

Foreword

This notice cancels and replaces Notice 700-18 (December 1997). Details of any changes to the previous version can be found in paragraph 1.2 of this notice.

Further help and advice

If you need general advice or more copies of Customs and Excise notices, please ring the **National Advice Service on 0845 010 9000. You can call between 8.00 am and 8.00 pm, Monday to Friday.**

If you have hearing difficulties, please ring the **Textphone** service on **0845 000 0200.**

If you would like to speak to someone in **Welsh**, please ring **0845 010 0300, between 8.00 am and 6.00 pm, Monday to Friday.**

All calls are charged at the local rate within the UK. Charges may differ for mobile phones.

Other notices on this or related subjects

[48 Extra-statutory concessions](#)

[700 The VAT Guide](#)

[727 Retail schemes](#)

[731 Cash accounting](#)

1. Introduction

1.1 What is this notice about?

If you make supplies of goods or services to a customer but you are not paid you may be able to claim relief from VAT on bad debts you have incurred.

This notice explains:

- When you are entitled to this relief; and
- How to claim it.

Also, you may have to repay VAT you have claimed if you have received supplies of goods or services which you have not paid for.

This notice also explains:

- When you will be required to repay input tax; and
- How you will be required to repay it.

1.2 What's changed?

With effect from 1 January 2003 there are major changes to the way the bad debt relief scheme operates, this notice has been re-written to explain these changes and how it works for supplies made prior to, and on or after this date.

You can access details of any changes to this notice since December 1997 either on our Internet website at www.hmce.gov.uk or by telephoning the National Advice Service on 0845 010 9000.

This notice and others mentioned are available both on paper and on our website.

1.3 Who should read this notice?

Anyone registered for VAT who has made supplies of goods or services to a customer for which they have not been paid, and anyone who has received a supply of goods or services and has not made payments for the supplies.

1.4 What law covers this notice?

The law that governs the claiming of bad debt relief is:	
The VAT Act 1994	<ul style="list-style-type: none">• Section 36; and• Section 26A (to take effect from 1 January 2003) which covers the repayment of input tax when a customer fails to pay for supplies received within six months of the relevant date
The VAT Regulations 1995	Parts XIX, and XIXA (XIXB from 1 January 2003)

1.5 Background

Since the introduction of bad debt relief there have been various changes made to its availability and the way it operates. For supplies made between 1 October 1978 and 26 July 1990, relief was only available for suppliers when their customers became formally insolvent. This scheme has now been withdrawn, but if you think you would have been able to claim relief under it you should apply to your local VAT Business Advice Centre who will consider allowing your claim administratively.

In 1990, a new scheme was introduced for supplies made after 1 April 1989. This scheme has been subject to various amendments since its introduction. From 1 January 2003, further changes to this scheme will take effect. This notice explains how the scheme works for supplies made prior to, and on or after, 1 January 2003.

2. Claiming bad debt relief

2.1 What is VAT bad debt relief?

If you have made supplies to your customers on or after 1 October 1989 and have not been paid, you can claim relief from the VAT on bad debts for the goods or services that you have supplied as long as you meet all the conditions. You may claim relief whether the payment due to you was in money or in goods or services to be provided to you in a barter arrangement.

2.2 What are the conditions?

Conditions for claiming bad debt relief

Number	Condition(s)
1.	You must already have accounted for the VAT on the supplies and paid it to Customs and Excise;
2.	You must have written off the debt in your day to day VAT accounts and transferred it to a separate bad debt account;
3.	The value of the supply must not be more than the customary selling price;
4.	The debt must not have been paid, sold or factored under a valid legal assignment. (See paragraph 3.12);
5.	The debt must have remained unpaid for a period of six months after the later of the time payment was due and payable and the date of the supply; and
6.	If the goods were supplied before 19 March 1997, ownership must have passed to your customer, or through the customer to a third party.
7.	For supplies made to a VAT registered customer between 26 November 1996 and 31 December 2002, you must send a notice to them. A copy of the notice must also be retained. (See paragraph 2.7 for an example).

Note: if you account for tax under the cash accounting scheme (see Notice 731 Cash accounting) or under one of the retail schemes (see Notice 727 Retail schemes) which allows you to adjust your daily gross takings for opening and closing debtors, you are only paying VAT on the amounts you have actually received from customers, so bad debt relief is unnecessary.

2.3 When can I claim bad debt relief?

You must wait at least six months from the later of when payment was due and payable or the date of supply. You cannot claim on a return for an accounting period earlier than the one in which you become entitled to the relief.

For supplies made after 1 May 1997, you must claim within three years and six months of the later of, when payment is due and payable or the date of supply.

2.4 How do I claim bad debt relief?

To claim a refund you should include the amount of the VAT you are claiming in Box 4 of your VAT return, which covers the date when you fulfil the conditions to make a claim.

2.5 Do I have to keep any records?

Yes, when you can claim a refund you must keep:

- A copy of the VAT invoices for the supplies on which you are claiming a refund. (If you did not issue a VAT invoice you must have a document showing the equivalent information.); and
- A separate bad debt account showing the:
 - (a) amount you have written off as a bad debt;
 - (b) amount of VAT you wish to claim as bad debt relief;
 - (c) VAT period in which you have claimed a refund;
 - (d) total amount of VAT charged on each supply;
 - (e) VAT period in which you originally accounted for;
 - (f) payment received for each supply;
 - (g) name of your customer; and
 - (h) date and number of the invoice to which the bad debt relates. (If you did not issue an invoice you must include sufficient information to allow the time and type of the supply to be readily identified.)
 - (i) a copy of any notice issued (see paragraphs 2.6 and 2.7).

2.6 Do I have to notify my customer that I'm making a claim?

Changes announced in the 2002 Budget remove the requirement for traders to issue notification letters for supplies made after 31 December 2002.

However, claims covering supplies made between 26 November 1996 and 31 December 2002 to a **VAT registered customer** require a notification letter to be sent. You must send a notice to your customer within seven days from the date you make your claim. The date a claim is made is the date you send Customs the VAT return including the claim.

The notice must contain all the following information:

- the date of issue of the notice;
- the date of your claim to bad debt relief;

- the date and number of any VAT invoice issued for each supply to your customer which is included in your claim;
- for each relevant supply the amount which has been written off as a bad debt; and

The amount of the claim, except where the claim is for a supply accounted for under a margin scheme. (See paragraph 5.7).

2.7 What should the notification look like?

Your notice need not follow this format but all the details must be included. The notice may form part of your existing debt recovery procedures and the details can be added to correspondence you would ordinarily send to your debtor. Or you can send it separately if you prefer.

Example of notification letter:

To: XYZ Ltd From: ABC Ltd

Notification of a claim for VAT bad debt relief

I hereby notify you of a claim for VAT bad debt relief in respect of the following supply/supplies made to you for which payment has not been received.

Date of this notice: 25 August 2002

Invoice date: 10 January 2002

Invoice No: 5/02

Total amount due: £117.50

Bad debt relief claim: £17.50

Date of claim: 21 August 2002

You are now required to repay any VAT claimed on these supplies to Customs and Excise until such time as payment is made.

This notification has been issued to comply with the VAT Regulations 1995 (as amended). Payment including VAT in respect of the supplies remains due and should be made forthwith.

2.8 How long must I keep the records?

After making the claim you must keep all the records listed in paragraph 2.5 for 4 years from the date you make your claim. This requirement does not alter the standard requirement to retain records for six years – see Notice 700 The VAT guide for details.

3. How much can I claim?

3.1 How do I work out how much I can claim?

Your entitlement to bad debt relief is based upon the outstanding amount in respect of the supplies concerned. In the case of a single supply for which you have received no payment your claim will be for the amount of VAT that you accounted for and paid. If you have received a part payment for the debt, you can only claim a refund on the VAT relating to the amount that is still unpaid.

3.2 How do I attribute payments?

Payments should be allocated to the earliest supply made unless the customer specifies that a payment is for a particular supply and pays for that supply in full. Notice 700 The VAT guide provides guidance on establishing the time of supply.

This method of attribution allows for a fair distribution of payments across supplies with varying liabilities, e.g. standard-rated, zero-rated and exempt supplies.

3.3 How would that work in practice?

Example of attribution of payments:

You have made the following supplies to your customer:

Supply No	Date of supply & when payment was due	VAT-exclusive cost (£)	VAT (£)	VAT-inclusive cost (£)
1	30 June 2002	1,000	Zero-rated	1,000
2	28 July 2002	1,000	175	1,175
3	25 August 2002	2,000	350	2,350
4	29 September 2002	350	Exempt	350
5	27 October 2002	800	140	940
6	24 November 2002	3,000	525	3,525
		8,150	1,190	9,340

You have received payments totalling £3,500 for these supplies, so the debt is:

Total value of supplies = £9,340

Payment received = £3,500

Debt = £5,840

As the payment doesn't relate to any particular supply it is treated as relating to the earliest supplies. Therefore payment is treated as made in full for supplies 1, 2 and for £1325 of supply 3 (the difference between the totals of supplies 1 and 2 and the payment of £3,500). The debt outstanding for supply 3 is therefore £1025. The VAT included in that outstanding amount is calculated using the VAT fraction as $£1025 \times 7/47 = £152.66$.

Bad debt relief can therefore be claimed on the following supplies:

Supply	VAT-inclusive amount (£)	VAT (£)
Part of 3	1,025	152.66
4	350	Nil
5	940	140.00
6	3,525	525.00
	5,840	817.66

The total bad debt relief claim is £817.66

3.4 What if I made a number of supplies on the same day?

If you made a number of supplies on the same day, you should add up, separately, the VAT-inclusive amount of the supplies and the VAT included in those amounts. You then treat the supplies as one supply when working out the relief.

Using the same figures as in the example in paragraph 3.3 but where supplies 1, 2 and 3 are made on the same day the bad debt relief should be calculated as follows:

Calculation	
VAT-inclusive value of supplies 1, 2 and 3	£4,525 (VAT included is £525)
Payment received	<u>£3,500</u>
Debt outstanding on supplies 1, 2 and 3	£1,025

To calculate the bad debt relief claimable on this debt you should apply the following calculation:

The balance of the debt x (amount of VAT in supplies 1, 2 and 3)

Total VAT-inclusive value of supplies 1, 2 and 3

Therefore: £1,025 x £525/£4525 = £118.92 VAT

So the total bad debt relief claim will be:	
VAT in supplies 4, 5 and 6	£665.00
Proportion of VAT claimable on supplies 1, 2 and 3	£118.92
Total	£783.92

3.5 Attribution of payments when goods are supplied with associated finance

Bad Debt Relief can be claimed on supplies of goods made by way of hire purchase, conditional sale or credit sale where the customer has defaulted.

Such transactions involve two supplies, a supply of goods and a separate supply of associated finance. Unless the supplier seeks an agreement with Customs to treat the supply of finance as occurring at the same time as the supply of goods, then the supply of goods occurs first.

This would normally mean that all payments received would be first applied to the goods and only when the goods are fully paid for would any payments be attributed to the supply of finance. However particular rules apply for businesses that supply goods and finance in this way.

Suppliers attribute each payment received, upon which interest is charged, to goods and to finance in the same ratio as the total cost of goods and the total cost of finance to the customer. This calculation should exclude any deposit payment which should be wholly allocated to the goods.

Example:

If a car cost £8,000 and the interest over the life of the agreement is £2,000, with nil deposit, each payment can be allocated 80% goods and 20% interest.

If the same car was financed in the following way, deposit is £1,000, and the balance of £7,000 attracts interest of £1750.

The deposit is attributed wholly to the goods.

The remaining payments for the goods and finance total £8750.

Payments after the deposit are split 80% goods and 20% interest.

Where the agreement allows for a variable rate of interest, you should attribute the payment as if the rate at the start of the agreement remained fixed for the whole of the agreement.

3.6 How should the proceeds from the sale of repossessed goods be treated?

When goods are supplied with finance the seller may have the right to repossess the goods if the customer does not make the payments required by the agreement at the right time. The proceeds from the sale of goods in this situation should be treated as a payment from the customer and any relief should be based upon the remaining amount unpaid.

Generally the sale of repossessed goods are not treated as a supply. There are however exceptions. If the condition of repossessed goods is changed prior to their sale the re-sale of those goods is subject to VAT. If a car is repossessed from a customer who has been entitled to reclaim input tax the re-sale of the car is subject to VAT.

Where the disposal of the repossessed goods are subject to VAT on the full selling price, you do not have to deduct the proceeds of the disposal from the outstanding debt of their customer, when claiming bad debt relief. Only the payments made by the customer have to be deducted.

3.7 What if I also owe the debtor money?

This example shows you how to work out bad debt relief where you owe a sum of money to the debtor, which you are able to set off against monies the debtor owes you (sometimes called a mutual debt).

A bad debt has arisen relating to a supply for which you charged £705 (£600 + £105 VAT). At the time you have written off the debt, you owe the debtor £115.

Amount of the debt is $£705 - £115 = £590$.

To work out how much VAT is included in the debt, multiply by the 'VAT fraction'.

So you can claim bad debt relief of $£590 \times 7/47$ (VAT at 17.5%) = £87.87

3.8 What if I hold a security against the debt?

If you hold an enforceable security against the debt you must reduce the amount you claim bad debt relief on by the value of that security. If you hold a security which can't be enforced you may write off the full amount of the debt and base your claim to relief on that amount.

3.9 What if I have insured against bad debts?

If you pay a premium for insurance against bad debts, payment by the insurers doesn't affect your entitlement to relief.

3.10 What if I receive payment from a guarantor or other person?

If you receive payment, in full or in part, from a guarantor or other person (e.g. a director of the debtor company), entitlement to relief is reduced by the amount paid. If full payment is made by the guarantor or third party there is no entitlement to bad debt relief.

3.11 What if the debtor's insurers pay?

If you make a supply to a debtor who is insured for the costs of that supply (for example when a garage repairs a damaged vehicle), for convenience the insurer may pay you direct. If the insured is VAT registered the VAT exclusive amount is usually paid. If the customer does not pay you the VAT element, you can only claim relief on the actual balance written off. Any payment is to be treated as in paragraph 3.2.

3.12 What if I assign or factor the debt?

Some businesses employ factoring companies to improve their cash flow. If debts are factored bad debt relief is not available where an assignment of the debt is absolute (that is where there is no provision for the reassignment of the debt in the contract).

Where there is provision for the reassignment of a debt, bad debt relief will be available once the debt is reassigned to the trader. No bad debt relief can be available during the period in which the debt remains assigned to the factor.

If you receive a payment from the factor for the purchase of the debts, this is considered to be for an exempt supply of finance and therefore will be disregarded for the purposes of bad debt relief.

3.13 What if my customer pays everything but the VAT?

If your customer refuses to pay the VAT charged, or you did not charge VAT when the supplies were made but issued supplementary invoices to recover the VAT from your customer, the claim to relief is limited to the VAT element of the total debt. For example if you originally charged £100 which your customer paid, and you unsuccessfully attempt to recover the £17.50 VAT charge originally omitted, you are only entitled to claim the VAT fraction of £17.50 as bad debt relief.

3.14 What If I receive payment after claiming bad debt relief?

If you have claimed a refund under this scheme and you later receive a payment for the supplies, you must repay to us the VAT element included in the payment. All payments you receive for the supply or supplies must be shown in your separate bad debt account. When you are repaying all or part of your refund, put the amount you are repaying in Box 1 of your VAT return for the period in which you received the payment.

If you are no longer registered for VAT and therefore do not make VAT returns, you must still repay all or part of the refund. Contact your local VAT office for guidance.

If you are insured for the VAT-inclusive amount of the debt, and your insurer pays you, your bad debt relief entitlement is not affected and you may still claim for the full amount.

3.15 How do I work out how much to repay to you?

Suppose you sold goods for £100.00 (plus VAT) for which you received no payment by the relevant date and claimed bad debt relief (assuming the usual conditions were met).

If you subsequently received £75.00 from your customer for the goods, you must repay to Customs and Excise the VAT element of that payment.

You calculate the amount of the repayment as follows;

Amount of claim x payment received ÷ consideration outstanding when claim made

(a) If the supply was standard-rated this would result in the following calculation

Gross value of supply is £117.50 Bad Debt Relief amount is £17.50

$$£17.50 \times £75 \div £117.50 = £11.17$$

Thus you should add £11.17 to Box 1 of your VAT return.

(b) If the supply was at the reduced rate of 5% this would result in the following calculation

Gross value of the supply is £105.00 Bad Debt Relief amount is £5.00

$$£5.00 \times £75 \div £105.00 = £3.57$$

Thus you should add £3.57 to Box 1 of your VAT return.

4. Repayment of Input Tax when supplies are not paid for

4.1 Do I have to repay input tax when I don't pay my supplier?

There are different rules depending upon when the supply was made to you. For supplies after 26 November 1996 but before 1 January 2003 you are only required to repay input tax if you receive a notification that your supplier has made a claim for bad debt relief (see paragraph 2.7).

For supplies on or after 1 January 2003 you are required to repay input tax if you do not pay for the supplies within six months of the relevant date. Your suppliers will not be required to issue a notification so you will need to monitor the time you take to pay your suppliers.

4.2 What is meant by the term 'relevant date'?

The relevant date is:

- the date of the supply, or if later;
- the due date for payment.

4.3 Can I use the invoice date when calculating the time at which I am required to re-pay?

If your supplier allows you time to pay, for example 30 or 60 days, then you are not required to repay any input tax until six months from this later date. In the absence of any separate agreement you can use the invoice date as the due date for payment and so use this as the time at which the six months starts.

The only exception is any case, (which is expected to occur rarely) where the invoice is not issued within fourteen days of the date on which the goods were supplied or service performed; and where the due date for payment falls before the date on which the invoice is ultimately issued. In this instance the input tax will become repayable six months after the date on which the goods were supplied or service performed, or (if later) the date when payment was due.

4.4 What if I'm in dispute with my supplier over the value of supplies made?

This will depend upon whether your supplier agrees to extend the due date for payment of the amount in dispute. If he agrees to extend the date then he will not be able to claim bad debt relief until six months after the extended date and equally you will not be required to make a repayment until six months after that date.

If your supplier does not agree to such a change the repayment of input tax will be required six months from the relevant date, as set out above. You will only be required to repay the unpaid element. Should you subsequently agree to pay the balance your entitlement to input tax will be restored.

4.5 How do I calculate the amount of input tax that I have to repay?

The same methods as outlined in calculating how much you can claim are used in calculating how much of a repayment you are required to make. The repayment is based upon the unpaid amount at the 'relevant date'. If you have been unable to claim the full amount of VAT charged by your supplier – for example because the supplies were used partly for a non-business or exempt activity the repayment will be based upon the amount of VAT originally deducted.

Example

Supply received £1000.00 plus £175.00 VAT - total £1175.00

By the time of the relevant date you have only paid £500.00

Unpaid amount = £1175.00 - £500.00 = £675.00

Repayment due

(a) if business originally entitled to deduct £175.00

$£175.00 \times 675.00 / 1175.00 = £100.53$

(b) if business originally entitled to deduct 50% of the VAT charged (£87.50)

$£87.50 \times 675.00 / 1175.00 = £50.26$

4.6 How do I make a repayment of input tax?

You should make a negative entry in the VAT allowable part of your VAT account, and account for the repayment on the return covering the date when repayment became due.

4.7 Payments made to suppliers after clawback of input tax

If you have repaid input tax claimed following a supplier's claim for bad debt relief and then you make payment for the supply, you can reclaim the input tax, in proportion to the payment made, subject to the normal rules. Reclaim the input tax by including it in Box 4 of your VAT return in the accounting period in which the payment is made.

4.8 Clawback of input tax following a transfer of a business

If you have taken over a business and the VAT registration number of that business using Form VAT 68, you acquire the obligations of the seller to repay input tax. That is, you must repay to us the VAT claimed by the seller on supplies where bad debt relief has been claimed because the supplier has not been paid. Notice 700/9 Transfer of a business as a going concern has more information about the transfer of business as a going concern.

4.9 Applying clawback where insolvency procedures have commenced

As a result of an Extra Statutory Concession (see Notice 48), the requirement to repay input tax does not apply to businesses where an insolvency procedure has commenced after the date of the supply but before the notification is received. This does not affect the requirement to issue a notice when claiming bad debt relief (where your supplies are between 27 November 1997 and 31 December 2002), either when the claimant is insolvent, or if the notice is to an insolvent business.

For supplies made on or after 1 January 2003 the concession is revised so that repayment of input tax will not be required where the supply was made prior to the insolvency procedure commencing but the requirement to repay input tax occurs after.

Insolvent businesses are however required to repay any bad debt relief claimed, should their debtors make subsequent repayments.

5. Frequently asked questions

5.1 Can I claim bad debt relief on an existing debt when I buy a business?

You can only claim relief if you were the actual supplier of the goods or services. Where a business is transferred, the purchaser cannot claim bad debt relief on supplies made before the transfer because the purchaser did not make the supplies. However, from 1 May 1997 there is an exception to this rule where the purchaser also takes over the VAT registration of the seller (using the Form VAT 68). In these circumstances the purchaser acquires the seller's entitlement to bad debt relief on supplies made by the seller.

5.2 Reservation of title agreements or hire purchase

The rules for claiming bad debt relief on goods supplied under an agreement with a clause reserving title until they have been paid for (known as a Romalpa clause) changed from 19 March 1997. If you supplied goods before that date, you can only claim bad debt relief if you have sent your customer a statement formally giving up your rights under the clause. For supplies made on or after 19 March 1997, the requirement that title to the goods must have passed no longer applies. This change allows claims for bad debt relief for supplies of goods on hire purchase and other reservation of title agreements without the requirement to formally give up the rights to title under the agreement.

5.3 Can I claim bad debt relief if I'm no longer registered?

Yes. But you must have all the information detailed in paragraphs 2.2 and 2.7 and write to your local VAT office giving:

- your former VAT registration number;
- the name and address of the debtor(s);
- the amount of refund you wish to claim;
- copies of other supporting evidence (for example, invoices);
- proof that the debt has remained unpaid for 6 months from the date payment became due and payable, or the time of supply if later; and
- proof that you possess a separate bad debt ledger.

For supplies made to VAT registered customers after 26 November 1996 and before 1 January 2003, you must send a notice to the purchaser of the supply for which the claim is made, within seven days of making your claim. The notice must contain the information set out in paragraph 2.6, and you must retain a copy of it.

5.4 What If I'm part of a group registration?

If you are registered under a group registration for VAT purposes, each member must keep its own separate bad debt record for debts written off. The representative member of the group will claim any refund on behalf of each member while they are in the VAT group. Bad debt relief claims for supplies made by a group member who has left the group before the time a claim can be made, are proper to the former group member and not to the representative member of the group.

5.5 What if I'm on Annual Accounting?

If you account for VAT using annual returns, relief can be claimed on debts over six months old on the same return in which the supply was accounted for. Debts over six months old are those where six months has elapsed from when payment is due or payable or, if later, six months from the date of supply.

5.6 Can I issue a Credit note instead of claiming relief?

No. You may not issue a credit note simply because your customer has not paid you for your supply. You may only issue a credit note where there is a genuine mistake or overcharge or an agreed reduction in the value of your supply.

5.7 Can I claim bad debt relief if I'm using a Margin scheme?

From 1 May 1997 bad debt relief can be claimed on supplies made under margin schemes, subject to a maximum of the VAT on the margin. If the debt is equal to or less than the profit margin, bad debt relief may be claimed on the VAT fraction of the debt. If the debt is greater than the profit margin, bad debt relief is limited to the VAT fraction of the profit margin since this is the amount of VAT that will have been paid to Customs. The notice to be sent to your customer following a claim, as detailed in paragraph 2.6, does not need to show a breakdown of the VAT for supplies made under a margin scheme. Paragraph 5.8 provides an example of the amount of bad debt relief that will be allowable for goods sold under a margin scheme.

5.8 How much of the debt can I claim if I'm using a Margin Scheme?

If for example you:

Purchased goods for	£400
And sold them for	£500
Margin on which VAT is paid to Customs	£100
If your customer pays you	£350
Then the debt is	£150 which is greater than the margin
So bad debt relief is	VAT fraction of £100 (margin)
But if customer pays	£450
Then the debt is	£50
So bad debt relief is	VAT fraction of £50 (debt)

Do you have any comments?

We would be pleased to receive any comments or suggestions you may have about this notice. Please write to:

HM Customs and Excise
Supply of Goods Team
4th Floor East
New Kings Beam House
22 Upper Ground
London
SE1 9PJ

Please note this address is **not for general enquiries**. You should ring our National Advice Service about those.

If you have a complaint or suggestion

If you have a complaint please try to resolve it on the spot with our officer. If you are unable to do so, or have a suggestion about how we can improve our service, you should contact one of our Regional Complaints Units. You will find the telephone number under 'Customs and Excise - complaints and suggestions' in your local telephone book. Ask for a copy of our code of practice 'Complaints and putting things right' (Notice 1000). You will find further information on our website at <http://www.hmce.gov.uk>.

If we are unable to resolve your complaint to your satisfaction you can ask the Adjudicator to look into it. The Adjudicator, whose services are free, is a fair and unbiased referee whose recommendations are independent of Customs and Excise.

You can contact the Adjudicator at:

The Adjudicator's Office
Haymarket House
28 Haymarket
LONDON
SW1Y 4SP

Phone: (020) 7930 2292

Fax: (020) 7930 2298

E-mail: adjudicators@gtnet.gov.uk

Internet: <http://www.adjudicatorsoffice.gov.uk/>

Update 1 issued November 2008

The main change in this update is an amendment to Section 3.5.

Replace para 3.5 with the following:

3.5 Attribution of payments when goods are supplied with associated finance

Bad debt relief can be claimed on supplies of goods made by hire purchase, conditional sale or credit sale where the customer has defaulted.

Such transactions involve two supplies, a supply of goods and a separate supply of associated finance. Unless the supplier seeks an agreement with HM Revenue & Customs to treat the supply of finance as occurring at the same time as the supply of goods, then the supply of goods occurs first.

This would normally mean that all payments received would be first applied to the goods and only when the goods are fully paid for would any payments be attributed to the supply of finance. However particular rules apply for businesses that supply goods and finance in this way.

For agreements entered into before 1 September 2006 suppliers must attribute each payment received, upon which interest is charged, to goods and to finance in the same ratio as the total cost of goods and the total cost of finance to the customer. This calculation should exclude any deposit payment which should be wholly allocated to the goods. **This is the Old Method.**

Example of the Old Method:

If Company A supplies a car to a consumer on hire purchase terms, over one year:

Car Price (including VAT)	£10,000
Deposit	£ 1,000
Amount financed	£ 9,000

Total interest (A)	£ 1,800
Total amount payable (B)	£10,800
Monthly payments	£900.00

The customer pays the deposit and three monthly payments and then defaults. The payments should be attributed as follows:

Payments made (P)	£2,700
Interest element of instalments received = $P \times (A/B)$	$2,700 \times 1,800/10,800 = £450$
Goods value = 2,700 less 450	£2,250
Net outstanding = amount financed (9,000) less goods value (2,250)	£6,750
BDR claim amount	$6,750 \times 7/47 = £1,005.32$

The New Method

From 1 March 2007 the method used to calculate the attribution of payments has changed so that it better reflects the actual commercial attribution.

For supplies of goods made before 1 September 2006 the old method of calculation must be used.

For supplies of goods made between 1 September 2006 and 31 August 2007 suppliers may choose either method.

For supplies of goods made on or after 1 September 2007 the new method of calculation must be used.

The new method requires suppliers to use figures which are derived from their existing commercial records. These records should reflect the commercial apportionment made between capital and interest, and are likely to be based on an actuarial or Rule of 78 accounting method. If the apportionment has been calculated correctly within the records, then applying the new method of calculation will result in the same figure and this can then be used as the basis of the bad debt relief claim.

Example of the New Method

Note for the purpose of the following example, assumed figures have been used for the rebate of interest figure and the capital value unpaid figure.

Payments made on or before the termination of the agreement must be attributed to the supply of credit by multiplying the amount of the payment by the fraction A/B and the balance is attributed to the supply of goods.

Calculation of 'A'	
Total charge for interest paid under the agreement	£1,800.00
LESS rebate of interest granted	(£1,038.46)
LESS interest attributable to any unpaid instalments	(£ 0.00)
	(£1,038.46)
Total Interest Due	£ 761.54

Calculation of 'B'	
Total amount payable under the agreement	
(total for the goods + total of 'A') (£10,000 + £761.54)	£10,761.54
LESS any reduction as a result of termination	(£ 0.00)
LESS amounts on which interest was not charged	
(e.g. fees, deposits)	(£1,000.00)
LESS any capital value unpaid at the time of termination	(£7,061.54)
	(£8,061.54)
Total Amount Payable	£2,700.00

The calculation then continues:

Payments made on or before termination (P) x (A/B) = Interest element (I)	$2,700 \times 761.54 / 2,700$ = £761.54
Payments (P) minus interest element (I) = Goods value (G)	$2,700 - 761.54 =$ £1,938.46
Amount financed minus the goods value (G) = bad debt relief amount	$9,000 - 1,938.46 =$ £7,061.54
Bad debt relief amount x 7/47ths = bad debt relief claim.	$7,061.54 \times 7/47 =$ £1,051.72