



**TC02241**

**Appeal number: TC/2010/02300**

*VALUE ADDED TAX – Input tax – Change from cash accounting – Return submitted 2½ years late – Capping provisions – Whether input tax capped as from time return due or from time received by Respondents – Status of Respondents’ manual published on Internet considered*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**LAKESIDE COLLECTOR CARDS      Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY’S  
REVENUE & CUSTOMS      Respondent**

**TRIBUNAL: JUDGE MISS JILL C GORT  
MRS SHAHWAR SADEQUE**

**Sitting in public in London on 6 February 2012**

**Mr John Cowling, accountant, for the Appellant**

**Mr Jonathan Holl, presenting officer, for the Respondents**

## DECISION (Provisional)

1. Here are the Tribunal's findings of fact in this case. We would now like to have submissions on the law, as per the attached Direction.

2. The appeal is against a decision of the Commissioners for HM Revenue and Customs ("HMRC") contained in a letter dated 23 December 2009 which amended an amount of VAT sought to be recovered for the tax period ending 31 May 2007, period 05/07, from an amount of £13,858.68 to a figure of £2,049.26, leaving the sum of £11,809.42 in dispute.

3. The grounds of appeal are that the input VAT in question should be deemed claimed at the date of entry in the VAT records (i.e. as at 1 March 2007). The input tax claimed on the 05/07 VAT return arose in respect of accounting periods ended not more than three years before the date that the VAT was claimed in the VAT account. The input VAT claimed on the 05/07 return would therefore fall outside the capping provisions of the VAT Regulations 1995 SI 1995/2518 which were the Regulations relevant to the return periods in question.

#### 4. The Issue

(i) Whether the Appellant was barred by the capping provisions from making adjustments to earlier returns by a return which was filed outside the three-year capping period where that return itself related to a period not covered by the capping provisions?

(ii) In considering the capping provisions are the operative rules those that were in force at the time the return in which the amendment is made was filed or those in force at the time covered by the period of the return in respect of which the input tax claim is made?

#### The background

5. In the 1990s Mr D N G Matthews, Mrs M E Matthews and her brother Mr J W Hodgetts formed a partnership ("the Appellant") and started a business buying and selling trading cards, that is rare playing cards which have become collectors' items, and phone cards. Mr Hodgetts was for the most part a sleeping partner and never played an active role in the business. The Appellant traded from premises at Lakeside Park in Basildon Essex and was registered for VAT with effect from 1 January 1998. It was fully compliant in its submission of VAT returns and the payment of VAT due up until 2007. The last return received by HMRC prior to the disputed one for the period 05/07 was for the period 02/07 which was received on 5 April 2007.

6. At first the Appellant did well, achieving a turnover of about £300,000 per annum. This was in part due to its original premises having a good location near the entrance to Lakeside Park. At some stage the owners of Lakeside Park decided to

reorganise it and the Appellant had to move to another unit in the retail park which was in a poorer location and where there were continuous building works. In 2003 the Appellant's business declined in part because of this and in part because e-Bay became the preferred source of specialist memorabilia. In mid-April 2007 Mr and Mrs Matthews decided to close the business. They locked the door of the unit and went home. Over the years they continued to sell from home stock they had accumulated in the past. They did not return to the Lakeside premises and did not collect any post from there, including the VAT returns. Large debts accumulated; no forwarding address was provided to HMRC who treated the Appellant as a missing trader, after having issued estimated assessments for a period, which remained unpaid. Eventually all three partners were threatened with bankruptcy and so called in Mr Cowling, an accountant, to sort out their financial affairs.

### The facts

7. We were provided with a bundle containing correspondence, emails and legislation, by each of the two parties. We were not provided with any skeleton arguments or authorities.

8. Up until 28 February 2007 the Appellant had been using the cash accounting method for VAT, accounting for output tax upon receipt of payment, but only being able to claim input tax when it had paid its suppliers. From time to time Mr and Mrs Matthews had purchased supplies using either their personal credit cards or money from their personal bank accounts. This money was not claimed back until the business itself had repaid the credit card company in respect of the particular purchase. Increasingly they were unable to pay off their credit cards in full, and only paid off the minimum that was necessary, thus getting further in debt. The consequence was that only a proportion of the VAT that had been paid out was being reclaimed as input tax as the business was only able to pay a part of what it owed back to Mr and Mrs Matthews and to the suppliers. No proper records were being kept. The VAT returns however were submitted regularly up until March 2007, when the return for the period 02/07 was submitted, as stated above.

9. Mr Cowling was called in in or about November 2009. He drew up in date order lists of the invoices that had come in and the credit card payments that had been made. He made a list of what the Appellant had not claimed but could have claimed during the previous period if it had not been using the cash accounting method. The Appellant, advised by Mr Cowling, changed to invoice accounting in respect of its VAT as from 1 March 2007 and an entry to this effect was made on the accounting records. The return for the period 05/07 was submitted to HMRC on 3 December 2009. HMRC had not been notified of the change in accounting method at this time. By that return input tax in the sum of £13,858.68 was claimed on the basis of invoices dated after 30 November 2003 (although the earliest entries on the schedule submitted to HMRC were dated July 2004). This date was chosen because the first return in which the input tax in respect of those invoices could be claimed would be the return for the period 3/04, which was within three years of 31 March 2007 and was the earliest date in respect of which a claim could be made if the capping provisions

applied to the time of the relevant return. HMRC only allowed the input tax relating to periods after 1 March 2006 on the basis that the three year capping provisions applied to the time the return was submitted.

5 The law

10. The Value Added Tax Act 1994 (“the Act”) provides where relevant as follows:

10 **Section 25(1) payment by reference to accounting periods and credit for input tax against output tax**

(1) A taxable person shall –

- 15 (a) in respect of supplies made by him, and  
(b) in respect of the acquisition by him from other member States of any goods,

20 account for and pay VAT by reference to such periods (in this Act referred to as “prescribed accounting periods”) at such time and in such manner as may be determined by or under regulations and regulations may make different provisions for different circumstances.

25 (2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26 and then to deduct that amount from any output tax that is due from him.

30 (3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the commissioners; and an amount which is due under this subsection is referred to in this Act as a “VAT credit”.

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**26. Input tax allowable under section 25**

40 (1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

45 (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business –

- (a) taxable supplies
- (b) ...

**26A Disallowance of input tax where consideration not paid**

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(1) Where –

- (a) a person has become entitled to credit for any input tax, and
- (b) the consideration for the supply to which that input tax relates, or any part of it, is unpaid at the end of the period of six months following the relevant date,

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it shall be taken, as from the end of that period, not to have been entitled to credit for input tax in respect of the VAT that is referable to the unpaid consideration or part.

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(2) For the purposes of subsection (1) above “the relevant date”, in relation to any sum representing consideration for a supply, is –

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- (a) the date of the supply; or
- (b) if later, the date on which the sum became payable.

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11. The Value Added Tax Regulations 1995 (1995/2518) provide where relevant:-  
Regulation 29(1) –

Subject to paragraphs (1A) and (2) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.

(1A) The Commissioners shall not allow or direct a person to make any claim for deduction of input tax in terms such that the deduction would fall to be claimed more than three years after the date by which the return for the prescribed accounting period in which the VAT became chargeable is required to be made.

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...

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Regulation 34 –

34-(1) Subject to paragraph (1A) below this regulation applies where a taxable person has made a return or returns, to the Commissioners which overstated or understated his liability or his entitlement to a payment under section 25(3) of the Act.

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(1A) Subject to paragraph (1B) and (1C) below, any overstatement or understatement in a return where –

5 (a) a period of 4 years has elapsed since the end of the prescribed accounting period for which the return was made; and

10 (b) the taxable person has not (in relation to that overstatement or understatement) corrected his VAT account in accordance with the regulation before the end of the prescribed accounting period during which that period of 4 years has elapsed,

15 shall be disregarded for the purposes of this regulation; and in paragraphs (2) to (6) of this regulation “overstatement”, “understatement” and related expressions shall be construed accordingly.

#### Regulation 57 –

20 Cash accounting scheme

25 57. A taxable person may, subject to this Part and to such conditions as are described in a notice published by the Commissioners, account for VAT in accordance with a scheme (hereinafter referred to in this part as “the scheme”) by which the operative dates for VAT accounting purposes shall be –

30 (a) for output tax, the date on which payment or other consideration is received or the date of any cheque, if later; and

(b) for input tax, the date on which payment is made or other consideration is given, or the date of any cheque, if later.

#### Regulation 60 –

35 60-(1) ...

(2) Subject to regulations 61-63 below a person may withdraw from the scheme at the end of any prescribed accounting period.

40 ...

#### Regulation 61

45 61-(1) Subject to paragraph (2) a person who ceases to operate the scheme, either of his own volition or because the value of taxable supplies made by him exceeds the level provided for in regulation 60(1), must –

- (a) settle up, or apply transitional arrangements

In paragraph 1(a), “settle up” means account for and pay on a return made for the prescribed accounting period in which he ceased to operate the scheme –

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(a) all the VAT that he would have been required to pay to the commissioners during the time when he operated the scheme, if he had not been operating the scheme, minus

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(b) all VAT accounted for and paid to the commissioners in accordance with the scheme, subject to any adjustment for credit for input tax.

## Regulation 65

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### Accounting

65-(1) Except in the circumstances set out in regulations 61 to 63, VAT shall be accounted for and paid to the commissioners by the date prescribed for the accounting period in which payment or other consideration for the supply is received.

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(2) Input tax may be credited either in the prescribed accounting period in which payment or consideration for a supply is given, or in such later period as may be agreed with the Commissioners.

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12. Notice 700/45 dated March 2002 provides as follows:

9.8 What is the time limit for making adjustments?

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You cannot make an adjustment if more than three years have elapsed since the end of the accounting period in which the original supply took place.

9.9 How do I make the adjustment?

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Subject to the three year limit, you should enter details of the document in your VAT account and include the value of VAT adjustment in your current return.

13. Notice 731 (July 2008) Cash Accounting provides:

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4.5 When can I reclaim VAT incurred on my purchases and expenses?

Once you start to use the scheme ...

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**The following text has the force of law**

If you pay by credit or debit card; the date of payment is the date a sales voucher is made out for the payment.

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6.4 How do I account for VAT if I leave the scheme voluntarily ...?

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When you leave the scheme there may be supplies that you have made for which you have not been paid and as a result you have not accounted for any VAT. You will need to account for this VAT even if you have not been paid by the customer there may also be cases where you have not paid your suppliers and you have not yet claimed your input tax. You are entitled to claim this input tax subject to the normal VAT rules. You may choose either to:

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- Account for all your outstanding VAT due in the period in which you stopped using the scheme. ... As an alternative you can opt for a further six months in which to account for the outstanding VAT.

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14. VAT Notice 700/45 (July 2009) provides:

4.7 What is the time limit for claiming input tax?

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The time limit for making claims was increased with effect from 1 April 2009 from three years to four. However, in order to ensure that the accounting periods that were out-of-time on 31 March 2009 are brought back in-time by the change, the following transitional arrangements apply.

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The transitional arrangements provide that no claim made between 1 April 2009 and 31 March 2010 can be made for any accounting period for which the VAT return was due before 1 April 2006.

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Thus on 31 March 2009, the earliest accounting period for which a claim may be made is that ending on 28 February 2006 (for which the due date of the return was 31 March 2006).

6.1 When am I entitled to claim input tax?

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The time limit prescribed in paragraph 4.7 for deducting input tax starts to run from the due date for the return that you are liable to make after you have both incurred the input tax and receive the associated VAT invoice.

6.2 What if I had the evidence on time but still didn't claim input tax in the right period?

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If you had the necessary evidence to enable you to claim the input tax in the VAT accounting period in which it became chargeable, but did

not record it in your VAT account, this is an error. You cannot claim it on a later return. You may be required to make a return adjustment under paragraph 4.3 or an error correction notification under paragraph 4.4.

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Should you wish to make a claim for input tax you must do so within the time limits prescribed at 4.7.

15. The Value Added Tax (Amendment) Regulations 1997 provide as follows:

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4. Regulation 29 –

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(a) In paragraph (1) for the words “subject to paragraph (2) below” there shall be substituted the word “subject to paragraph (1A) and (2) below”; and (b) after paragraph (1) there shall be inserted the following –

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“(1A) The Commissioners shall not allow or direct a person to make any claim for deduction of input tax in terms that such a deduction would fall to be claimed more than three years after the date by which the return for the prescribed accounting period in which the VAT became chargeable is required to be made.”

25 16. The Value Added Tax (Amendment) Regulations 2009:-

1. These regulations may be cited as a Value Added Tax (Amendment) Regulations 2009 and come into force on 1 April 2009.

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3. In Regulation 29 (Claims for Input Tax) –

(a) ...

(b) ...

(c) In paragraph (1A) –

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(i) subject to “paragraph (1B)”,

(ii) for “three years” substitute “four years”.

(iii) ...

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(d) after paragraph (1A) insert –

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“(1B) the commissioners shall not allow or direct a person to make any claim for deduction of input tax where the return for the first prescribed accounting period in which the person was entitled to claim that input tax in accordance with paragraph (1) above was required to be made on or before 31 March 2006”, and ...

### The Respondents' case

17. HMRC did not allow the full claim for input tax made by the partnership  
5 because they considered that the invoices prior to 1 March 2006 were capped. In Mr  
Holl's submission the relevant date for the capping provisions was the date that the  
05/07 return was filed, i.e. December 2009. The relevant provisions were therefore  
those which were in force as at December 2009.

10 18. HMRC also contended that the partnership had not demonstrated that the  
returns which were submitted in the period 08/04 to 02/06 were not correct at the date  
of their submission, given the clear guidance to those operating the Cash Accounting  
Scheme contained in the Regulations and Notice 731. Mr Holl drew our attention to  
the part of that notice which refers to a credit or debit card payment.

15 19. HMRC rely on regulation 29(1) as governing input claims.

### The Appellant's case

20 20. It was submitted by Mr Cowling that the input tax claimed in the 05/07 return  
was by way of an adjustment arising out of a change from cash to invoice accounting,  
following the change made on 1 March 2007. There were no errors in the earlier  
returns which required correcting.

25 21. The Appellant's principal case was that the relevant capping provisions were  
those extant at the date the 05/07 return was due, not the date that that return was  
submitted. The claim of £13,857.22 should be deemed to have been made on 1 March  
2007 which was the effective date of entry into the accounting records, not 3  
December 2009.

30 22. Mr Cowling relied on the words of Regulation 29(1) where the  
Commissioners are given a discretion to allow a claim for input tax. We were  
referred to the Manual which HMRC published on the Internet document VR7540  
which is headed "4 Year Cap – other provisions: Capping of late returns : Where the  
35 VAT return declared liability accepted by HMRC is a repayment return". That  
document states:

40 "Where no central assessment was issued, if a late return shows a net  
repayment due to the business, the return should, if agreed by HMRC,  
be accepted and the net amount claimed on the return should be repaid,  
subject to verification, adjustment or denial of a VAT credit as normal.

45 "However, any assessed amount which was paid more than four years  
earlier should not be repaid because it is considered to be an  
overpayment by way of VAT which is capped under section 80(4) of  
the VATA ... ."

There is then set out an example as follows:

“Baker Ltd fails to render a return for accounting period 06/06 and receives and pays a centrally issued assessment for £20,000.

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“In 2011, the company submits its return for that accounting period and it turns out to be a repayment return for £30,000. That VAT credit should be paid subject to verification as normal. However, the £20,000 paid by Baker Ltd on the assessment should not be repaid.”

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We were also referred to VR7510 which is headed “Four year cap – other provisions: capping of late returns : general” . That document states: “Returns rendered late are not capped but the action you will need to take in relation to late returns which are received more than four years after the end of the relevant accounting period will depend on the circumstances. ... Generally speaking late returns will be processed subject to normal checking and adjustment procedures.”

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23. It was submitted that HMRC had been unjustly enriched in this case if the input claim was not allowed. The fact that the return was submitted late should not prejudice the Appellant’s ability to recover what was properly due by way of input tax.

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**MISS J C GORT  
TRIBUNAL JUDGE**

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**RELEASE DATE: 6 September 2012**