[2016] UKFTT 377 (TC)

TC05131

Appeal numbers: TC/2014/06398
TC/2015/02424

VALUE ADDED TAX – zero rating as new residential development – self - supply charge – whether a sale and lease back 'disposed of an entire interest' – no – Paragraph 36 of Schedule 10 Value Added Tax Act 1994 – Appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

BALHOUSIE HOLDINGS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE RUTHVEN GEMMELL WS
IAN G SHEARER

Sitting in public at Edinburgh on 21 and 22 April 2016

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

1. Balhousie Holdings Limited ("BH") appealed against a decision by HMRC by letter dated 24 June 2014, upheld on review by letter dated 29 October 2014, (the "Review Decision") that BH was liable to a VAT self-supply charge arising from the disposition of Huntly Care Home to Target Healthcare REIT Ltd on 8 March 2013, and a penalty assessment dated 9 February 2015 in respect of the Review Decision. A further appeal TC/2015/03401 in respect of an alternative decision by HMRC was withdrawn at the request of BH and HMRC. These appeals were considered alongside appeals by one of BH's subsidiaries, Faskally Care Home Limited ("FC") TC/2014/06479 and TC/2015/02414, which are the subject of a separate judgement.

2. BH operates 25 care homes mostly in the north east of Scotland and forms a VAT group with its subsidiaries Balhousie Care Ltd ("BC"), Dalnaglar Care Homes Ltd, Glencare (Scotland) Ltd and ARB Properties Scotland LLP. BH's subsidiary FC having originally operated a care home which was then sold to BC was not part of the VAT group and was during the relevant period utilised to provide project management services including the managing of the design and build process of new buildings as well as dealing with extensions and/or refurbishments of existing buildings. FC was, based on professional advice, used for this purpose in order to recover input VAT incurred on professional fees which would have been heavily restricted if BH or anyone within its VAT group sought to recover it, because they were partly exempt for VAT purposes.

3. The Tribunal had before them seven bundles of productions, including agreements between FC and contractors submitted on the day of the hearing (the "new documents") and skeleton arguments. HMRC objected to the submission of the "new documents" which were accepted by the Tribunal but viewed in the context of that objection as having been unseen previously by HMRC. Within the bundles were witness statements of Anthony (Tony) Banks ("TB"), Chief Executive and Proprietor of BH, Scott Whittet ("SW"), consultant to and then initially the sole employee of FC, and John Shearer ("JS"), a Higher Officer of HMRC in the Tax Avoidance and Partial Exemption Team, all of whom gave evidence and were examined and cross-examined; and witness statements from and confirmed by Kirsty Drummond, a Higher Officer of HMRC, on which there was no examination or cross-examination. All the witnesses were credible.

Legislation

4. See Appendix 1.

Cases and Authorities referred to

5. See Appendix 2.

The Facts

6. TB founded the Balhousie Care Group in 1991 and has been actively involved in its management and growth. About 2010 BH decided to construct three new care

homes; Monkbarns in Arbroath, St Ronan's in Dundee and Deveron Way, in Huntly ("the three properties"). The land and subsequently the new home at Huntly belonged to FC and after its completion it was acquired by BC. In view of the difficulties, at that time, of obtaining bank finance a previously used mechanism of selling properties and leasing them back ("sale and lease back") was adopted for Monkbarns, St Ronan's and Huntly. This funding model was said to provide funding for growth and to allow BH to focus on its core capabilities of providing care.

7. This arrangement was entered into in March 2013 in respect of all three properties, which by that time were owned by BH's subsidiary BC, with Target Healthcare REIT ("Target") and missives were concluded by means of an offer on behalf of Target dated 8 March 2013 and accepted on an unqualified basis by BC on the same day. The consideration for the sale was £14,184,427 made up as follows:- the Monkbarns, Arbroath property £5,049,590; the St Ronan's, Dundee property £5,127,276 and the Huntly property £4,007,561.

8. The missives provided that the consideration should be paid by Target on the date of entry or on the date of settlement which were defined respectively as "8 March 2013 or such other date as may be agreed in writing between BC and Target" and "the date on which settlement is actually effected whether that is the date of entry or another date". The missives provided that at the date of entry BC should give Target entry to and actual vacant possession of the three properties; the giving of such possession "being an essential condition of the missives".

9. The missives included an obligation by Target to grant leases of the three properties by way of leases to BC with effect from the date of settlement. The leases, attached to the missives, were between Target and BC with a guarantee provided by BH who was consequently a party to the leases as guarantors.

10. The leases provided that the properties must be used for an "Approved Use" which was specified as "use as a residential care home and/or nursing home within the provision of such care as regulated by the Act [Regulation of Care (Scotland) Act 2001] and falling within Class 8(a) or (b) of the Use Order (Primary Use)". The term commencement date was 8 March 2013. The Huntly lease was produced and was for a term of 30 years.

11. TB gave evidence that BC were already in occupation of the three properties and had been for a few months prior to the sale and lease back. The construction costs had been financed in part by "leeway" from the principal contractor, Muirfield Construction, essentially on credit which in relation to the Huntly home was backed up by a standard security. TB confirmed that the Huntly property belonged to FC until it was sold to BC on 7 March 2013, the day before the sale and lease back. The other two properties, however, belonged to BC. TB said that he "never understood" why Huntly had been handled differently in this respect.

12. On 9 July 2013, Kirsty Drummond carried out a visit to FC's principal place of business in Perth to examine the records for VAT purposes. Following the visit Kirsty Drummond contacted JS who subsequently visited BH on 1 October 2013 which was

followed by a letter of 8 October 2013 requesting amongst other information "Details of all properties in which BH VAT Group holds and (*sic*) interest, whether owned or leased….. Details of all properties which have been sold and leased back by BH VAT group during the period since VAT registration. This should include the details of the purchaser and the sale value in each case".

13. The letter of 8 October 2013 explained that BH VAT Group made a mixture of supplies which, for VAT purposes, were both taxable and exempt. BH were, therefore, described as a partly exempt trader and "must undertake calculations in every VAT period to establish the amount of VAT input tax that is recoverable by the VAT group. As no partial exemption special method has been proposed or agreed by HMRC, this calculation must be made using the partial exemption standard method. This calculation has not been undertaken to date". On 29 November 2013, JS issued a statutory notice to BH to make a further request for the information specified in the October letter. Some information was then provided on 6 December 2013.

14. On 10 January 2014 Grant Thornton, who had been recently appointed as agents for BH, wrote to JS setting out an analysis of transactions which occurred in relation to BH's design and build projects. The Huntly property was given as an example although during the design and build process that property belonged to FC and not BH. The letter continued "we do accept that the financial accounts for FC may be misleading and these are currently under review. I trust this demonstrates that the contracts and transactions have been undertaken appropriately and there are no outstanding VAT implications". Various documents were enclosed with the letter to provide supporting evidence of the contracts and transactions.

15. An entry dated 15 January 2014 in JS's notebook evaluated the letter and other material sent by Grant Thornton. Among other things he noted the disposition of Huntly by FC to BC, agreed and signed on 7 March 2013 for a consideration of £5,007,561, with the date of entry being 8 March 2013.

16. After further correspondence and requests for outstanding information, an entry from JS's notebook of a meeting with Grant Thornton and representatives from BH and FC on 28 February 2014 showed among other things confirmation that the reason the Huntly site was sold by BC to Target for a lesser value (exactly £1,000,000 lower) than the price of the purchase from FC was that it excluded six bungalows retained by BC; confirmation that the persons involved in the Huntly purchase/disposal no longer worked for BH; and a note that no evidence was provided of BH's intention at the time of the purchase from FC. Consequently board minutes were requested.

17. On 5 March 2014 HMRC wrote to Grant Thornton confirming a discussion that the VAT treatment of properties purchased by BH from FC included a newly completed care home in Huntly. This purchase was treated as a VAT zero-rated first grant of a major interest in a relevant residential property. The letter continued "In order for this treatment to be correct BH must have – before the purchase had been made – provided a certificate to FC confirming that they intend to use the property solely for a relevant residential purchase. Without the required certification this disposal should have been treated as standard rated for VAT purposes by FC. If,

however, the appropriate certificate was issued, any further disposal of the property by BH within 10 years of practical completion would make them liable to a change of use "self-supply" charge – on which they must account for VAT at the standard rate. It is understood that the Huntly property has since been sold to Target. Any self-supply charge due would be calculated based on the value of the original zero-rated first grant".

18. By that stage it had become apparent that the only property owned by FC was the property at Huntly, prior to its sale to BC on 7 March 2013. HMRC requested the Land Registry documents for the three properties which were disposed of by BH under the known sale/lease back arrangements. The Land Registry documents were provided to HMRC on 1 April 2014 for Monkbarns, St Ronan's and Huntly and the dispositions associated with the sale to Target.

19. Although there was some subsequent uncertainty and correspondence about the requisite zero-rating certificate from BH to FC, by the time of the Tribunal it was a matter of common ground between the parties that such certification existed and that the first sale of Huntly by FC to BC was correctly zero-rated.

20. At a meeting on 11 April 2014, as recorded by JS in his notebook, Grant Thornton explained to HMRC that if BH was liable for a self-supply charge it would be a "potentially business ending issue", that they had engaged Mr Simpson as a tax counsel whose "preferable option" was that BH had not disposed of an interest due to the sale and lease back; that the sale would not have happened without the lease back and that BH had retained an element of interest.

21. On 29 April 2014 HMRC wrote to Grant Thornton setting out their views on the analysis of the arrangements whereby a building had been sold by BC to a third party and subsequently leased back to them on a long lease basis. HMRC disagreed with Grant Thornton's view that, due to the associated lease back, the onward sale to Target did not result in BC becoming liable to a VAT self-supply charge in relation to the originally zero-rated supply (with the required certification) received from FC. HMRC viewed the sale and lease back as two separate transactions namely: – "the sale of the property by BC to Target and; the 30 year lease granted by Target to BC".

22. HMRC referred to the disposition of the Huntly property which they said confirmed that BC had disposed of their entire interest in the property to Target. BC then regained an interest in the property by entering into a subsequent long lease with Target. It continued "However irrespective of any time factor occurring between those transactions, they are still separate transactions for VAT purposes and must be accounted for accordingly".

23. On 24 June 2014 HMRC issued their decision letter confirming their view that "although linked to the subsequent lease by an overriding agreement as confirmed in the missives, the sale by BH constitutes the disposal of their entire interest in the property. BH regained an interest, by entering a long lease, but this must be viewed as a separate transaction. You argue that one transaction (the sale by BH) would not

have happened without the agreement for the other (the lease to BH) to happen simultaneously".

24. HMRC referred to the case of *Southern Primary Housing Limited* in which, concerning the direct and immediate link between outputs and inputs, the Court of Appeal, in its conclusion, commented on transactions that would not have happened but for associated transactions. The court said "VAT law does not work in such a generalised way. You have to look at transactions individually, component transaction by component transaction. They may be linked in the sense that one would not have happened without the other, but they remain distinct transactions nonetheless. Only if one transaction is merely ancillary to a main transaction can one disregard the distinct nature of each transaction…. If that were not so, the principle of neutrality would be violated. Moreover there would be intractable problems as to which input was being attributed to which part of the 'overall transaction'".

25. HMRC's view was that BH were liable to a VAT self-supply which relevant to the VAT period 04/13 was calculated as the amount of VAT that would have been chargeable on a relevant zero-rated supply, namely the purchase of the property by BC from FC. After adjustment for the retained cottages/bungalows, HMRC estimated the charge at £801,492. Additional to this, was interest of £24,308.26 making a total, as evidenced by a statement of account at 27 June 2014, of £825,800.26.

26. On 29 October 2014 HMRC issued a review of the decision notified to BH by JS on 24 June 2014 and also the notice of VAT assessment letter issued by Kirsty Drummond on the same date and concluded that they were both correct. HMRC reiterated the view that if within 10 years of completion a building that benefited from zero rating is not used as originally intended, is initially and is then put to another use, or is disposed of then a tax charge may arise. It continued "Normally, when considering, for VAT purposes, how an item is used, HMRC will regard the economic use to which it is put as determinative. However, in the case of the zero rate for qualifying buildings it is the occupation or physical use of the building that determines whether or not it can be zero rated and whether or not a 'change in use' has taken place.

27. HMRC then referred to the Guidance VCONST21500 which stipulates that "if the entire interest held in a qualifying building is sold to another person, whether or not that person intends to use the building solely for a qualifying use, a change of use charge is due on the sale. HMRC said the law was drafted this way as the only person who can pay a 'change in use' charge is the person who received the zero rated a supply. When a change of use or the disposal of a certificated building occurs within 10 years of its completion, the person concerned must account for VAT on a self-supply as output tax".

28. HMRC then considered the Counsel's Opinion which Grant Thornton had copied to them, but confirmed their view that they saw the sale and lease back as two separate transactions and confirmed that the VAT assessment was in line with the 'best judgement' principles. Thus the review upheld the HMRC decisions.

29. On 9 February 2015 a notice of penalty assessment was issued to BH for the tax period 1 February 2013 to 30 April 2013 for an inaccuracy penalty in an amount of £144,268.56.

BH's Submissions

30. BH say that they did not dispose of their entire interest in the Huntly property by means of a sale and lease back transaction entered into by BC and Target on 8 March 2013 within the meaning of paragraph 36 of Schedule 10 VATA and consequently zero rating should not be withdrawn. The sale and lease back involved missives between BC and Target, a disposition between BC and Target and a lease between Target and BC. The missives governed both and included forms for both the disposition and the lease

31. On the date the missives were concluded, in March 2013, the date of entry under the BC disposition and the date of the term of the lease were the same, 8 March 2013; they were contemporaneous. The missives constituted an offer by Target *inter alia* to purchase the Huntly property and lease it back to BC and an acceptance of that offer by BC. Similarly BC were bound to sell Huntly to Target and Target to lease Huntly to BC, the latter with effect from the date the former in fact settled. BH say these were reciprocal obligations and, in accordance with common law rules, had one party failed in its obligation (to sell or grant a lease) the other would have been entitled to refuse to perform its obligation (to buy or accept a lease), and this is clear from the terms of the missives. There were two separate conveyances in a single transaction and, therefore, reciprocal obligations which created a mutuality of contract being accordingly a single transaction in the same document in the sense of *Inveresk plc v Tullis Russell.*

32. BH say that the context of the transaction was merely as a means of funding as an alternative to bank lending and that the transactions were wholly, therefore, interdependent and to all intents and purposes, simultaneously, part of a single transaction.

33. BH had always used Huntly for residential purposes as a matter of fact and the terms of the lease continued that use with BH. The terms of the lease, contained within the missives, are clear as regards the use to which the property must be put as a matter of law.

34. BH say it is unrealistic to say that they disposed of their entire interest and refer to *UBS AG v HMRC* and *DB Group Services (UK) Ltd v HMRC,* a recent Supreme Court case, and reference was made to the judgement delivered by Lord Reed:- "As the House of The Lords explained in *Barclays Mercantile Business Finance Ltd . Mawson*, in a single opinion of the Appellate Committee delivered by Lord Nicholls, the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible in the way which best gives effect to that purpose. Until the case *of W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300, however, the interpretation of fiscal legislation was based predominantly on a linguistic analysis. Furthermore, courts treated every

element of a composite transaction which had an individual legal identity (such as a payment of money, transfer of property, or creation of a debt) as having its own separate tax consequences, whatever might be the terms of the statute…. The significance of the *Ramsay* case was to do away with both those features. First, it extended to tax cases the purposive approach to statutory construction which was orthodox in other areas of law. Secondly, and equally significantly, it established that the analysis of the facts depended on that purposive construction of the statute."

35. The judgement continued:-"Since the facts concerned a composite transaction forming a commercial unity, with the consequence that the commercial significance of what had occurred could only be determined by considering the transaction as a whole, the statute was construed as referring to the effect of that composite transaction". The judgement continued that it was necessary to ascertain what the purpose was and what Parliament intended. BH refer (as did Lord Reed) to *The Collector of Stamp Revenue v Arrowtown Assets Ltd* and to Mr Justice Ribeiro who in discussing *Ramsay* stated "the ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed realistically".

36. BH also make reference to the Court of Appeal case *The Pollen Estate Trustee Company Limited v HMRC* as authority for the purposive construction of tax statutes where Lord Justice Lewison said "the essence of this approach is to give the statutory provision purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the court have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the fact as found".

37. BH says that the policy behind paragraphs 36 and 37 of Schedule 10 of VATA is that zero rating should be available only to the extent that the person who first acquires the building actually uses it for a relevant charitable or residential purchase for 10 years. It is about use. Revenue & Customs Brief, issue 49, 6 December 2010 says that if the building ceases to be used solely for that "qualifying purpose" within that 10 year period or if that use decreases, the "change in use" provisions allow HM Revenue & Customs to "claw back" some or all of the original relief. The Brief then also gave examples of how the previous provisions worked and how the proposed simplified provisions would work in an annex.

38. BH refer to an extract from Hansard's report of the Third Delegated Legislation Committee at which the Exchequer Secretary to the Treasury, Mr Gauke, on 31 January 2011, explained the reasons for introducing the provisions: "The second of the two issues addressed by the Treasury order relates to the change-in-use provisions that enable HMRC to charge tax where the construction or acquisition of a building has been zero-rated on the basis of its expected use, but where that use has changed so

that the zero-rating is no longer appropriate… This ensures that buildings that are no longer used for a relevant purpose are taxed in the same way as other commercial buildings. The current legislation is complex and provides different VAT results depending on how the changing use arises. It also lacks clarity, so that it has the potential for tax avoidance… If the relevant use of a building changes, the adjustment will be the same irrespective of how the change in use came about".

39. BH say that VAT Notice 708, Buildings and Construction at paragraph 19.3 refers to buildings completed on or after 1 March 2011 and that a chargeable tax event arises within 10 years of the completion of the building if the building is sold. BH submit that its wording suggests that it anticipated an outright sale to a third party, and not a sale and lease back transaction entered into for financing purposes. BH noted that the Notice does not specifically help to clarify the meaning or purpose of the provision's use of the phrase about the person disposing of their "entire" interest in the premises.

40. BH say that none of these sources providing evidence of the purpose of the legislation, refer to a policy directed at requiring not only that the building continues to be used for a relevant residential purpose but also that it continues to be so used by the person who first acquired it. There is no obvious reason why such a policy would have been intended. It may arise out of concerns about policing withdrawal when the property is no longer used by the first acquirer. BH says that such concerns do not arise in the present case in any event because BH is still in occupation and responsible for its use in terms of its lease. It need not do anything further to monitor the use of the building as it continues to use it and there is therefore no mischief.

41. BH say that against this background the policy proposition is met and applying the legislation, purposively construed, to the facts, realistically viewed, BH has not disposed of its entire interest in the subjects. The building continues to be used for a relevant residential purpose; and the person using the building for that purpose is the person who first acquired it, and thereby benefited from the initial zero rating.

42. BH say that merely leasing the building to another entity who uses it for a relevant residential purpose does not lose zero-rating and accordingly if, in a single transaction the first acquirer, or deemed first acquirer, disposes of only the right to use the premises for a limited period, the zero rating is not withdrawn.

43. Similarly, BH say, if the first acquirer disposed of merely a fee in the building while retaining a liferent (or other right of occupation), for example limited to a specified period, that would not be enough to mean the withdrawal of zero rating. BH say that HMRC accept that these circumstances would not engage paragraph 36(2) of Schedule 10 VATA and consequently can see no reason why a sale and lease back transaction should produce an opposite result. The same result as the disposal of a fee and retention of a liferent would follow if an owner settled property into a trust in terms of which the owner had a right of liferent/occupancy and the fee was vested in a third party.

44. BH say that the income tax case of *Sargaison v. Roberts* considered similar wording to that of paragraph 36(2) of Schedule 10 VATA when considering capital

allowances. In this case, in 1964, a farmer created a trust for his family and conveyed the land into the trust. The land was then immediately leased back to the farmer. The farmer continued to claim capital allowances in respect of previous expenditures but the claim was refused on the grounds that the right to capital allowances was lost if "the whole of [the person's] interest in the land in question... is transferred... to some other person": Income Tax Act 1952, section 314. BH say that there is no material difference between those words and those used in paragraph 36(2) of Schedule 10 VATA.

45. The farmer appealed to the High Court and Mr Justice Megarry held that the farmer had not lost his right to capital allowances. He identified the issue as being whether the words applied "where an owner conveys away the whole of his interest but receives back some lesser interest, as in the now familiar transaction of sale and lease back". He described the statute as being "drafted not in terms of English property law, with references to estate owners and the like, but in broader more popular language which invites a broader and less technical construction". He gave the reason for this being that the statute had to be workable in three different legal systems, England and Wales, Scotland and Northern Ireland.

46. Mr Justice Megarry then held that the appropriate approach was to look at the "substance of [the] transaction" and not at "the machinery used to carry it through". He concluded, "the taxpayer's interest has, *uno ictu*, been merely reduced from ownership of the freehold to ownership of the lease: the whole of his interest in the land has therefore not been transferred to another; and that is the end of the case".

47. BH say that HMRC's position depends on the fact that although the subject of a single contract, the missives, the two grants were the subject of separate conveyances (the disposition and the lease) and it is assumed in terms of abstract property law that there must have been a *scintilla temporis* at which Target was in right of the full title to Huntly, and immediately thereafter granted to BH the real right conferred by the lease. BH refers to Lord Hoffmann in the direct tax case *Ingram v Inland Revenue Commissioners*: "but the Revenue's version of reality seems entirely dependent upon the *scintilla temporis* which must elapse between the conveyance of the freehold to the donee and the creation of the leasehold interest in favour of the donor. For my part, I do not think that a theory based on the notion of a *scintilla temporis* can have a very powerful grasp on reality".

48. Lord Hoffmann continued "if one looks at the real nature of the transaction [conveying property to the taxpayer's solicitor as a nominee before granting the taxpayer leases of the land and a subsequent conveyance of the title into a trust for the benefit of the taxpayer's descendants] there seems to be no doubt... that the trustees and beneficiaries never at any time acquired the land free of [the taxpayer's] leasehold interest. The need for a conveyance to be followed by a lease back is a mere matter of conveyancing form. As I have said, [the taxpayer] could have reserved a life interest by a unilateral disposition. Why should it make a difference that the reservation of a term of years happens to require the participation of another party if the substance of the matter is that the property will pass only subject to the lease?".

49. Accordingly BH say that HMRC's position, which is ultimately that the *scintilla temporis* means that BH disposed of its entire interest in Huntly, is based wholly on the form of the transaction and their approach leads to different results depending on whether the same effect is achieved by retention of the lesser interest out of a grant of the greater one, or the grant of the greater interest followed by a grant of the lesser interest in return. This is the approach rejected by Lord Hoffmann.

50. BH say that in the context of European law and in particular in the context of VAT, the proper approach to analysing facts against legislative wording is even less tied to the literal meaning of the words in the legislation than the approach set out above based on direct tax cases.

51. BH say that HMRC's contention that paragraph 36(2) of Schedule 10 relates to the disposal of an entire interest and not to use, is a narrow interpretation of the section, which at Part 2 of Schedule 10 VATA is entitled "Residential and Charitable Buildings: Change of Use etc." and BH stress the words "Change of Use etc.". Consequently BH say the focus is on change of use and that the amendments to the legislation were simply to deal with how to know if there is a change of use which clearly is of issue if taxpayers dispose of their entire interests. This is not an issue if a taxpayer retains some interest as they automatically have a right to know or monitor the use.

52. BH say that there is no inference from HMRC's 708 guidance that a sale and lease back was not envisaged; the guidance is an interpretation of what the author believed the legislation to say.

HMRC's submissions

53. HMRC say that a first grant made by a person constructing a building will be zero rated for VAT purposes where the building is intended for use solely for a relevant residential purpose. The supply will not be taken as relating to a building intended for a relevant residential purpose unless the person to whom the grant is made provides the person making it with a certificate confirming the intended use.

54. Where a person who is in receipt of zero rated supplies, in respect of a building intended for use solely for a relevant residential purpose, dispose of that person's entire interest in the relevant premises within 10 years of supply, that person must account for VAT on the original supply as output tax.

55. HMRC referred to the need to have regard to the purpose of a particular provision and insofar as it is possible, interpret its language in a way which gives effect to that purpose and referred to *UBS AG v HMRC.*

56. HMRC say that the sale of a property constitutes disposal of a party's entire interest in the property and that this is in keeping with the ordinary meaning of the words used. It was a sale of the property irrespective of the other transactions and it is irrelevant whether the party, thereafter, obtains a separate interest in the property, for example and interest under a lease.

57. HMRC say that in respecting the principle of fiscal neutrality each transaction has to be looked at separately even if they are linked, in the sense that one would not have happened without the other. They cite the VAT case, *Commissioners of Customs & Excise v Southern Primary Housing Association Ltd,* concerning whether input tax was recoverable on a land purchase. LJ Jacob stated: "… [The Tribunal] concluded that there was a direct and immediate link between the land purchase and both the land sale and development contract, with both an exempt and non-exempt transaction. VAT law does not work in such a generalised way. You have to look at transactions individually, component transaction by component transaction. They may be linked in the sense that one would not have happened without the other, but they remain distinct transactions nonetheless. Only if one transaction is merely ancillary to a main transaction can one disregard the distinct nature of each transaction".

58. HMRC say that VAT is a transactional tax.

59. HMRC say there is a difference between the right of ownership and the real right of lease which are separate categories of real right referred by to Professor Kenneth Reid in his Law of Property in Scotland [1996].

60. HMRC say that the purpose of paragraphs 36 and 37 of Schedule 10 VATA is to set out the circumstances in which a change of use charge will be incurred. However, HMRC emphasise that s36(2), the provision which refers to the disposal of the taxpayer's entire interest, does not itself make any reference to use: it stands on its own, and regard must be paid to its exact words. They say it is wrong to suggest, as BH do, that there is an "over-arching purpose" relating to use, within which it must be construed. HMRC refer to the Revenue & Customs Brief, Issue 49, 6 December 2010 which explains the changes proposed to the legislation. This stated "The current provisions are complex and, as can be seen from the examples at Annex A, produce uneven tax consequences. A change of use in one set of circumstances can produce a different tax charge to the one produced by a different set of circumstances even though, overall, the same percentage of the building continues to be used for a relevant use. The new provisions will produce similar tax charges where use changes to a similar degree, regardless of the circumstances in which the change in use comes about". This Brief announced a four week consultation period but HMRC say that following that consultation different proposals were adopted and that the Brief does not reflect the conclusions reached by that consultation process.

61. HMRC refer to Hansard's report of the Third Delegated Legislation Committee. Whilst noting the comments on this report made by BH, HMRC point out that the Exchequer Secretary also said, "During consultation on the measure, HMRC officials met representatives of the Charity Tax Group... As a result of that meeting, changes were made to the draft legislation, together with some clarifications that will be put in agreed guidance. The representatives were very supportive of the changes, which will provide fairness, certainty and consistency. They will minimise avoidance risks and will be more straightforward to apply, which will be of particular benefit to charities". HMRC suggest that charities were particularly interested to ensure certainty and clarity that a sale would lead directly to a change-in-use charge. However, at the hearing HMRC were not able to confirm, in answer to a question from the Tribunal,

whether or not the specific wording of the draft clause 36(2), on disposal of the taxpayer's "entire interest", did change as a result of the consultation, as they appeared to be suggesting. The consultation version of the clauses was not produced in evidence.

62. HMRC then referred to VAT Notice 708 and to the difference between the provisions at paragraph 19.2 - Buildings completed before 1 March 2011 and paragraph 19.3 - Buildings completed after 1 March 2011. HMRC say that the major change was that with the former a taxable charge arose, within 10 years of completion of the building, if the taxpayer either sold or leased the building *and* [emphasis added] the building is no longer intended for use solely for either or both of the qualifying purposes – that is to say a sale and change of use were needed to bring about the charge, compared with the provisions after 1 March 2011 whereby a taxable charge arises when, within 10 years of completion of the building, the taxpayer sells the building, regardless of whether it continues to be used solely for either or both of the qualifying purposes or not.

63. HMRC say that the legislature has determined that liability should occur when ownership of the property is transferred irrespective of whether or not the transferee intends to use the building for a qualifying use. By making the "change of use" charge payable on transfer of ownership, the seller does not require to monitor the use of the building after sale. It is this which increases certainty and is straightforward to apply. It also reduces the opportunity for parties to avoid the provision by "retaining" lesser real rights in the property on sale.

64. HMRC says it is clear that there are two distinct transactions comprising two VAT-able supplies and consequently that BH were disposing of their entire interest. That interpretation provides certainty, and is consistent not only with the wording of the provision but also its stated purpose. It is necessary to look at each tax transaction individually. The interpretation contended for by BH would require consideration to be given to whether, in the whole circumstances of the transaction, the taxpayer has retained a sufficient interest in the property to avoid incurring the charge. The test would not be straightforward to apply. It would increase avoidance risks if the provision could be avoided where the seller either obtained or retained a lesser right in the property following the sale. This would be in contrast to the stated aim of the provision.

65. HMRC say that there is nothing to show that the purposive interpretation of the legislation referred to in the *Sargaison* case is the same when comparing the legislation on direct tax and capital allowances with the VAT legislation on indirect tax and zero-rated supplies. HMRC say that this was a well-known case and that the Parliamentary draughtsman must have been aware of it and chose to use different words when drafting the VAT legislation which consequently were meant to have a different meaning.

Decision

66. The Tribunal considered that the ordinary and literal meaning of the words "dispose of P's [the taxpayer as defined at Paragraph 35(1) of Schedule 10 of VATA] entire interest", referred to in Paragraph 36(2) of Schedule 10 of VATA, required a taxpayer to relinquish all and every interest in the relevant property and that this was not the case with a sale and lease back transaction.

67. The Tribunal followed Mr Justice Megarry's reasoning when considering section 314 of the Income Tax Act 1952, that Paragraph 36 (2) of Schedule 10 of VATA was drafted in "broader more popular language which invites a broader and less technical construction" and that the appropriate approach was to look at the substance of the transaction and not at the machinery used to carry it through. Similarly the Tribunal followed Mr Justice Megarry's conclusion that the taxpayer's interest of the freehold changing to the ownership of a lease did not transfer the whole of the taxpayer's interest in the land, when considering that a sale and lease back transaction did not dispose of an "entire interest".

68. The missives between BC and Target provided for a contemporaneous sale, evidenced by a disposition, and a lease; and these obligations were reciprocal and created, as submitted by BH, a mutuality of contract being a single transaction in the same document. The background to this arrangement was merely as a means of funding as an alternative to bank lending and this was consistent with the provisions of the missives.

69. Both BH and HMRC referred to the *UBS AG v HMRC* Supreme Court case. In his judgement Lord Reed discussed purposive interpretation of fiscal legislation and stated in the judgement, "since the facts concerned a composite transaction forming a commercial unity, with the consequence that commercial significance of what had occurred could only be determined by considering the transaction as a whole, the statute was construed as referring to the effect of that composite transaction". The Tribunal considered that the sale and lease back was a means of providing an alternative to bank lending and formed a "commercial unity" with the consequence that the transaction should be considered as a whole and the statute construed as referring to that composite transaction.

70. The Tribunal considered that the purpose of part 2 of Schedule 10 VATA related, as its title "Residential and Charitable Buildings: Change of Use etc." indicated, to use. The requirement for VAT to be accounted for on the original supply as output tax applied only if the taxpayer disposed of the taxpayer's entire interest in the relevant premises within 10 years of supply.

71. The Tribunal did not consider that the entire interest in a property would be disposed of if a taxpayer retained ownership of the property but leased it nor if the fee in the building was retained and a liferent granted, as long as, in both cases, the use requirement was met. The Tribunal could see no justification for a sale and lease back transaction being treated differently. If it had been Parliament's intention, as the VAT Notice 708 stated, to remove the zero rating on the sale of a building it could have so

provided and, in the reasoning of Mr Justice Megarry, such a word would have been workable and clearly understood in the three different legal systems, England and Wales, Scotland and Northern Ireland.

72. The Tribunal considered that the VAT Notice 708 provided taxpayers with only guidance and was the interpretation of Paragraph 36 by the author of that guidance. As BC submitted, the guidance, in any event, did not disqualify a sale and lease back transaction in its interpretation of the legislation but instead a sale of property.

73. The Tribunal considered the evidence put forward to explain Parliament's purpose in amending the legislation being the Revenue & Customs Brief and the extract from Hansard's report of the Third Delegated Legislation Committee. The Tribunal considered that these were concerned about where use is changed so that zero rating is no longer appropriate and accordingly were concerned with change of use. The Tribunal accepted BH's submission that none of these sources provided evidence that the purpose of the legislation related to a policy directed at requiring not only that the building continues to be used for a relevant residential purpose but also that it continues to be so used by the person who first acquired it. The change in the legislation was to reduce the potential for tax avoidance and to provide clarity.

74. HMRC say that the same evidence shows that there was a change as a result of the consultation carried out and the revised effect was summarised in the VAT Notice 708 which drew a distinction between buildings completed before and after 1 March 2011. Before 1 March 2011 a taxable charge arose, within 10 years of completion of the building, if the taxpayer either sold or leased the building *and* (emphasis added) the building was no longer intended for use solely for either or both of the qualifying purposes, that is to say a sale *and* (emphasis added) change of use were needed to bring about the change". This HMRC say is to be compared with the position after 1 March 2011 whereby a taxable charge arises when, within 10 years of completion of the building, the taxpayer sells the building, "regardless of whether it continues to be used solely for either or both of the qualifying purposes or not". This submission, however, relies on the author of VAT Notice 708 interpreting the legislation as requiring a sale whereas the legislation clearly refers to the disposal of an entire interest. As stated the Tribunal does not accept these are one and the same and if the pre-1 March 2011 legislation referred to a sale or a lease, no explanation was given as to why the wording was changed to an "entire interest".

75. On a purposive interpretation of Paragraph 36(2) of Schedule 10 VATA, the Tribunal accordingly considered that an "entire interest" was not disposed of, in these circumstances, by a sale and lease back transaction.

76. The Tribunal accepted that there was a difference between a right of ownership and the real right of the lease which are separate categories of real right in the law of Scotland, but considered that they were both interests and consequently if one was disposed of but the other retained then there was not a disposal of an entire interest.

77. The Tribunal considered that the sale and lease back transaction was a composite transaction forming a commercial unity, in the circumstances of this case, and

accepted, that there must have been a *scintilla temporis,* in strict property law, as submitted by HMRC. The Tribunal considered HMRC's submission that following the Court of Appeal case, C*ommissioners of Customs & Excise v Primary Housing Association Ltd,* the transactions have to be looked at individually, component transaction by component transaction, unless one transaction is merely ancillary to a main transaction because of the *scintilla temporis*.

78. The Tribunal considered that in the context of the reasoning behind the sale and lease back, being an alternative to bank lending, the transactions had to be looked at as a composite transaction as one would not have happened without the other. Whereas it may be going too far to say that there was a main transaction and an ancillary one, HMRC's submission would also need to be tested in the case of a taxpayer transferring ownership into a trust and accepting a liferent which would also have a *scintilla temporis* but would not be considered by HMRC to be the disposal of an entire interest. The Tribunal say that the reality of the transaction is that notwithstanding the existence of a technical *scintilla temporis,* it is a composite transaction.

79. In the context of Paragraph 36 of Schedule 10 VATA, the transaction that causes the taxable event is the disposal of an entire interest and for the reasons noted above that is not achieved where there is a sale *and* (emphasis added) a lease back which is a composite transaction.

80. The Tribunal considered Lord Hoffman's judgement in the House of Lords case *Ingram and Another v Commissioners of Inland Revenue* and concluded that looking at the real nature of this transaction, Target never at any time acquired the building free of BH's leasehold interest. The Tribunal accepted BH's analysis of HMRC's position, which is that BH disposed of its entire interest in the three properties, based wholly on the form of the transaction; and that HMRC's approach would lead to different results depending on whether the same effect is achieved by retention of the lesser interest out of a grant of the greater one, or the grant of the greater interest followed by a grant of the lesser interest in return, which would be rejected when following Lord Hoffman's judgement in *Ingram*.

81. The legislation is clearly intended to deal with the issues of ensuring that use continues for relevant residential purposes and how that test may be policed. The Tribunal do not consider that policing of use is relevant in this case as BH is still responsible for the use of the buildings in terms of the leases. Its use, before and after 8 March 2013, was the same.

82. The appeal is allowed.

83. 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.

W RUTHVEN GEMMELL WS
TRIBUNAL JUDGE

RELEASE DATE: 31 MAY 2016

Appendix 1 - Legislation

Value Added Tax Act 1994

Schedule 10 Buildings and land

Part 2 Residential and Charitable Buildings: Change of Use etc.

35 -

(1) This Part of this Schedule applies where one or more relevant zero-rated supplies relating to a building (or part of a building) have been made to a person ("P").

(2) In this Part of this Schedule -

"relevant zero-rated supply" means a grant or other supply which relates to a building (or part of a building) intended for use solely for -

(*a*) a relevant residential purpose, or

(*b*) a relevant charitable purpose,

and which, as a result of Group 5 of Schedule 8, is zero-rated (in whole or in part);

"relevant premises" means the building (or part of a building) in relation to which a relevant zero-rated supply has been made to P;

"relevant period", in relation to relevant premises, means 10 years beginning with the day on which the relevant premises are completed.

(3) Where P is a body corporate treated as a member of a group under sections 43A to 43D, any reference in this Part of this Schedule to P includes a reference to any member of that group.

Disposal of interest or change of use following relevant zero-rated supply

36 -

(1) Paragraph 37 applies on each occasion during the relevant period when—

(*a*) there is an increase in the proportion of the relevant premises falling within sub-paragraph (2) or (3), and

(*b*) as a result, the proportion of the relevant premises so falling ("R2") exceeds the maximum proportion of those premises so falling at any earlier time in the relevant period ("R1").

(2) The relevant premises fall (or part of the relevant premises falls) within this sub-paragraph if P has, since the beginning of the relevant period, disposed of P's entire interest in the relevant premises (or part).

Appendix 2 - Cases and Authorities referred to

Sargaison v Roberts [1969]1 WLR

Ingram v Inland Revenue Commissioners [2000] 1 A.C. 293

Commissioners of Customs & Excise v Southern Primary Housing Limited [2003] EWCA Civ 1662

The Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA 52

Inveresk plc v Tullis Russell [2010] S.C. (SC) 106

The Pollen Estate Trustee Company Ltd v HMRC [2013] 1 WLR 3785

UBS AG v HMRC [2016] UKSC 13

DB Group Services UK Ltd v HMRC [2016] UKSC 13