

VAT & Voluntary Arrangements

Guidance to the practical implications of the Paymex decision

The decision in *Paymex Limited v. The Commissioners for Her Majesty's Revenue and Customs* [2011] UKFTT 350 (TC) found that Nominees' and Supervisors' fees in a consumer IVA were exempt supplies. Subsequently HM Revenue & Customs determined that Nominees' and Supervisors' fees in all types of Individual Voluntary Arrangements, Company Voluntary Arrangements and Partnership Voluntary Arrangements constituted exempt supplies. Separate advice sought by ICAS concludes that Trust Deeds are caught by this decision and HMRC has confirmed to the RPBs that they are exempt. Guidance has already been issued by the bodies listed at the foot of this document but in view of the range and complexity of the issues involved, Counsel's advice has been obtained. This document which replaces the guidance previously issued, seeks to summarise the issues in the light of this advice in generic terms.

This further guidance does not constitute legal advice nor does it seek to instruct or direct IPs in the administration of their voluntary arrangements. The bodies issuing this guide do not accept any liability in respect of actions that IPs may take in accordance with it, as it must be for each IP to be satisfied that his/her conduct meets the legal and professional requirements placed upon office-holders. However, notwithstanding the above, IPs should have regard to the regulatory as well as legal consequences of their actions. This further guidance should be read in conjunction with, the following:

- i. Paymex Ltd v HMRC decision [2011] UKFTT 350 (TC)
- ii. *Dear IP* letter no.50 issued by the Insolvency Service
- iii. Briefing issued by HMRC [Brief 27/11]
- iv. HMRC VAT notice How to correct VAT errors and make adjustments or claims [Notice 700/45]
- v. Clarification notice issued by HMRC [Brief 35/11.]
- vi. Revenue & Customs Notice on Finance issued in November 2011 [Notice 701/49.]
- vii. Insolvency Code of Ethics
- viii. SIPs 1, 3, 9, & 11
- ix. Clients' money regulations/guidance
- x. The Definitions set out as an Annexe to this document

The guidance is provided on the basis of the commonly utilised charging mechanism, namely that the costs of the supervisor, whether of himself or of the staff, are usually charged by way of an invoice from the firm to the supervisor. The supervisor then pays the invoice to the firm out of the assets within the IVA in accordance with its terms, including the VAT thereon charged as output tax. The firm then usually accounts to HMRC in the usual way, for the output tax against which the firm's input tax (in relation to its own business expenses) is set off in the usual way. On the basis of this mechanism, there are issues as to how VAT can be validly reclaimed by the supervisor from the firm and by the firm from HMRC.

1) CHARGING VAT

IPs who have not already done so should ensure that their firms stop charging VAT on invoices for fees and disbursements in IVAs, CVAs and PVAs with immediate effect. IPs should also consider the current VAT quarter and whether any adjustments are required to reflect the exempt status of these supplies.

2) RECOVERING VAT - PRELIMINARY CONSIDERATIONS

IPs should consider each voluntary arrangement on a case-by-case basis. Where a debtor (corporate, partnership or individual) is or was VAT registered it will not usually be necessary to make a VAT reclaim as the VAT will have been recovered as input tax. Where, however, the debtor is either unregistered or partially exempt consideration should be given to seeking a recovery of the VAT mistakenly paid.

3) POWER AND OBLIGATION TO MAKE A CLAIM – CURRENT CASES

Counsel advises that in principle a supervisor in open cases has the power and obligation to make a claim to recover the mistakenly paid VAT, on the basis that the right to recover is an asset within the arrangement and so held on trust for the purposes of the arrangement.

The obligation to make a claim is not automatic or absolute. The supervisor, in his/her capacity as such, is entitled to exercise his/her commercial judgement as to whether the steps to be taken are in the interests of the general body of creditors and, ordinarily, the court will not interfere with a supervisor's decision made in the day-to-day administration of the arrangement unless such decision is fraudulent or in bad faith or one which no reasonable supervisor in the circumstances would have made. Such a decision must be made on a case-by-case basis taking into account the potential benefit for creditors versus the *allowable* costs involved in making the claim, both in respect of the potential legal costs of doing so as well as the time chargeable by the supervisor. In open cases he/she has an absolute entitlement to charge remuneration in accordance with the terms of the IVA. Consequently, it is unlikely that a court would regard as perverse a decision by a supervisor not to seek to reclaim the mistakenly paid VAT if the costs of doing so, and administering the recovered sum, would exceed the sum recovered, or result in little benefit to the creditors.

Whatever the decision, the IP should record his/her decision and his/her reasoning.

Where a third party has paid Nominee's fees or Supervisor's fees there is no duty on the office holder or former office holder to reclaim the VAT

charged, though such a claim would no doubt be made were that third party to seek to recover the VAT mistakenly paid by it.

4) POWER AND OBLIGATION TO MAKE A CLAIM – CLOSED CASES

Where the terms of the arrangement provide for a continuing trust on failure or are silent on the point, a former supervisor of a failed arrangement also has the power and obligation to make a claim to recover the mistakenly paid VAT.

If the arrangement provides for the trust to come to an end on termination (e.g. HMRC's standard modification to limit the trust to funds held by the supervisor at the date of termination) the power and obligation to make a claim will either lie with the former supervisor (to the extent that the right to recover the mistakenly paid VAT is regarded as part of the assets already realised for the purposes of the arrangement), the trustee in bankruptcy (to the extent that the right to recover the mistakenly paid VAT is not regarded as a realised asset) or potentially even with the debtor (if there has been a terminating event pursuant to which the trust does not survive, but which is not brought about, or followed, by the bankruptcy of the debtor). The exact situation will depend upon the precise terms of the agreed modification; in any case the IP must conduct a case-by-case analysis and may choose to seek legal advice.

The obligation to make a claim where the claim to recover the mistakenly paid VAT continues to be held on trust for benefit of the creditors under a continuing trust is more onerous. The IP no longer holds office as a supervisor, and so cannot rely upon the latitude afforded to commercial day-to-day administrative decisions. The IP holds the assets as a trustee. Thus the duties are of a trustee, rather than a supervisor, which include an obligation to collect the trust assets. A failure to make a claim might be seen as a breach of trust. Counsel advises however, that a court would be unlikely to impose a liability where, in circumstances where the supervisor has acted honestly and reasonably on the basis that there would have been little ultimate benefit for the creditors, a decision is made not to bring a claim. The IP should record his/her decision and his/her reasoning.

Where the beneficiary under the continuing trust is the debtor Counsel advises that this gives rise to a bare trust. In these circumstances where possible the former supervisor should notify the debtor of the potential for a claim, and the possible amount of it, and seek his/her instructions.

Where a third party has paid Nominee's fees or Supervisor's fees there is no duty on the office holder or former office holder to reclaim the VAT charged, though such a claim would no doubt be made were that third party to seek to recover the VAT mistakenly paid by it.

5) IDENTIFICATION OF BENEFICIARIES

In a current case, or a closed case where there is a continuing trust, the claim to recover the mistakenly paid VAT will be an asset held for the purposes of the arrangement, and the beneficiaries will be the creditors.

However, an IVA may have been completed where the terms of the arrangement were such that creditors had received all that they could have expected (e.g. the creditors have received 100p in the £ or the stated maximum dividend). In those circumstances, there can be no continuing trust for the benefit of the creditors. Any sum recovered would be held on bare trust for the debtor. An exception is where a fee was capped and VAT inclusive (e.g. a Nominee's fee). Any VAT recovered in this respect less any deduction arising from attributable input tax (see section 6) would be payable to the supervisor's firm.

6) DESTINATION AND EXTENT OF CLAIM

Any claim for mistakenly charged VAT should be made by the supervisor, former supervisor or other estate administrator (TiB, OR etc) against the Firm to whom the VAT was mistakenly paid by the estate in the first place. This may include a former Firm or Firms where cases have been transferred. The claim against the Firm or former Firm should be for the full amount of VAT mistakenly charged.

The Firm, or former Firm, may then make a claim against HMRC. Under existing statute and case law however, the Firm will only be able to claim against HMRC for a period of four years. Moreover that claim may be reduced by input tax directly attributable to the voluntary arrangement and mistakenly claimed by the Firm and input tax disallowed as a consequence of the operation of the partial exemption rules. In these circumstances the Firm would receive a net sum. In practice certain major creditors and their representatives have indicated that they would accept a net payment.

Where refunds include deductions for input tax wrongly claimed either in respect of case specific disbursements or as a consequence of the partial exemption rules applying, IPs will be required to calculate the appropriate amount to be credited to each estate. The simplest and most equitable method of calculation may be one that has the effect of apportioning the input tax arising from the application of the partial exemption rules across the cases rateably, i.e. if input tax represents 40% of the output tax claimed on average and consequently only 60% of output tax claimed is refunded, then each estate should receive 60% of the output tax suffered, the balance being regarded as irrecoverable VAT.

Case specific input tax should be applied to that case.

The refunded amount(s) should be paid into designated estate accounts (or a general clients' account in respect of any closed cases) and should be transferred by the firm into those accounts as soon as they are cleared.

These are in effect third party funds and should be segregated from those of the firm.

Where Nominee's or Supervisor's fees have been agreed in a fixed sum, inclusive of VAT then it would appear that it would not be in breach of HMRC's unjust enrichment provisions for the Firm to keep the value of the sum reclaimed from HMRC (less any adjustment arising from the partial exemption rules or the disallowance of case specific input tax) without passing it on to the relevant estate, whether in an open case or a closed case.

7) CLAIMS PROCESS

The claims process is set out in HMRC's Notice 700/45. The time limit for making claims is four years but not longer. Creditor agents understand this and have indicated that they will not be pressing for more.

IPs should note that time continues to run until a claim is made.

In order to avoid unjust enrichment, HMRC will require confirmation from the firm that sums paid will be passed without deduction to the estates from which VAT was paid in the first place. These provisions are imposed by statute, under the Value Added Tax Act 1994 and the VAT Regulations 1995. Where IPs are claiming refunds in respect of closed cases, they should distribute these as soon as reasonably practicable.

Once refunds have been paid into the estates, the normal IVA procedures apply and office holders may be remunerated out of estate monies in accordance with the terms of the IVAs in the usual way. HMRC concurs with this treatment of the refunds.

8) POSTPONING THE TERMINATION OF OPEN CASES

Where possible cases which would otherwise be due for closure should be kept open where a claim has been or is to be made either by exercising the discretion usually included in a proposal or by seeking a variation. This is because a supervisor is likely to have more extensive powers in an open case and could therefore deal with the issue more easily. As this appears to be a proper exercise of the supervisor's powers criticism would be unjustified.

9) REMUNERATION

The proposal document as modified and varied together with any standard terms and conditions determines the extent of the supervisor's remuneration both in open and closed cases.

In open cases where, as a result of having to make the claim to recover the mistakenly paid VAT and administer its distribution, the supervisor is seeking further fees or remuneration above that provided for in the IVA, he is usually able to summon a variation meeting. That is certainly provided for

in R3's and the Protocol Standard Conditions. Without a variation he is not entitled to further fees above those provided for in the IVA and would be vulnerable to a challenge by a creditor or debtor.

In closed cases, the supervisor will have to rely upon the remuneration provisions that apply in respect of the continuing trust. The Protocol Standard Conditions do not provide for any fees to be paid where there is a trust although the proposal itself might make some provision. By contrast the R3 Standard Conditions do allow fees to be charged by the operation of condition 28(3) which provides that proceeds shall be "applied and distributed in accordance with the terms of the Arrangement" and condition 17(2) which provides that the "fees, costs, charges and expenses of the Supervisor shall be paid out of the assets of the Arrangement".

In practice certain creditors or their representatives have indicated that they do not want to be faced with multiple variation meetings but would agree to an additional right to remuneration based on the sum recovered. IPs should understand that while an informal agreement of this sort is acceptable insofar as it affects the sums paid to the approving creditors, it cannot be binding on other creditors. In an open case in the event of challenge by one or more minority creditors, the IP might argue that the majority creditors' preference to avoid multiple variation meetings combined with the voting power of those majority creditors (who would have been expected to approve a binding resolution at any such meeting had one been convened) would have resulted in approval of the fees. In a closed case, there is no mechanism for binding dissenting creditors; therefore, unless R3 standard terms or similar apply (in which case time costs may be allowable), IPs will need to seek creditor approval for fees and deduct a charge only from those creditors who consent.

There is no objection to an informal arrangement between the IP and a debtor regarding fees.

Certain fee provisions refer to a fee based on a percentage of realisations. Counsel considers that the recovery of mistakenly paid VAT does not constitute a realisation, because it is the recovery of a sum mistakenly paid out of a realisation. But if creditors agree (some creditor agents have done so), it may be treated as if it were.

This guide is issued by:

Association of Business Recovery Professionals (R3)
Insolvency Practitioners Association
Institute of Chartered Accountants in England & Wales
The Institute of Chartered Accountants of Scotland
The Association of Chartered Certified Accountants
Chartered Accountants Ireland
Debt Resolution Forum

ANNEXE

DEFINITIONS

IP	Insolvency Practitioner authorised by an RPB or the IS
RPB	Recognised Professional Body under IA86
IS	The Insolvency Service, an executive agency of the Secretary of State for Business, Innovation & Skills acting as Competent Authority under IA86
IA86	Insolvency Act 1986, as amended
Office holder	IP acting as Nominee/Supervisor as defined in IA86 in relation to an IVA.
IVA	Individual Voluntary Arrangement as defined in IA86
CVA	Company Voluntary Arrangement as defined in IA86
PVA	Partnership Voluntary Arrangement as defined in IA86
HMRC	Her Majesty's Revenue & Customs
VAT	Value Added Tax
SIP	Statement of Insolvency Practice
Regulators	RPBs and the IS
Firm	VAT-registered entity, partnership or company, in association with which the IP carries out his/her office holder duties
Office a/c	Bank account in the name of the firm
Clients' a/c	Bank account satisfying the definition in the RPBs' Clients' Money Regulations
Estate	Trust managed by the office holder on behalf of creditors and/or other beneficiaries
Estate fund	Monies held in the estate
Estate a/c	Bank account operated on trust principles for an estate
TiB	Trustee in Bankruptcy – an IP acting as such in relation to a bankruptcy
Trustee	IP acting as trustee of a continuing express or implied trust subsequent to completion of an IVA, CVA or PVA
Creditor	Person, corporate or otherwise, owed money by the debtor, where that person's claim is admitted by the office holder for dividend purposes
Creditor agent	Third party acting on behalf of and with the authority to exercise voting rights for one or more creditors, or a debt purchaser with such rights
Debtor	Individual subject to an IVA, company subject to a CVA or partnership subject to a PVA
Bankrupt	Debtor subject to bankruptcy proceedings subsequent to failure of an IVA
OR	Official Receiver (part of the IS) acting as TiB in the absence of an IP appointed for that purpose
Fees	Office holder remuneration (and charges for disbursements) as approved by creditors in accordance with the terms of an IVA, CVA or PVA as modified or varied

Further guidance following Paymex

Nominee	IP's role in the period immediately prior to approval of an IVA, CVA or PVA in respect of which an agreed fee may have been approved/ modified by creditors
Supervisor	IP's role subsequent to approval of an IVA, CVA or PVA in respect of which a fee may have been approved by creditors