[2018] UKFTT 309 (TC)

TC06539

Appeal number: TC/2017/03206

VAT – option to tax under Part 1 Schedule 10 VATA – whether disapplication provisions in paragraphs 12 to 17 applied on basis that land was exempt land - circularity of statutory provisions – anti-avoidance and genuine transactions - whether there was the necessary "intention" or "expectation" in respect of "relevant transferee" – no- appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DAVID MOULSDALE **Appellant**
t/a
MOULSDALE PROPERTIES

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE ANNE SCOTT
MEMBER: PETER SHEPPARD

Sitting in public at George House, 126 George Street, Edinburgh on Wednesday 2 May 2018

Philip Simpson, QC, for the Appellant

Elisabeth Roxburgh, Advocate, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

The decision under appeal

1. The disputed decision of the respondents ("HMRC") is a decision dated 16 March 2017 that the sale by the appellant of the property at 5 Deerdykes Road, Cumbernauld ("the property") was a taxable supply for the purpose of Value Added Tax ("VAT") as the requirements of paragraph 12 of Schedule 10 to the VAT Act 1994 ("VATA") were not met. In other words the election to waive exemption (hereafter the option to tax) made by the appellant in respect of the property was not disapplied and the property was not exempt from VAT.

Background

2. At the outset of the hearing the parties agreed that there was no dispute in relation to the relevant facts and lodged a Statement of Agreed Facts in the following terms (paragraph 3 is as amended in the course of the hearing):-

> "1. On or about 3 May 2001 the Appellant purchased a property at 5 Deerdykes Road, Westfield, Cumbernauld (the "**Property**"). The vendor had opted to tax the Property. The Appellant did not opt to tax the Property prior to the purchase. The purchase price of the Property excluding VAT was £1,140,000. VAT was £199,500. The VAT Return that included the purchase is that for period (06/01). The Appellant received a VAT repayment of £195,455.22 pursuant to the completed VAT Return.
>
> 2. The Appellant subsequently opted to tax the Property on or about 9 May 2001.
>
> 3. On or about 11 September 2001 the Appellant leased the Property to Optical Express (Westfield) Limited ('**OEWL**'). At all material times, OEWL's occupation of the property has not been wholly, or substantially wholly, for eligible purposes.
>
> 4. OEWL was a person connected with the Appellant for the purposes of Schedule 10 of VATA 1994 at all material times.
>
> 5. Throughout the period to 2007, the Appellant continued to account for output tax on the lease of the Property to OEWL. In 2007 following a VAT visit the Appellant became aware that the grant of the lease and subsequent supplies under it should be treated as exempt supplies by virtue of Schedule 10 of VATA. The Respondent advised the Appellant that the Appellant was entitled to revisit the last three years and the Appellant sought repayment of output tax charged to OEWL for the period which was not time barred under the three year capping restrictions. On or around 2 September 2014 the Appellant sold the Property to Cumbernauld SPV Limited ('**CSPV**'). The Property was sold subject to the lease in favour of OEWL. The price was £1,149,374.
>
> 6. CSPV is not a person connected with the Appellant for the purposes of Schedule 10 of VATA. CSPV did not advise HMRC of an election to waive exemption on the Property prior to purchasing the Property. CSPV was not VAT registered at that time nor has it subsequently become VAT registered."

3. Although the correspondence, Notice of Appeal and Statement of Case, and indeed the skeleton arguments, canvassed a number of disparate issues, the parties agreed that the sole issue for determination by the Tribunal was the interpretation of

the relevant provisions of Schedule 10 VATA because of the admitted circularity caused thereby.

4. In summary, the circularity can arise where a taxpayer wishes to sell an opted building, or land, but at the point of sale the building or land is not a capital item in the Capital Goods Scheme ("CGS") for the seller. However, if the sale price exceeds £250,000 and is subject to VAT because of the option to tax, it has the potential to become a capital item in the hands of the purchaser and that is relevant in terms of the legislation. In circumstances such as where the "exempt land test" (see below) is met the seller's option to tax is potentially disapplied rendering the supply exempt. However, that can result in circularity since, if the supply is no longer taxable, for the reasons set out below, a capital item in the CGS would not be created and therefore the supply then becomes taxable.

5. At this juncture we observe that the parties are not alone in finding that that circularity causes uncertainty and complication. The leading textbook in the field, namely Scammell on *VAT on Construction, Land and Property* at paragraph H16.4.4 makes it explicit that that circularity has long been controversial and there is no consensus on the approach to be adopted.

The statutory framework

6. It is a matter of agreement that in looking at the relevant statutory provisions, the approach in *UBS AG v HMRC*[1] as articulated by Lord Reed at paragraphs 66 to 68 was appropriate. The relevant sections of those paragraphs read:

> "66… 'The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically'. …
>
> 67. References to 'reality' should not, however, be misunderstood … tax avoidance is the spur to executing genuine documents and entering into genuine arrangements.
>
> 68. Secondly, it might be said that transactions must always be viewed realistically, if the alternative is to view them unrealistically. The point is that the facts must be analysed in the light of the statutory provision being applied. If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. …".

7. There is no dispute that in this case the documentation and the arrangements were genuine.

8. One of the many problems with which we were faced in this matter was that although the parties agreed that the legislation should be construed purposively, the purpose of the relevant legislation was less than clear.

9. As can be seen from the Statement of Agreed Facts, the appellant had opted to tax the property. Part I of Schedule 10 VATA makes provision for a person to opt to tax any land and if a taxpayer opts to tax then the expectation or assumption is that any grant or other supply in respect of that land will be taxable unless it comes within a

[1] 2016 UK SC 13

specified exemption. In other words grants made by that person in relation to the land at a time when the option has effect, do not fall within Group 1 of Schedule 9 VATA. Such grants therefore give rise to standard rated, ie taxable supplies.

10. Schedule 10 VATA deals with Buildings and Land and Part 1 at paragraphs 1-11 is "The option to tax land" and the next section, with which we are concerned, at paragraphs 12-17 is headed "Anti Avoidance".

11. Although at all times HMRC argued that Schedule 10 VATA deals with anti-avoidance, even HMRC's own Manual VATLP23100 Option to Tax – Anti-Avoidance Test – sets out HMRC's perceived understanding of the legislation and it states:-

> "It is not the aim of the legislation to upset normal commercial property transactions … However, the test is a mechanistic one. There does not have to be an intention to avoid tax for the test to be triggered. Therefore some arms-length commercial arrangements are caught by it".

12. *Scammell*, to which we refer above clearly identifies at paragraph H15.1.1 that these provisions "…apply in a range of situations where no avoidance is involved: motive is irrelevant".

13. Both parties agreed that the provisions in paragraphs 12-17, although described as anti-avoidance, can and do apply to non-tax avoidance arrangements.

14. As HMRC's manual makes clear the original Rules were introduced in 1997. Ms Roxburgh relied on the Budget Notice 30/04 "VAT: Commercial Buildings – Anti-Avoidance" dated 17 March 2004 to demonstrate the objectives of the legislation. Unfortunately as *Scammell* makes explicit those were simply amendments at that point and we have no information in regard to the original provisions and/or any other amendments. That Budget Notice is therefore of very limited value.

15. We agree entirely with Judge Falk in *PGPH Limited v HMRC*[2] ("PGPH") at paragraph 6 where she said:-

> "The option to tax provisions reflect Article 137 of Directive 2006/112/EC (the 'Principal VAT Directive') which permits Member States to allow a right of option for taxation in respect of certain supplies, including supplies of land and buildings. Article 137(2) provides that Member States may restrict the scope of this right. The UK has chosen not only to allow an option to tax but also to restrict it pursuant to Article 137(2). The domestic law provisions which give effect to this restriction are those in paragraphs 12 to 17 of Schedule 10, entitled 'Anti-Avoidance'. Their effect is to prevent an option to tax rendering supplies taxable where certain conditions are met. Despite the title, the conditions set out do not include any tax avoidance purpose."

16. We find that the purpose of the legislation, insofar as it is discernible, is to restrict the scope of the right to opt for taxation in certain stipulated circumstances and that it is not limited to anti-avoidance.

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[2] TC/2014/03441

17. Lord Dunedin at paragraph 52 in *Whitney v Commissioners of Inland Revenue*[3] said:-

> "63. … A statute is designed to be workable, and the interpretation thereof by a Court should be to secure that object, unless crucial omission or clear direction makes that end unattainable."

18. The parties take different approaches to achieving that object but both submit that it is attainable but with diametrically opposed outcomes.

19. Broadly, HMRC's current approach is set out in VATLP23500 Option To Tax-Anti-Avoidance Test: How does the anti-avoidance test work in practice at Example 5 it reads:

> "To avoid circularity the CGS item created by the transfer (and under the grant subject to the anti-avoidance test) is ignored for the purposes of deciding whether the grantor's option is disapplied. As a result the sale of the property is a taxable supply".

20. Two points arise out of that. Firstly, that is simply HMRC's interpretation of the position and, secondly, and more pertinently for this appeal, *Scammell* points out that that and the following example were only added in 2017 which is some years after the transaction with which we are concerned.

21. Mr Simpson's approach can be summarised as saying that a linear approach should be adopted, that it is the intention before the supply is made that is relevant, and at that stage there is an assumption that there will be tax chargeable so the CGS provisions are met and once it is established that the transaction is exempt then one should not revisit the anti-avoidance provisions.

22. If he is correct then, where exempt land is concerned and the value of the land exceeds £250,000, the Schedule 10 provisions would be limited in their application.

23. We set out at Appendix 1 the relevant provisions of paragraphs 12 to 17, Schedule 10 VATA together with paragraph 113 of the Value Added Tax Regulations 1995 (the "VAT Regulations").

The approach to the legislation based on the facts in this case

24. The starting point is paragraph 12 which reads:

> "(1) A supply is not, as a result of an option to tax, a taxable supply if:
>
> (a) the grant giving rise to the supply was made by a person ('the grantor') who was a developer of the land, and
> (b) the exempt land test is met.

25. "Developer" does not carry its usual everyday meaning and can include someone who has merely purchased the building. Paragraph 13 defines a "developer" for the purposes of paragraph 12 and the test is in fact whether the property is or will be a

[3] 1926 AC 37

capital item in the hands of the grantor or of a person to whom the property is to be transferred.

26. In this case, there was no dispute that although the property had been a capital item in the hands of the appellant it was no longer so due to the expiry of time, and therefore the only possibility of qualification would be if it were to be a capital item in the hands of the purchaser. (The expiry of time was because the 10 interval adjustment period had expired in terms of Regulations 113(2) and 114 of the VAT Regulations.)

27. In the interests of brevity, and since we agree entirely with the analysis, we adopt the explanation of legislative provisions by Judge Falk at paragraphs 8 to 10 in *PGPH* where she explains

> "8. Paragraph 13 effectively defines developer by describing when a grant is made by a developer for the purposes of paragraph 12. Under paragraph 13(2) this test is met if the land 'is, or was intended or expected to be, a relevant capital item' and the grant is made at an 'eligible time as respects that capital item'. The remainder of paragraph 13 expands on these concepts. In summary, 'relevant capital item' is defined by reference to whether the asset in question falls to be treated as a capital item for the purposes of regulations under s26(3) and (4) VATA which provide for adjustments relating to the deduction of input tax over a period. This is a reference to what is generally known as the Capital Goods Scheme, contained in Part XV of the VAT Regulations. A grant is made ~~[it]~~ at an 'eligible time' if it is made before the end of the adjustment period provided for in those regulations (10 years in the case of land and buildings). The effect of paragraph 13(4) is that the relevant intention or expectation must be that of the grantor ....
>
> 9. Regulation 113 of the VAT Regulations lists the items which are to be treated as capital items. The list includes a building or part of a building on which capital expenditure with a value of not less than £250,000 is incurred on acquisition, construction, refurbishment, fitting out, alteration or extension...
>
> 10. Paragraph 12(2) provides that the exempt land test is met if, when the grant was made, the grantor … intended or expected that the land would become exempt land or would continue to be exempt land. The concept of exempt land is explained in paragraphs 15 and 16. Under paragraph 15(2) land is exempt land if a 'relevant person' is in occupation and the occupation is not wholly, or substantially wholly, for eligible purposes. In broad terms occupation for the purposes of making taxable, but not exempt, supplies counts as eligible purposes (paragraph 16). 'Relevant person' is defined as the grantor, a development financier and any person connected with either of them, see paragraph 15(3)."

28. Taking matters linearly and chronologically, a prudent taxpayer who had opted to tax, would first assume that tax would be levied on any supply of the land but would then have to check if the supply fell into one of the restricted categories.

29. The parties agreed that the appellant could only be a "developer" for the purposes of paragraph 12(1) if paragraph 13(2) was engaged. Ms Roxburgh conceded that if 13(2)(a) was met then sub-paragraph (b) was also met. The question therefore is whether "(a) the land is, or was intended or expected to be, a relevant capital item (see sub-paragraphs (3) to (5)),…".

30. Paragraph 13(3) is not engaged because the property was no longer a capital item for the appellant.

31. Therefore the only remaining possibility would be reliance on paragraph 13(4) and therefore whether the appellant intended or expected that the property would become a capital item in relation to "any relevant transferee". That phrase is defined in paragraph 13(5) as being a person to whom property is transferred in the course of a supply or transfer of a business.

32. The appellant now concedes that the property was not transferred in the course of a transfer of a business or part of a business as a going concern. It was, of course, transferred in the course of a supply so the purchaser was the relevant transferee.

33. Returning to paragraph 13(4) the issue therefore is whether or not the appellant could have intended or expected that the property would become a capital item in the purchaser's hands. We agree, again, with Judge Falk in *PGPH* at paragraphs 116 to 118 where she states:

> "116. It is clear that the references to intention or expectation in paragraphs 13(2) and (4) of Schedule 10 impose a subjective test. For the test to be satisfied the relevant person…must have had an intention or expectation at the date of the grant…
>
> 117. It is not the case that the capital item must exist at the date of the grant….
>
> 118. There is no indication …that Parliament only intended the rules to apply if the land did become a capital item…"

In summary, it is a subjective test, as to what would be a genuine or real, not a hypothetical, intention or expectation as at the time of the grant.

34. Mr Simpson advanced the argument that the intention should be considered prior to the supply on the basis that it is the grant that triggers the exempt land test. With respect that does not advance matters since the wording of paragraph 12(1) sits well with that since it refers to the "grant giving rise to the supply". We reiterate that what matters is the intention or expectation at the time of the grant.

35. Capital item is defined in Regulation 113 of the VAT Regulations. There is no dispute between the parties that the property qualified under Regulation 113(2), (3), (4) and 8. The problem is Regulation 113(1) which reads:

> "The capital items to which this Part applies are any of the items … on or in relation to which the owner incurs VAT bearing capital expenditure …".

36. The phrase "VAT bearing capital expenditure" is defined at Regulation 115(3) as being capital expenditure at the standard or reduced rate. The purchaser would only incur VAT if VAT was charged on the supply of the property. Therein lies the problem.

37. The appellant correctly, and conscious of its obligations in terms of VATA, considered the relevant taxing provisions. The starting point is that having opted to tax, the supply should bear tax. However, it can only do so if the option to tax is not disapplied. That is the relevance of the provisions of Schedule 10. Looking back at paragraph 12(1)(b), the supply will not be taxable if the "exempt land test" is met.

38. The appellant then quite properly looked at paragraph 15. The property was occupied by a relevant person, which was OEWL which was connected with the appellant, but not the purchaser. As can be seen from paragraph 3 of the Statement of Agreed Facts, OEWL's occupation of the building fell, and falls, squarely within paragraph 15(2) and therefore the land is exempt land.

39. For completeness, although it does not affect the outcome, we note that the appellant argued that in terms of the exempt land test at paragraph 12(2) it was sub-paragraph (b) that was met whereas HMRC argued that it was sub-paragraph (a). Of course, it is the appellant's intention that matters!

40. Mr Simpson argues that in order to avoid circularity, having decided that the transaction was "caught" by Schedule 10, the process should stop at that point

41. As we indicate at paragraph16 above, we find that although labelled "anti-avoidance" the purpose of Schedule 10 is not limited to that and the purpose is rather to limit the circumstances where the option to tax can be used. Accordingly, we do not accept the ingenious argument advanced by Mr Simpson that when looking at anti-avoidance in the context of a taxpayer's intentions one must assess the position before the anti-avoidance provisions come into play (see paragraph 21 above).

42. We have some difficulty with his proposition that the process comes to a halt once it is established that the transaction is exempt in that that would mean that in cases where the sale price of the land and buildings was over £250,000 and the relevant person occupying it met the "exempt land test" there would be no charge to tax. Although the purpose of the legislation is to limit the circumstances in which the option to tax can be deployed it is also aimed at anti-avoidance and to implement that approach would be to encourage the avoidance of tax.

43. As a matter of fact, we find that at the date of the grant the appellant knew that the supply would not be, and could not be, taxable. Accordingly, given the terms of Regulation 113(1) of the VAT Regulations (see paragraph 27 above), and knowing that no other relevant expenditure was likely, the appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser.

Decision

44. We observe that the general tenor of European VAT law is to make more supplies taxable and minimise exemptions. The unfortunate drafting of these legislative provisions can achieve the opposite result rendering a normal commercial transaction, where there is an option to tax, exempt. The circularity is to be deplored. However, in this case, we find that the disapplication provisions are not engaged and we must therefore dismiss the appeal for the reasons given.

45. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ANNE SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 15 JUNE 2018

APPENDIX 1

Paragraphs 12 to 17 together with paragraph 113 of the Value Added Tax Regulations 1995

Anti-avoidance

Developers of exempt land

12 (1) A supply is not, as a result of an option to tax, a taxable supply if-
(a) the grant giving rise to the supply was made by a person ("the grantor") who was a developer of the land, and
(b) the exempt land test is met.

(2) The exempt land test is met if, at the time when the grant was made (or treated for the purposes of this paragraph as made), the relevant person intended or expected that the land-
(a) would become exempt land (whether immediately or eventually and whether or not as a result of the grant), or
(b) would continue, for a period at least, to be exempt land.

(3) "The relevant person" means-
(a) the grantor, or
(b) a development financier.

(4) For the meaning of a development financier, see paragraph 14.

(5) For the meaning of "exempt land", see paragraphs 15 and 16.

…

Meaning of grants made by a developer

13 (1) This paragraph applies for the purposes of paragraph 12.

(2) A grant made by any person ("the grantor") in relation to any land is made by a developer of the land if-
(a) the land is, or was intended or expected to be, a relevant capital item (see sub-paragraphs (3) to (5)), and
(b) the grant is made at an eligible time as respects that capital item (see sub-paragraph (6)).

(3) The land is a relevant capital item if-
(a) the land, or
(b) the building or part of a building on the land,

is a capital item in relation to the grantor.

(4) The land was intended or expected to be a relevant capital item if the grantor, or a development financier, intended or expected that-

(a) the land, or

(b) a building or part of a building on, or to be constructed on, the land,

would become a capital item in relation to the grantor ...

…

(6) A grant is made at an eligible time as respects a capital item if it is made before the end of the period provided in the relevant regulations for the making of adjustments relating to the deduction of input tax as respects the capital item.

…

(8) In this paragraph a "capital item", in relation to any person, means an asset falling, in relation to the person, to be treated as a capital item for the purposes of the relevant regulations.

(9) In this paragraph "the relevant regulations", as respects any item, means regulations under section 26(3) and (4) providing for adjustments relating to the deduction of input tax to be made as respects that item.

Meaning of "exempt land": basic definition

15 (1) This paragraph explains for the purposes of paragraphs 12 to 17 what is meant by exempt land.

(2) Land is exempt land if, at any time before the end of the relevant adjustment period as respects that land-

(a) a relevant person is in occupation of the land, and

(b) that occupation is not wholly, or substantially wholly, for eligible purposes.

(3) Each of the following is a relevant person-

(a) the grantor,

(b) a person connected with the grantor,

(c) a development financier, and

(d) a person connected with a development financier.

...

(4) The relevant adjustment period as respects any land is the period provided in the relevant regulations (within the meaning of paragraph 13) for the making of adjustments relating to the deduction of input tax as respects the land.

…

Meaning of "exempt land": eligible purposes

16 (1) This paragraph explains what is meant for the purposes of paragraph 15 by a person occupying land for eligible purposes.

(2) A person cannot occupy land at any time for eligible purposes unless the person is a taxable person at that time (but this rule is qualified by sub-paragraphs (5) and (6)).

(3) A taxable person occupies land for eligible purposes so far as the occupation is for the purpose of making creditable supplies (but this rule is qualified by sub-paragraphs (5) to (7)).

(4) "Creditable supplies" means supplies which--
(a) are or are to be made in the course or furtherance of a business carried on by the person, and
(b) are supplies of such a description that the person would be entitled to a credit for any input tax wholly attributable to those supplies.

…

(10) For the purposes of this paragraph a person occupies land-
(a) whether the person occupies it alone or together with one or more other persons, and
(b) whether the person occupies all of the land or only part of it.

[Note: paragraph 17 also forms part of the disapplication rules but is not relevant on the facts.]

Other definitions etc

34…(2) For the purposes of this Part of this Schedule any question whether a person is connected with another person is to be decided in accordance with section 1122 of the Corporation Tax Act 2010 …

Extract from the Value Added Tax Regulations SI 1995/2518

113 *Capital items to which this Part applies*

(1) The capital items to which this Part applies are any of the items specified in paragraph (2) on or in relation to which the owner incurs VAT bearing capital expenditure of a type specified in paragraph (3), the value of which is not less than that specified in paragraph (4).

(2) The items are-
(a) land;
(b) a building or part of a building;
(c) a civil engineering work or part of a civil engineering work;
(d) a computer or an item of computer equipment;

(e) an aircraft;
(f) a ship, boat or other vessel.

(3) The expenditure--
(a) in the case of an item falling within paragraph (2)(a) or (d), is the expenditure relating to its acquisition;
(b) in the case of an item falling within paragraph (2)(b), (c), (e) or (f), is the expenditure relating to its-
(i) acquisition,
(ii) construction (including where appropriate manufacture),
(iii) refurbishment,
(iv) fitting out,
(v) alteration, or
(vi) extension (including the construction of an annex).

(4) The value for the purposes of paragraph (3) is-
(a) not less than £250,000 where the item falls within paragraph (2)(a), (b) or (c);
(b) not less than £50,000 where the item falls within paragraph (2)(d), (e) or (f).