VAT update – June 2016

In this Month's edition of the VAT update we look at:

1 Purchase of a dental surgery involved VAT because of the option to tax
2 Spot the ball is a game of chance and exempt from VAT
3 Despite retaining former coach house walls, zero rating was available.
4 University tax plan was an abuse of rights and failed

1. Purchase of a dental surgery involved VAT because of the option to tax

Mr. & Mrs. Hills (the dentists) bought the freehold interest in Unit 4, 5 Cardiff Gate Business Park ("the Property") by NM Pensions Trustees Limited ("the Trustee") on 22 or 23 December 2011 The issue was whether the sale was chargeable to VAT at the standard rate. Dentists are exempt or at best partially exempt and if VAT was charged by the vendor, it meant that the purchaser had to pay another £130,000 of irrecoverable VAT.

This problem arose because the buyer did not accept that there was a valid option to tax election in place and therefore the sale of the property was an exempt transaction. This unusual situation arose because the vendor had accounted for VAT on the rental income when it was let to Dr Patel as a dental practice but had not made a timeous option to tax. HMRC has discretion to accept a retrospective option to tax which it did. However, the dentists argued that an option to tax requires prior permission from HMRC which had not been obtained and so the option to tax was invalid.

The decision of the UT is worth a read for the detailed consideration of the arguments and the legal position of the time line for exercising the option and then charging VAT on the supplies (paragraph 3(9) Schedule 10 VATA 1994.)

The debate and argument also considered Article 13 of the Sixth Directive and the rules of interpretation which follow the ordinary principles of EU law, viz reasonableness, fiscal neutrality, legitimate expectation and legal certainty. The vendor thought that the option to tax was valid but the question was whether the buyer had a legitimate expectation that the purchase of the property should be an exempt transaction.

When Mr and Mrs Hills bought the Property it appears that the Trustees and the Patels (the vendors) thought that the onward sale to Mr and Mrs Hills was liable to VAT. HMRC gave no assurance to Mr and Mrs Hills that the sale of the Property to them would be anything other than a taxable transaction. Therefore, the UT considered that the principle of legitimate expectation provides no assistance to Mr and Mrs Hills in this case.

I feel sorry for the buyers because the error about VAT on a property has cost them a lot of money. In addition, losing an appeal leaves them potentially liable for costs

which will be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

http://www.bailii.org/uk/cases/UKUT/TCC/2016/189.html

2. Spot the ball is a game of chance and exempt from VAT

In IFX Investment Company Ltd & Ors v Revenue And Customs [2016] EWCA Civ 436, the Court of Appeal ruled unanimously, overturning the decision of the Upper Tribunal (UT), that Spot the Ball (SBT) was a game of chance and within the VAT exemption in Group 4 of Schedule 9 to the Value Added Tax Act 1994 ("VATA"), and the statutory provisions which VATA replaced.

The First Tier Tribunal (FTT) had found as a fact that it was a game of chance but the UT had overturned their decision having been persuaded that it was not a game because there was an absence of active participation tween competitors. Lady Justice Arden gave the leading judgement and she analysed a number of lottery and bingo cases before concluding that the FTT were right to rule it was a game.

To fall within the gaming exemption, STB must be a "game of chance" within the meaning of the Gaming Act 1968 ("GA 68"), and the dispute was over the word "game". Finding in favour of the appellant, LJ Arden ruled: “I agree that there is no hard and fast rule or presumption about inter-player participation in a "game" for GA 68 purposes and that the FTT made no error of law in holding that STB was a "game of chance". The appeal must therefore in my judgment succeed.”

http://www.bailii.org/ew/cases/EWCA/Civ/2016/436.html

3. Despite retaining former coach house walls, zero rating was available.

In J3 Building Solutions v R&C [2016] UKFTT 0318, the issue was whether the retention of some walls denied zero rating for what common sense described as a new build. This decision is one of fact and must be final.

Construction work involved the demolition of a coach house and building a new residence on the site was carried on by the appellant at 82, Moor Lane North, Gosforth, Newcastle-upon-Tyne (“the site”)should be zero-rated. The VAT in issue was £40,069.00 if, as HMRC argued, this was a repair or replacement because some walls were retained..

There should be equality at arms in an appeal but the appellant received favourable leniency because they had omitted vital documents like the planning consent document. Their mistake was excused and they were given extra time to produce this because they were not tax specialists and because HMRC ought to have included a copy of this document within HMRC’s bundles. The judgement is polite but there is, in my view, implicit criticism of the way that HMRC conducted this appeal. Using a bad metaphor, HMRC did not play with a straight bat.

The appellant sought permission from Newcastle City Council on 19 December 2012 to demolish part of the original coach house and all the extensions on the site and to replace them with a building on the footprint of the coach house and with a more extensive footprint and higher to replace the previous extensions, all to become a single dwelling. The original proposal was to retain the north and west walls of the coach house and a small part of the south wall that adjoined the west wall. If this had occurred, zero rating was not available.

What actually happened was that the boundary wall was retained including the north and west walls of the coachhouse. The coach house walls (which were not cavity or double skinned walls) were stripped of their plaster on the inside. New walls were erected inside the old north wall with a membrane between them to prevent the ingress of water etc. The membrane was attached to the inside of the existing wall, and lead flashing was carried from the exterior of the new wall over the top of the old wall. A fillet was inserted at the east end of the north wall between the old wall and the new. The new exterior walls at the east side of the coach house's footprint was joined to the existing exterior wall on the north side. A window in the west wall was blocked up with stone, and a chimney breast built behind it.

Group 5 of Schedule 8 to the Value Added Tax Act 1994 ("VATA") sets out what supplies are zero rated. The Building control viewed the change as the construction of a new dwelling and so not disqualified by notes 16 & 18 which state:

Notes
(16) For the purpose of this Group, the construction of a building does not include—
(a) the conversion, reconstruction or alteration of an existing building; or
(b) any enlargement of, or extension to, an existing building except to the extent the enlargement or extension creates an additional dwelling or dwellings; …
(18) A building only ceases to be an existing building when:
(a) demolished completely to ground level; or
(b) the part remaining above ground level consists of no more than a single facade or where a corner site, a double facade, the retention of which is a condition or requirement of statutory planning consent or similar permission."

The tribunal observed that the building footprint was 15% larger and the floorspace 90% larger. The found as a fact that the works here were the construction of a building designed as a dwelling which was not the reconstruction of an existing building (para63).

At 32 pages, this long decision reaches its conclusion at paragraph 119: The works consist of the construction of a building designed as a dwelling and are not prevented from being such a construction by Note 16 to Group 5 of Schedule 8 VATA, so the works fall to be zero-rated.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9068/TC05087.pdf

4. University tax plan was an abuse of rights and failed

One of my pet hates is to read tax cases which involve HMRC disputing something with another part of a government funded body. Such disputes add nothing to the

consolidated fund and detract from the UK's resources which could be applied towards more constructive and beneficial outcomes.

The Court of Appeal has ruled in University of Huddersfield Higher Education Corp. v Revenue And Customs [2016] EWCA Civ 440, that the tax avoidance scheme operated by the University was an abuse of rights. My summary of the scheme is that it involved the lease of the property by the university to a discretionary trust, the option to tax being made by the trust. The refurbishment was then carried out by a university property company registered for VAT and the property was then leased back from the trust to the university on a repairing basis only. The intention to enable an otherwise exempt educational body to recover the VAT on the refurbishment and the plan was to collapse the structure, removing the discretionary trust after a period. This was held to be abuse of rights.

The costs of creating this scheme and the costs subsequently in pursuing the legal disputes must be horrific. We, the ordinary citizens, should be asking whether this was money well spent or whether the sums involved would be better invested in other things like Health, infrastructure and other beneficial things which the State provides. This all began in 1995 and over 20 years have been wasted incurring huge legal and professional costs in pursuing this dispute.

The University of Huddersfield ("the University") makes supplies of education which are exempt from VAT. It makes a few taxable supplies and under the VAT code it is able to recover a proportion of input tax at its partial exemption recovery rate. In 1996 this rate was 14.56 per cent but it later fell to 6.04 per cent. In 1995, the University wanted to refurbish two Grade II listed derelict mills of which it had bought the leasehold. They were known as East Mill and West Mill and were both situated in Canalside, Huddersfield. The University recognised that, as its arrangements then stood, if it paid a construction company to refurbish the mills, it would have to pay VAT to that company for the refurbishment and would only be able to recover a small proportion of that input VAT. The University sought advice from its accountants KPMG as to how to save VAT or defer its liability to pay it. The University dealt with West Mill first, but this appeal is concerned only with the arrangements for East Mill.

The dispute on VAT began in 2002 The reason for the long delay was the need for a reference to the CJEU. The decision of the Upper Tribunal is at [2014] UKUT 438 (TCC), [2015] STC 307.

When the University answered HMRC's questions about the rationale for the Trust it gave bogus answers. That to my mind suggests evasion rather than avoidance but setting that aside. The University paid the £3.5 million plus £612,500 VAT to its wholly owned Properties Ltd. There was no intention that Properties Ltd would make a profit on the supply. Properties Ltd had no other assets of its own.

In fairness to the University, the scheme was devised before Halifax was decided (2005). The principle of abuse of rights rests on two tests, both of which must be satisfied:

i) The transactions concerned, although formally valid under the VAT code, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of its provisions; and

ii) The essential aim of the transactions is to establish a tax advantage.

The judgement is worth a read for its analysis and reviews of a number of important cases including:
Halifax plc v Customs and Excise Commissioners [2006] Ch 387
WHA Ltd v HMRC [2013] UKSC 24, [2013] 2 All ER 907 ,
HMRC v Pendragon plc [2015] UKSC 37, [2015] 1 WLR 2838
HMRC v Weald Leasing Ltd [2011] STC 596.
Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas [2000] ECR I-11569

An interesting conclusion by LJ Lewison at Paragraph 28 is:
"Having found that the tests for abuse of rights were both met, the Upper Tribunal then had to redefine the transactions. This is where Mr Lasok's fourth principle comes into play. They decided that the way to do this was to disregard the artificial steps (i.e. the creation of the Trust and the creation of the leasehold structure). Mr Lasok took issue with this, arguing that the University could have achieved the same tax advantage by entering into a similar leasehold arrangement as part of an arms' length financing package. However, in my judgment the question of redefinition does not enable past history to be completely rewritten. The fact is that the University did not enter into any financing package. On the facts found it paid Properties Ltd out of its own funds. Properties Ltd was merely the conduit through which monies passed from the University to the contractor. The fact that other, non-abusive, structures could have been adopted does not undo the abusive nature of what the University in fact did. The task for the Upper Tribunal was to remove the abusive elements of the scheme; not to replace them with a different and wholly fictional scheme."

http://www.bailii.org/ew/cases/EWCA/Civ/2016/440.html

Derek Allen
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This podcast concentrated on VAT. There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 30 June 2016.