include charges for professional services connected with the sale eg legal and estate agency fees. The easement does not include costs incurred on services provided to, and used by, the lender as principal, even though they may be charged on to the borrower under the mortgage deed. Examples of such costs include legal fees associated with taking possession, and locksmith’s fees for securing the property. Costs incurred in pursuing claims against a valuer for negligence are also excluded.

Other expenses

The position of certain other expenses incurred by lenders was discussed at meetings with trade representatives. Treatment of these under the arrangements is as follows:

Law of Property Act Receivers’ charges

Law of Property Act receivers’ charges which relate specifically to the sale (not letting) of the property and any costs incurred by them in respect of the sale can be regarded as falling within the scope of the arrangements, but only where the proceeds of sale received by lenders have been reduced by the VAT element of the charges. Where this happens, lenders may be regarded as acting as agents for the borrower in paying the costs.

This means that HMRC are not prepared to apply this arrangement where the Law of Property Act receiver recovers the VAT incurred on behalf of a VAT registered borrower and this is reflected in the proceeds passed to the lender. This may occur, for example, where the Law of Property Act receiver has control of the borrower’s VAT returns.

Build-out costs (expenses incurred on completion of a partly-built building or major refurbishment of the property, before sale)

HMRC legal advice is that lenders incur such costs as principals and do not make any onward supplies to the borrower even though the costs are charged on under the terms of the mortgage deed. It was argued at the meetings with trade representatives that strict application of this line would create a hidden VAT charge in respect of buildings whose sale is zero-rated. HMRC are sympathetic to this view and are therefore prepared, very exceptionally, to treat the onward charge of the build-out costs as a supply by the lender as principal to the borrower, where the sale of the building by the borrower is the subject of a taxable supply or the transfer of a going concern for VAT purposes. In the case of build-out costs only, HMRC are also prepared to see a supply where the property is the subject of a taxable let and output tax on the rents has been accounted for to HMRC.

HMRC are not prepared to see an onward supply (creating an entitlement to bad debt relief) when the sale of the building is exempt, where the VAT incurred on building costs would be sticking tax. HMRC believe it would be quite wrong to allow recovery of tax by lenders in these circumstances. As at (i) above, the arrangements will also not apply if the proceeds of sale or rent received by lenders reflect any input tax on build-out costs recovered by the borrower.

Other building works (repairs and maintenance)

Lenders can be seen as agents of the borrower in incurring these expenses and may use the s47(3) VATA 1994 invoicing procedure to qualify for bad debt relief.

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