

Hire purchase transactions

[Including detailed information on the calculation of relief of VAT in respect of bad debts and for early determination in hire purchase transactions].

This document should be read in conjunction with sections 19, 20, 56 and 87 of VAT Consolidation Act 2010 (VATCA 2010).

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1. Introduction

The Finance Act 2007 amends the VAT treatment of hire purchase transactions. The amendments allow finance houses to become entitled to bad debt relief in respect of such transactions. Under the new provisions, with effect from 1 May 2007, finance houses involved in hire purchase transactions are accountable persons in respect of the supply of the underlying goods concerned and on the subsequent sale of such goods if repossessed by them. This manual provides guidance in relation to the Finance Act amendments and also information on bad debt relief in general.

2. Summary of New Provisions

Arising from the changes in the Finance Act 2007 there is a supply by the dealer of the goods to the finance house and the supply from the finance house to the customer who acquires the goods under the hire purchase agreement. These two supplies occur simultaneously. The finance house continues to be exempt from VAT on its finance charges.

The new legislation provides that the transfer of ownership of goods from the dealer to the finance house is a taxable supply. The dealer must issue a VAT invoice to the finance house. (The special documentary procedure for hire purchase transactions in operation since 1996 no longer applies).

The finance house makes a taxable supply when the goods are handed over to the customer. Accordingly, it must account for the VAT on that supply, and may claim deductibility in respect of the VAT chargeable in relation to that supply. (The handing over of the goods to the customer has always been a taxable supply but prior to Finance Act 2007 that supply was treated as a supply by the dealer directly to the customer.)

Where the customer defaults on the hire purchase payments the finance house is entitled to claim bad debt relief in respect of the VAT element of the outstanding payments. This should be calculated on a pro-rata basis as outlined in paragraph 19 below.

Where the hire purchase agreement is terminated early and the goods are handed back to the finance company then the finance company can claim relief in respect of the VAT element of the outstanding payments in accordance with paragraph 20 below.

If the finance house repossesses goods before the hire purchase agreement has run its course, and subsequently sells those goods, that sale is a taxable supply on which the finance house must account for VAT.

3. Invoices

A finance house must issue a VAT invoice in respect of a supply of goods under a hire purchase agreement where the supply is to an accountable person. However, if the hire purchase document contains all the details required by regulation for a VAT invoice then that document will be accepted as a VAT invoice.

Where the supply by the finance house consists of qualifying goods as defined in section 56 of the VAT Consolidation Act 2010 and that supply is to a taxable customer who holds a section 56 authorisation then the VAT invoice/hire purchase document will show the zero rate of VAT together with the usual authorisation number. It should be noted that motor vehicles do not come within the meaning of qualifying goods and therefore the supply is not zero-rated.

4. Taxable amount

The taxable amount of goods supplied by the finance house to the customer is usually the same as that of the supply of those goods from the dealer to the finance house. This is because the finance house does not apply a profit margin to the value of the supply of the goods from the dealer. Therefore, (apart from the situation outlined in paragraph 9), the tax on the purchase from the dealer by the finance house and the tax on the supply of the goods by the finance house will be the same amount.

In the case of a new motor vehicle the amount on which VAT is chargeable in respect of the supply by the dealer does not include Vehicle Registration Tax (VRT). In the case of the supply by the finance house to its customer, the amount of the VRT is treated for VAT purposes as a disbursement on behalf of the customer and accordingly is not included in the taxable amount.

Interest charges are treated as consideration for the supply of credit and are not part of the taxable amount for the goods. These charges are exempt from VAT.

5. Transfer of ownership at the end of the hire purchase agreement

The transfer of ownership of the goods from the finance house to the customer at the end of the hire purchase agreement is not a supply for VAT purposes.

6. Payments of instalments by the customer

No VAT liability arises for the finance house at the time the instalments are received by it during the term of the hire purchase agreement.

The VAT will have been accounted for when the goods were handed over to the customer. The interest element of the instalments is treated for VAT purposes as consideration for the exempt supply of credit. The cash receipts basis of accounting for VAT does not apply to hire purchase transactions.

7. Entitlement to deductibility

Finance houses which supply goods on hire purchase terms are entitled to full deductibility in respect of the purchase by them of those goods for onward supply. As regards dual-use inputs used by the finance house for both deductible and non-deductible supplies, the finance house is entitled to deduct only the proportion of input tax which correctly reflects the extent to which those inputs are used for the taxable supplies.

8. Cases where a customer defaults on repayments

The conditions under which bad debt relief is allowed are set out in Regulation 10 of the VAT Regulations 2010. In general, a taxable person must be in a position to demonstrate that:

1. The consideration due for the supply is treated as a bad debt only after the taxable person has taken all reasonable steps to recover the debt
2. The bad debt is allowable as a deduction for the purposes of the Taxes Consolidation Act 1997 and has been written off as such in the financial accounts of the taxable person and the requirements of Regulation 27(1)(m) of the Value-Added Tax Regulations 2010 in respect of that debt have been fulfilled
3. The debt is not due from a person connected with the taxable person within the meaning of Regulation 25(5)(b) of the Value-Added Tax Regulations 2010.

The VAT bad debt relief should be calculated in accordance with the VAT analysis of the transactions outlined in paragraphs 9 and 10 below.

9. Bad debt relief for a supply, other than a supply under hire purchase

Before dealing with bad debt relief in respect of a supply under a hire purchase agreement it may be helpful to first outline the general method for calculating bad debt relief. This is calculated in accordance with the following formula (First Formula):

$$A \times B / 100 + B$$

where:

A: is the amount which is outstanding from the debtor in relation to the taxable supply

B: is the percentage rate of VAT applicable to the supply

Example 1

Bad debt relief for a supply, other than a supply under hire purchase:

Sale Price of the Goods: €24,200

[B]VAT standard rate: 23%

VAT amount accounted for on the supply: €4,525

Amount received from debtor: €14,520

[A]Amount outstanding from debtor: €9,680

Therefore the VAT adjustment for bad debt relief, using the First Formula, is as follows:

$$€9,680 \times 23 / 100 + 23$$

$$\text{Bad debt relief} = €1,810$$

10. Bad debt relief for a supply made under a hire purchase agreement

Relief from VAT on bad debts arises only in respect of the VAT element of hire purchase transactions. A hire purchase agreement is made up of different elements, comprising payment in respect of the goods, VAT, VRT (in the case of motor vehicles) and credit charges. In the normal course, the value of each of these elements should be available in the records of the finance house. Bad debt relief should be calculated in accordance with the following formula (Second Formula):

$$(C - D) \times (E - F) / C$$

where:

C is the sum of all the amounts scheduled for payment by instalment under the hire purchase agreement

D is the total amount paid by the customer against the instalments scheduled for payment under the hire purchase agreement up to and including the date on which the bad debt is written off in the financial accounts of the accountable person

E is an amount equal to the amount of tax accounted for by the taxable person on the supply of the goods under the hire purchase agreement, and

F is an amount equal to the tax attributable to a part payment referred to in the hire purchase agreement calculated in accordance with the Third Formula. However, if there is no part payment F is equal to zero.

The result of this calculation gives the amount of the VAT bad debt relief which can be claimed. The following examples will help to clarify the position:

Example 2

Hire Purchase of equipment where no part payment is made and the customer defaults after three years:

Sale Price of the Goods: €24,200

VAT rate: 23%

[E] VAT accounted for: €4,525

Hire Purchase term: 5 years

Credit charges over 5 years: €4,800

[C] Total of instalments scheduled for payment: €29,000

Annual instalment Payment: €5,800

[D] Total paid by instalment in the first 3 years: €17,400

[C-D] Amount outstanding: €11,600

Therefore the VAT adjustment for bad debt relief, using the Second Formula, is as follows:

$$(\text{€}29,000 - \text{€}17,400) \times (\text{€}4,525 - 0) / \text{€}29,000$$

Bad debt relief = €1,810

Example 3

Hire purchase of a new means of transport where no part payment is made and the customer defaults after 3 years:

Sale Price of the Goods: €32,266

VRT (say 24% of €32,266): €7,743

VAT inclusive price (32,266 – 7,743): €24,523

[E] VAT accounted for: €4,586

Hire Purchase term 5 years

Credit charges over 5 years €6,453

[C] Total of instalments scheduled for payment: €38,719

Annual instalment Payment: €7,744

[D] Total paid by instalment in the first 3 years: €23,232

[C-D] Amount outstanding: €15,487

Therefore the VAT adjustment for bad debt relief, using the Second Formula, is as follows:

$$(\text{€}38,719 - \text{€}23,232) \times (\text{€}4,586 - 0) / \text{€}38,719$$

Bad debt relief = €1,834

Example 4

Hire purchase of new means of transport involving a part payment (such as a trade-in or a cash payment/deposit) where the customer defaults after 3 years:-

[H] Sale Price of the Goods: €32,266

VRT (say 24% of €32,266): €7,743

VAT inclusive price (32,266 – 7,743): €24,523

[E] VAT accounted for: €4,586

[G] Part Payment: €5,000

[F] Tax attributable to the part payment: €672

Hire Purchase term 5: years

Credit charges over 5 years: €5,453

[C] Total of instalments scheduled for payment: €32,719

Annual instalment Payment: €6,544

[D] Total paid by instalment in the first 3 years: €19,632

[C-D] Amount outstanding: €13,087

As this example includes a part payment it is necessary to calculate the tax attributable to that part payment in order to establish a value for F so that the Second Formula can be completed. The tax attributable to the part payment is calculated in accordance with the following formula (Third Formula):

G x E / H

€5,000 x €4,586 / €32,266

F is therefore equal to €711

Therefore the VAT adjustment for bad debt relief, using the Second Formula, is as follows:

(€32,719 - €19,632) x (€4,586 – €711) / €32,719

Bad debt relief = €1,550

11. Early Determinations

Under the Consumer Credit Act 1995 a customer is entitled to end the hire purchase agreement on a date earlier than the date fixed in the agreement for termination of that agreement. This is referred to as a determination. The customer may in these circumstances have to pay an additional amount as part of that determination.

Where early determination of the hire purchase agreement occurs and the full amount payable on the original agreement is not paid and **no transfer of title from the finance house to the customer takes place, the finance house will be entitled to relief in respect of the excess VAT already accounted for.** The relief should be calculated on a pro-rata basis in accordance with the following formula (Fourth Formula):

$$J \times (E - K) / C$$

where:

J: is the total amount paid by the customer against the instalments scheduled for payment under the hire purchase agreement up to and including the prior date agreed under the determination plus any amount paid by the customer as part of the determination

E: is an amount equal to the amount of tax accounted for by the accountable person on the supply of the goods under the hire purchase agreement

K: is an amount equal to the amount of tax attributable to the part payment shown in the hire purchase agreement calculated in accordance with the Third Formula (however, if there is no part payment K is equal to zero), and

C: is the sum of all the amounts scheduled for payment by instalment under the hire purchase agreement.

Example 5

Early determination of hire purchase agreement after 1 year, where a deposit is paid, an amount is paid as part of that determination and the goods are returned to the finance company:

[H] Sale Price of the Goods: €24,200

VAT rate: 23%

[E] VAT accounted for: €4,525

[G] Part Payment: €5,000

[K] Tax attributable to the part payment: €884

Hire Purchase term: 5 years

Credit charges over 5 years: €3,840

[C] Total of instalments scheduled for payment: €23,040

Annual instalment Payment: €4,608

[J*] Total paid by instalment in the first year: €4,608

[J*] Amount paid as part of the determination: €4,412

Total amount paid: €14,020

***One element of the value of J**

If the customer opts to end the hire purchase agreement after one year and return the goods to the finance company he or she is obliged under the hire purchase agreement to pay at least half of the hire purchase price and so must pay a further €4,412.

The tax attributable to the part payment

Before calculating the relief that can be claimed in this case it is necessary to first calculate the tax attributable to the part payment. This is calculated as follows using the Third Formula:

G x E / H

€5,000 x €4,525 / €24,200

Tax attributable to the part payment is therefore equal to €935

This figure is also needed in order to establish a value for K so that the Fourth Formula can be completed.

The tax attributable to the remaining payments made by the customer

It is now necessary to calculate the tax attributable to the amount paid by the customer against the instalments scheduled for payment under the hire purchase agreement plus any amount paid by the customer as part of the determination.

This is calculated as follows using the Fourth Formula:

$9,020 \times (4,525 - 935) / 23,040 = €1,405$

The total VAT due in relation to the payments made by the customer is therefore equal to €2,340 (i.e. €935 + €1,405)

VAT accounted for on the handing over of the goods was equal to €4,525

Therefore the relief for the determination of the hire purchase agreement is equal to €2,185 (i.e. €4,525 – €2,340).

Relief cannot be claimed until the credit note, required to be issued in accordance with section 39(2) of the VAT Consolidation Act 2010, has been issued.

Relief does not arise where early determination of the hire purchase agreement occurs and the transfer of title from the finance house to the customer takes place.

Relief, in the case of early determination of a HP agreement, cannot be claimed:

1. Until the credit note required to be issued in accordance with section 39(2) of the VAT Consolidation Act 2010 has been issued
2. Where transfer of title from the Finance House to the customer takes place.

12. Sale of repossessed goods

Where a finance house repossesses goods which have been subject to a hire purchase contract which terminates early, or on which the customer defaults, such repossession is not a taxable event as the title had not been transferred from the finance house to the customer. However, the subsequent sale by the finance house of those goods is taxable. The taxable amount is the consideration received by the finance house for that sale of those goods.

13. Hire Purchase transactions in respect of second-hand means of transport:

The provisions regarding residual input credit allowed to taxable dealers under section 87 of the VAT Consolidation Act 2010 apply to finance houses involved in the sale on hire purchase of second-hand means of transport. The finance house may deduct the residual tax deemed to be included in the value of the means of transport when acquired by it and must account for VAT on the subsequent supply of that means of transport.

14. EU Intra-Community acquisitions

Arising from changes in the Finance Act 2008 a finance house is required to account for VAT on the Intra-Community Acquisition of goods acquired by it where those goods are funded through a hire purchase agreement.