

## VAT Treatment of Debt Factoring and Invoice Discounting

This document should be read in conjunction with paragraph 6(1)(c) and 6(1)(e) of Schedule 1 to the VAT Consolidation Act 2010 (VATCA 2010)

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A more recent version of this manual is available.

## Introduction

This guidance sets out the VAT treatment of debt factoring and invoice discounting.

### 1 What is Debt factoring

Debt factoring is a financial service provided by a financier which involves:

- (i) the purchase of debts (referred to as the assignment of debts) from the originator of the debt (the client),
- (ii) the giving of notice of such purchase/assignment to the client's debtors,
- (iii) the collection of the debts, and
- (iv) an advance funding service, which entails the provision of funding or credit to the client.

### 2 What is Invoice discounting

Invoice discounting means the assignment of a debt to a financier by a client and the collection of the debt by the client as the appointed agent of the financier. Such assignment and the corresponding agency appointment may be disclosed to the client's debtor or may be kept confidential.

### 3 What is meant by "with recourse" and "without recourse"

Debt factoring can be provided by a financier either with recourse or without recourse in the event of payment default by a debtor.

Debt factoring with recourse means that the risk of debtor default remains with the client who collects the debts as the appointed agent of the financier.

Debt factoring without recourse means that the financier assumes the risk of debtor default.

Invoice discounting can also be provided either with recourse or without recourse in the event of default by a debtor.

## 4 VAT treatment of debt factoring and invoice discounting

The sale of debts or non-performing loans by a client to a financier is VAT exempt.

The acquisition of the debts or non-performing loans by a financier at a price below their face value is not a supply for VAT purposes.

Debt collection services and debt collection administration services provided by a financier as part of a debt factoring or invoice discounting service are subject to VAT at the [standard rate](#).

The [supply of services](#) that are ancillary to a taxable debt collection service (including debt factoring and invoice discounting) are subject to VAT at the [standard rate](#).

The provision of an advance funding service by a financier to a client is the VAT exempt giving of credit.

The [supply of services](#) that are ancillary to the VAT exempt provision of credit are treated as VAT exempt.

## 5 VAT treatment of other services

Debt factoring and invoice discounting agreements often contain fees and charges for other services supplied.

See Appendix 1 for a description of some of the more common of these other fees and charges. Each case must be decided by reference to its own particular facts and circumstances. Where possible, an outline of the VAT treatment to be applied to these fees and charges is set out.

## 6 Deductibility – financier

Under normal deductibility rules, a taxable person engaging in taxable activities has an entitlement to recover VAT on costs incurred in respect of this activity. A taxable person engaging in VAT exempt supplies has no entitlement to recover VAT on costs incurred in respect of this activity unless it is a "[qualifying activity](#)".

Where a financier engages in both (i) taxable debt factoring or invoice discounting activities and (ii) VAT exempt activities (such as the provision of credit), an entitlement to recover VAT incurred will arise in respect of the former activity only. VAT on general overheads and for costs that relate to both [taxable and exempt activities](#) will need to be apportioned taking account of both business activities.

## 7 Deductibility – client

A client who is an accountable person, is entitled to deduct VAT charged to it by a financier under [normal VAT rules](#).

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## Appendix 1

### VAT treatment of certain fees charged by the financier

#### Take-on Fee (of a fixed amount)

In general, this is intended to cover the workload involved by the financier in (i) testing and verifying the client's sales ledger and other records before the commencement of the relationship, (ii) obtaining the sales ledger and (iii) setting up the control account and all necessary reconciliations. In such cases, the take-on fee relates to debt collection and ledger management. Accordingly, the fee is subject to VAT at the [standard rate](#).

#### Arrangement Fee

In general, this fee is agreed before negotiations for the credit facility start and is payable upon commencement of the credit facility. The VAT liability depends on the activity and the specific circumstances, e.g. if the arrangement only relates to the negotiation of the terms for the advancement of credit then this would be an exempt supply of the [negotiation of credit](#).

#### Computerised Services

Financiers often agree to provide licensed software and a user manual to enable the client to send Electronic Data Interchange ("EDI") messages, download details of debts, request payments and view accounts. Such services are often provided free of charge, in which case the agreed services covered by the normal taxable service charge will also include the computerised services. Any fee for this service is subject to VAT at the [standard rate](#).

#### Collect-out Fee

This fee becomes payable upon breach of the agreement by the client to collect the debts or on the client's insolvency. This fee is often described as being for "additional work in collecting or procuring the collection of debts" as a result of such breach or insolvency. This fee is subject to VAT at the [standard rate](#).

#### General Indemnities

There are often indemnities in favour of the financier for various out of pocket expenses incurred before and during the lifetime of the factoring or invoice discounting agreement. As the indemnities are in very general terms, and often akin to claims for damages, each transaction must be evaluated on a case-by-case basis to determine the correct VAT treatment.

### Facility Fee (payable annually)

Among factoring and invoice discount companies, a facility fee is normally charged in relation to the provision of financial facilities and if this is the case then it would be exempt from VAT. If it is not for a financial facility, then the fee is subject to VAT at the [standard rate](#).

### Arrangement fee (for variations to the agreement or services)

An arrangement fee is subject to VAT at the [standard rate](#) where the variations to the agreement or services relate to taxable supplies. If the fee relates to VAT exempt supplies such as the negotiation of credit, it is exempt from VAT.

### Costs of outside visits

Costs of outside visits to the client's premises are an ancillary charge to the financier's debt collection and factoring services and, as such, are subject to VAT at the [standard rate](#).

### Legal fees incurred

Legal fees that relate to perfection of security (legal steps required to be taken in relation to a security interest in order to make it effective against third parties), debt collections or enforcement of rights, are considered ancillary to the financier's debt collection and factoring services and, as such, are subject to VAT at the [standard rate](#).

### Debt enforcement costs

Where debt enforcement costs are ancillary to factoring and invoice discounting services, they are subject to VAT at the [standard rate](#).

### Credit Status Reports

Financiers often agree to provide credit status reports on any of the client's customers or proposed customers. This is ancillary to the factoring or invoice discounting service and is subject to VAT at the [standard rate](#).