



**TC05450**

**Appeal number: TC/2015/02946**

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*VAT –Relevant capital item, requirement to aggregate acquisition cost and cost of refurbishment, restriction of the right to deduct, anti-avoidance rule para 12 Schedule 10 VATA, capital goods scheme*

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**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

15

**WATER PROPERTY LIMITED**

**Appellant**

**- and -**

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

**TRIBUNAL: JUDGE GETHING  
MEMBER JACQUI DIXON**

20

**Sitting in public at Birmingham, City Tower 5-7 Hill Street, Birmingham, West  
Midlands, B5 4UU on Friday 13 May 2016**

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**Mr C Wright of Compton Ward, Accountants, for the Appellant**

**Mr B McGurk, Counsel for the Respondents**

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## DECISION

This case concerns whether

5 (a) the anti-avoidance provision contained in Para 12 of Schedule 10 VAT Act 1994 ("VATA") entitles HMRC to disregard the effect of the option to tax where a taxpayer has incurred expenditure on buildings land and similar assets within the capital goods scheme and grants an interest in land to a person with whom the taxpayer is connected who proposes to uses the land for exempt purposes, and

10 (b) input tax claimed in respect of the cost of acquisition, conversion and refurbishment of premises may be deducted as incurred or spread under Part XV of the VAT Regulations 1995.

We heard representations from Mr McGurk and Mr Wright and received assistance from Mr M Waters, a director of Water Property Limited.

15 We also sought assistance of Mr McGurk and Mr Wright after the hearing to address:  
(1) the purposive construction of the legislation,  
(2) the *vires* of the legislation in question, and  
(3) the effect of the anti-abuse doctrine in this case.

20 and they provided written representations.

### ***Facts***

We found the following facts from the correspondence and statements made at the hearing:

25

1. Land and buildings formerly used as a public house called The Coach House were acquired in 2013 by Water Property Limited, subject to planning permission to convert the ground floor into a children's day care nursery and the upper floor into residential flats. The planning permission was granted on 25 March 2013.

30 2. Water Property Limited paid £210,000 plus £37,500 VAT on the acquisition of The Coach House in March 2013.

3. Water Property Limited was a developer and investment company run by Mr Waters.

35 4. Smiles Childcare Limited was established to carry on a business of the provision of nursery care for infant children. It was jointly owned by Mr and Mrs Waters. Mrs Waters as the operator of the children's nursery.

5. The children's nursery business was kept separate from the property development business to enable the children's nursery business to be sold at a date in the future and for the leasehold reversion to be retained as an investment by Water Property Limited.

6. Water Property Limited was registered for VAT and the form VAT1 received by HMRC on 13 November 2013 stated that the company's business was property investment and the company intended to make taxable supplies.
7. HMRC sent an undated letter to Water Property Limited upon receipt of VAT1:
- 5           (a) Confirming the registration was effective from 1 November 2013;
- (b) Informing Water Property Limited that it was entitled to claim input tax on pre- registration supplies;
- (c) Directing Water Property Limited to Notices 300 and 706 available on the website. A copy of Notice 706 formed part of the bundle. The Notice is dated  
10           October 2011; and
- (d) Advising that some VAT may not be treated as input tax and may be reclaimed if Water Property Limited did not make taxable supplies in a period.
8. By letter to Water Property Limited dated 4 December 2013 HMRC acknowledged receipt of Water Property Limited's option to tax in respect of The Coach House effective from 1 November 2013.
- 15
9. A lease of the land and building destined to become the children's daycare nursery was granted by Water Property Limited to Smiles Childcare Limited on 23 January 2014 at an initial rent of £23,600 per annum plus VAT with five yearly reviews. We find that the rent was intended to be a market rent. There was a rent free period  
20           expiring on 30 June 2014. The term of lease was 15 years, expiring on 23 January 2029.
10. Water Property Limited entered into two building contacts with Cremin Construction Limited:
- (a) For alterations to form a children's daycare nursery; and
- 25           (b) For alterations to form three residential flats.
11. Both building contracts were dated 17 February 2014; both had an anticipated completion date of 27 June 2014 but the penalties for delay were significantly different, £1,250 per week for works to the nursery and £420 per week for works to the residential flats.
- 30           12. The value of the building contract for the children's daycare nursery was £209,812.34 including VAT. The value of the contract for the residential flats was £161,546.42 including VAT.
13. The same architects and surveyors were named in each building contract.
14. The contracts were based on Standard Form Minor Works Building Contract 2011  
35           published by Sweet & Maxwell, legal publishers.
15. Work on the children's daycare nursery was completed on Friday 30 June 2014. To complete electrical work on the nursery access to the ceiling void was required via

the residential flats above. Work on the flats began after the nursery work was completed and was completed on 12 September 2014.

5 16. Water Property Limited claimed a deduction in respect of VAT on the construction costs and relevant costs of acquisition in relation to the development and acquisition of the children's daycare nursery. No deduction was claimed in respect of the expenditure referable to the residential flats.

10 17. It was accepted by Water Property Limited that Smiles Childcare Limited and Water Property Limited were "connected" within the meaning of Para 13 of Schedule 10 to the VATA and that the activity of carrying on the business of a children's day care nursery was an exempt activity.

15 18. The acquisition of the land and building comprising the Coach House was financed out of the resources of Mr Walters and his wife. The finance for the development was sourced separately. The ability to secure the finance was uncertain and there are different persons interested in the finance for the children's daycare nursery and the residential flats.

19. It is commonplace in relation to an acquisition of real estate which is hoped to be developed, for the contract of purchase of the real estate to be subject to planning permission being obtained.

20 20. It is also commonplace for a developer engaging the same building contractors, surveyors and advisers in a phased development.

25 21. Advice on VAT was sought from Smith & Williamson who gave advice on 10<sup>th</sup> February 2014 to the effect if the construction works were phased and the value of each phase did not exceed £250,000, the VAT on the refurbishment of the ground floor would be recoverable. This was after the election to opt to tax had been made and after the lease had been granted to Smiles Childcare.

22. VAT Notice 706/2: Capital goods scheme was updated by HMRC on 19th October 2011 after changes were made to the capital goods scheme by Finance Act 2011.

30 23. HMRC accepted that the policy pertaining to phased development described at paragraph 4.12 of VAT Notice 706/2 has applied since 2011 and there has been no change in that policy to date.

24. Para 4.12 of the Notice reads as follows:

*"What if the refurbishment is in phases?"*

35 *If you do this you will need to decide whether the work should be treated as a whole for CGS [capital goods scheme] purposes or whether there is more than one refurbishment. If you think that each phase is really a separate refurbishment then they should be treated separately for CGS purposes.*

*Normally there is more than one refurbishment when:*

- *There are separate contracts for each phase of work: or*
  - *A contract where each phase is a separate option which can be selected; and*
- 5                   • *Each phase of work is completed before work on the next phase starts.*

*A refurbishment which is only undertaken in phases because the building is occupied and where the contractors work on one floor at a time is normally considered to be only one refurbishment."*

- 10   25. HMRC denied a deduction for the input VAT incurred on the refurbishment of the part of the Coach House which was converted into a children's day care nursery by reason of the anti-avoidance provision contained in paragraph 12 of Schedule 10 to the VAT Act 1994.

#### **Water Property Limited's contentions**

- 15   26. Water Property Limited contended (as set out in its skeleton argument) that the anti-avoidance provision set out at para 12 of Schedule 10 to VATA is inapplicable in this case for two reasons:

20           (1) There was no avoidance in this case. Para 12 of Schedule 10 to VATA is intended to apply to arrangements where for example a banking group establishes a property development company outside of the VAT group of which the Bank is a member and the property development company constructs a new head office for the bank. The property development company makes an election to tax, grants a long lease at a peppercorn rent to the bank and recovers the VAT on the construction costs but no taxable supplies of value are ever made. In the present case there is no absolute saving or avoidance of VAT. At best there is a deferral of VAT.

25           (2) There was no relevant capital item because the guidance in the booklet VAT Notice 706/2 "Capital Goods Scheme" indicates that where developments are undertaken in phases, pursuant either to separate contracts or a single contract which allows for the contract to be executed in phases, and there is no overlap in the works pertaining to the phases, then there is no relevant capital item if the value of each phase does not exceed the £250,000 limit stipulated in the legislation. In consequence the developer condition of Para 12 (1) and Para 30   13(2) was not satisfied. The Coach House was not a relevant capital item as defined by Schedule 10, Para 13 nor was it intended to be a relevant capital item.

35   27. Water Property Limited did not accept that it had granted any interest in land as "a developer" within the meaning of the Regulations because the financial threshold in

Regulation 113(4) was not met. The interest in land had been acquired for less than £250,000 and the development cost referable to each phase (see para 12 above) of the development was below £250,000. Water Property Limited's representative referred the Tribunal to the Booklet 706/2. The Booklet was updated in October 2011 after VATA had been amended. HMRC contends that the amendment requires aggregation of the costs of acquisition and development, seemingly whenever those costs are incurred. HMRC confirmed during the course of the hearing that the policy of HMRC regarding phasing is unchanged. It seems to us that for the Booklet, the policy and the legislation to be reconciled, there cannot be a requirement to aggregate.

10 **HMRC's contentions**

28. HMRC's skeleton argument suggested that there were two grounds on which their conclusions could be supported, one being the restriction of the right to deduct under Para 12 of Schedule 10 to VATA and the other being the capital goods scheme.

15 29. The capital goods scheme can apply to spread input VAT in relation to a capital item over a period of years and to restrict the right to deduct if the capital item is used for exempt purposes.

30. HMRC said that Para 12 of Schedule 10 to VATA applied because:

20 (1) Works undertaken at a single property were part of a single indivisible project and thus constituted a single "relevant capital item".

(2) The option to tax in this case engaged the anti-avoidance provision at para 12 Schedule 10 VATA such that the option to tax must be disregarded

25 31. In amplification of (1) Mr McGurk submitted that the acquisition cost referable to the residential flats and the children's day care nursery and the cost of all alterations to the nursery must be aggregated in determining whether there is a capital item. The facts of the purchase of the land and buildings being subject to planning permission, the same builder and surveyor were used for each of the two phases of the development, that the contracts were entered into on the same day was indicative of a single project and as a matter of law as a single capital item.

30 32. HMRC submitted that Para 12 of Schedule 10 is compatible with Council Directive 206/112 on the common system of value added tax ("the Principal VAT Directive") and in consequence the UK was entitled to restrict the option to tax land and buildings in any manner it chooses.

35 33. Notwithstanding that the anti-abuse doctrine cannot apply in this case because the transactions are all commercial, Para 12 of Schedule 10 can still apply to deny the right to input tax deduction.

40 34. Water Property Limited is not entitled to rely upon paragraph 4.12 of the VAT Notice 706/2 booklet and the Tribunal has no jurisdiction to require HMRC to adhere to the terms of the booklet.

35. HMRC submitted that the fact that:

- (a) the purchase of the land was conditional on planning permission,
- (b) that contracts for the development were executed the same day with the same builder and surveyor,
- (c) such contracts were carried out in sequence,
- (d) the amounts payable under the contracts were recorded in the financial statements as capital items,
- (e) Mrs Water publicised the planned opening of the nursery in advance of the completion of the works,
- (f) means that there was a single relevant capital item.

36. The bundle initially provided to the Tribunal contained out of date legislation; which impaired the Tribunal's preparation to hear the case. When asked at the hearing about the vires of the regulations on which HMRC rely on for its case, Counsel was unable to assist the Tribunal. In consequence as mentioned above, we sought written representations from the parties on the purposive construction of the legislation, the vires of the UK legislation on which HMRC rely, its conformity with the "the Principal VAT Directive" and whether the abuse of law doctrine applied and the impact of it not being capable of applying because the transactions are all commercial. We were concerned to understand the parties' submissions on abuse of law because of the reference in Article 131 of the Principal VAT Directive to that concept. We appreciate the notice of appeal and the Commissioner's statement of case did not deal with EU law but that does not absolve the tribunal considering such principles of EU law as are relevant.

37. In his written representations made on behalf of HMRC,

(1) Counsel cautioned the Tribunal against advancing arguments not advanced by the taxpayer.

(2) Counsel asserted that the tribunal may adept an inquisitorial role only where a taxpayer is a litigant in person. Water Property Limited was represented by its accountant and had taken advice on the VAT consequences of the arrangements from Smith & Williamson in 2014.

38. In asking for representations on the issues identified above the Tribunal was not advancing new argument. The Tribunal considers that the points were sufficiently raised by Mr Wright on behalf of Water Property Limited in his Skeleton Argument when he asserts that the legislation is aimed at avoidance arrangements and not at arrangements of the kind before the tribunal. This is effectively an assertion the legislation should be construed purposively and we read it in that sense. The Tribunal notes that unlike Water Property Limited, HMRC was represented by counsel who was experienced in VAT. We have taken fully into account the points made by HMRC at para 9 of their supplemental note, referring to the observations of Judge

Cannon in *Outkey Trading Limited v HMRC*, and we have guarded against "effectively preparing the case for an appellant".

### 39. *The Legislation*

The following relevant legislation is set out in the appendix:

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#### **VATA**

Paragraphs 12-17 of Schedule 10 (Anti-avoidance provision)

#### **Council Directive 2006/112 on the common system of value added tax.**

#### **Articles Title IX – Exemptions**

10 Articles 131, 135 and 137

#### **Part XV of the VAT Regulations 1995 SI 1995/2518**

#### **Capital Goods Scheme**

Regulations 112 and 113

#### **Our Decision**

15

#### **VAT Notice 706/2**

40. We were surprised that this case came before the Tribunal at all. The taxpayer had relied on the guidance issued by HMRC relating to phasing of developments in paragraph 4.12 in VAT Notice 706/2. In doing so Water Property Limited and their advisers had concluded that there was no requirement to aggregate the cost of the two phases of alterations (or the cost of the acquisition of the land and buildings) provided that the phases of work do not overlap in time. The consequence would be that there is no relevant capital item within the meaning of paragraph 12 of Schedule 10 to the VATA and no grant of land as a developer. The booklet was issued in the autumn of 2011 after the changes made earlier that year to the scope of the capital goods scheme. The booklet is issued to provide guidance to taxpayers. It is reasonable to expect taxpayers to reply upon it, otherwise what is the purpose of the guidance. Further HMRC advised the Tribunal that there had been no change in policy and that the paragraph relating to phasing accords with current policy. It seems to us that Water Property Limited would have a legitimate expectation to rely on the guidance although we recognise that this Tribunal has no jurisdiction to require HMRC to follow the guidance.

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#### ***Purposive Construction of Para 12 of Schedule 10 to the VAT Act 1994***

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41. We consider that Para 12 of Schedule 10 to VATA should be construed purposively as indicated by Mr Wright in his Skeleton Argument.



42. Relevantly Para 12 provides:

"Anti-avoidance

Para 12 A supply is not, as a result of an option to tax, a taxable supply if:

- 5
- (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 the grant was made..., the relevant person is intended or expected that the land:-*

- 10
- (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 oat least, to be exempt land.*

(3) *The "relevant person" means:-*

- (a) *The grantor, or*
- (b) *...*

15 43. Para 13 provides that a grant of an interest in land by a grantor is made by a developer of land if –

*"(1) The land is or was intended or expected to be, a relevant capital item; and*

20 *(2) The grant is made at an eligible time as respects the land" (that is before the end of the of the adjustment period. It was not disputed that the grant was so made.)*

44. Under Para 13(3), a "land is relevant capital item", if:

- (a) the land; or
- 25 (b) the building or part of a building on the land

is a "capital item" in relation to the grantor (in this case Water Property Limited) and under Para 13(8) "capital item" in relation to any person, means an asset falling, in relation to that person, to be treated as a capital item for the purposes of the relevant regulations.

30 45. Under Para 13(9), "the relevant regulations" as respects any item, means regulations under VATA sections 26(3) and (4) providing for adjustments relating to the deduction of input tax to be made as respects that item" and in this case the "relevant regulations" are those in Part XV of the VAT Regulations 1995 ("the **Regulations**"), as amended.

46. Regulation 113 of the Regulations thus provides the definition of "capital item", and it does so by adopting a two-fold test, both parts of which must be satisfied if the asset is to be a capital item. The first part of the test, contained in paragraph 113(2), is concerned with the type of the asset, which relevantly includes:

- 5 (a) land
- (b) a building, and
- (c) part of a building

47. The second part of the test of "capital item", contained in paragraphs 113(1), 113(3) and 113(4) read together, is concerned with the amount of expenditure of six  
10 specified types in relation to the asset, which (where the asset is a building, part of a building or land), are expenditure in relation to:

- (a) the land or building's acquisition,
- (b) the building's construction,
- (c) the building's refurbishment,
- 15 (d) the land or building's fitting out,
- (e) the building's alteration
- (f) the building's extension (including the construction of an annex).

48. Para 113(4) stipulates that an item is only a capital item where the value of the expenditure is £250,000 or more. We observe that paragraphs 113(1), 113(3) and 113(4)  
20 contain no express indication of how the £250,000 threshold is to be applied where expenditure is of more than one of the specified types, as is the case here, and we were not referred to any case-law authority relevant to the issue. (We observe that the stamp duty legislation (where the value of the assets to which the tax relates is relevant to the calculation of the tax) does contain rules permitting such values to be a  
25 aggregated where the assets are transferred under a single "transaction" or "series of transactions" but no similar provision is found in the Regulations or Schedule 10 to the VATA). The main question in this appeal is whether or not the amount of more than one type of expenditure can be aggregated for the purposes of Para 13, and, if so, in what circumstances.

49. It is clear that a building is capable of being a "capital item". It is also clear that refurbishment expenditure on a building is capable of being a "capital item". What is not clear is whether expenditure which is not incurred all at once must be aggregated  
30 to determine whether the financial limits in sub-para (4) are exceeded. It is at this point that HMRC's statement about its policy pertaining to phasing becomes relevant in practice. Guidance dealing with phasing of expenditure where in aggregate the expenditure is less than £250,000 would be meaningless. The guidance must therefore  
35 be referring to expenditure which in aggregate exceeds £250,000.

50. We do not agree with HMRC's submissions. We consider that the question whether the acquisition of property and refurbishment of the property are a single  
40 item for the purpose of Regulation 113(4) (so that the expenditure on acquisition and

refurbishment must be aggregated for the purpose of the Regulation 113(4) threshold) is one of fact.

51. We find that it is commonplace and a requirement of local authorities for all plans pertaining to the development of land in phases to be the subject of a single approval process. We also note that the Coach House was acquired on 25<sup>th</sup> March 2013 and financed out of the resources of Mr Water and his wife. They required external finance to carry out the refurbishment and it was uncertain whether the finance would be available. There were two contracts for building works, one for each phase and the work on the refurbishment of the children's nursery was completed before the work on the residential flats began. The consideration for the acquisition of the Coach House and each phase of the building works was in each case below £250,000.

52. We have considered HMRC's assertions in light of the facts above and we consider that the separation in time of the acquisition and the commencement of the building works and the uncertainties as to the availability of finance and therefore whether the works would be carried out, on balance outweigh the indications pointing the other way which HMRC has identified. In consequence we find there is no capital item to which Part XV of the regulations applies. We derive some comfort from the fact that this accords with HMRC's published policy.

53. In relation to the other elements of Para 12(2) of Schedule 10 we note for completeness that it was common ground that:

- (1) The ground floor of The Coach House was expected to be converted for use as a children's day-care nursery.
- (2) The running of a children's day nursery is an exempt activity.
- (3) The nursery was to be run and operated by Astwood Smiles Ltd.
- (4) Astwood Smiles Limited was connected with Water Property Limited.
- (5) Water Property Limited was the grantor of the lease to Astwood Smiles Limited

and in consequence, the exempt land test would be satisfied.

54. We conclude that the supplies of land/buildings made by Water Property Limited were not grants "made by a developer "(within the meaning of paragraph 13(2) of Schedule 10 to the VATA), consequently that the expenditure on acquisition and conversion of the Coach House was not a "capital item "(within paragraph 13 of the Regulations) and therefore that paragraph 12 of Schedule 10 to VATA does not prevent the option to tax made by Water Property Limited from taking effect.

### ***The Principal VAT Directive***

55. The Tribunal is grateful to Counsel for HMRC and Water Property Limited's written representations. Counsel for HMRC helpfully set out the provisions of the Principal VAT Directive under which Para 12 of Schedule 10 to VATA was introduced.

56. The relevant Articles of the Principal VAT Directive are set out in the appendix to this Decision. They all form part of "**Title IX- Exemptions**". That part comprises Articles 131 to 166. Of particular relevance is the content of Articles 131 -145. The articles are divided into chapters.

5 57. Chapter 1 of Title IX is entitled "**General provisions**" and comprises a single article 131. Article 131 allows Member States to lay down rules relating to the exemptions in accordance with conditions which the Member States may lay down for the purposes of -

10 *"ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse."*

58. Article 135(l) mandatorily exempts "*the leasing and letting of immovable property*". This is reflected in group 1 of Schedule 9 of VATA.

15 59. Article 137 provides for the exemption of leasing and letting of immovable property with a right to opt to tax. Relevantly, Article 137 provides-

*(1) Member States may allow taxable persons a right of option for taxation in respect of the following transactions*

*(a) ..*

*(b) The supply of a building or parts thereof.....*

20 *(c) ..*

*(d) ..*

*(2) Member States shall lay down the detailed rules governing the exercise of the option under paragraph 1. Member States may restrict the scope of that right of option"*

25 60. In our view Article 131 qualifies the application of Articles 132-145, and therefore qualifies Article 137(2). It would be surprising if the Council of Ministers had meant that the Member States could apply Article 137(2) on a completely arbitrary basis unrelated to correct and straightforward application of the exemption and the need to prevent evasion, avoidance or abuse.

30 61. It is clear to us from Article 131, that in devising the rules relating to exemption from tax and options to tax, the discretion conferred upon Member States must:-

*(1) ensure correct and straightforward application of exemptions, and*

*(2) prevent any possible evasion, avoidance or abuse.*

62. HMRC submit that:

35 (1) The anti-avoidance provision derives its authority from the Articles 137(2) of the Principal VAT Directive (extracts of which are set out above)

(2) Member States have a right (but not a duty) to create an option to tax and a further right to restrict its scope.

(3) The Principal VAT Directive in fact confers a very wide discretion on Member States as to both the scope of the right to opt to tax and when that right may be restricted.

(4) Member States may impose whatever restrictions they choose including the test adopted in the UK "*of ensuring the correct and straightforward application of the exemption*".

(5) Member States are permitted to limit the right to opt to tax not only to combat avoidance in whatever way they consider appropriate but also to protect the Revenue generally

We note however that HMRC did not identify any evasion, avoidance, abuse or non-straightforward application of the right to deduct in this case.

63. The Tribunal was grateful to counsel for HMRC for the submissions on abuse of law at paragraphs 20 to 34 of the Commissioners' Supplementary Note.

64. We do not however agree with HMRC that the Principal Vat Directive confers a "wide discretion", if by "wide" is meant "unrelated to Article 131". Indeed HMRC refer in their Supplementary Note to the criterion of ensuring the correct and straightforward application of the exemption as having being the test adopted by the United Kingdom.

65. HMRC also seem to suggest that the United Kingdom has the ability to restrict the right to opt to tax "for the protection of the Revenue" as if that notion were wider or different from the criteria mention in Article 131, to prevent possible evasion avoidance or abuse. We do not accept that it can have a wider meaning.

66. It seems to us that the measures in this case which apply a blanket denial of the benefit of the option to tax where a lease of land is granted to a connected person is neither a measure to ensure correct and straight forward application of exemptions nor a measure to prevent possible evasion, avoidance or abuse.

67. Astwood Smiles Limited has operated the childcare nursery from September 2014 to date. As those who operate a childcare nursery must be approved or authorised to carry on such a business it would be a practical necessity to separate the childcare business from the property development business. Water Property Limited also hoped to be able to sell the childcare nursery business at a future date and a purchaser of either business is unlikely to wish to acquire an interest in the other. Establishing the nursery business in a separate company was a commercial and not a tax avoidance manoeuvre.

68. The lease of the nursery was on commercial terms at a market rent and with 5 year rent reviews. Astwood Smiles Limited has paid and will continue to pay VAT on the market rent payable under the term of a commercial lease. That VAT will represent output tax for Water Property Limited.

69. These arrangements were wholly commercial. They do not involve any evasion, or avoidance. The same result in terms of ability to deduct input tax would ensue if the developer and day care nursery were not in common ownership because the transactions were on commercial terms. The parties did not have an avoidance motive.  
5 As all of the steps and the overall transactions were commercial there can be no abuse.

70. The construction we have given to Para 12 of Schedule 10 to VATA is therefore supported by the Principal VAT Directive.

***Capital Goods Scheme***

10 71. Adjustments of deductions of input tax in respect of capital goods (and certain services) are also permitted by the Principal VAT Directive, Articles 184-192. Article 187 permits input tax to be spread over a period of between 5 and 20 years starting from the time at which the goods were acquired or first used but only in respect of capital items. We have concluded that the neither the acquisition of the Coach House  
15 nor the two phases of refurbishment were capital items and therefore there is no question of an adjustment of input tax under Part XV of the VAT Regulations and we do not need to consider this point further.

72. We allow the appeal.

20 73. 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  
25 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**HEATHER GETHING  
TRIBUNAL JUDGE**

**RELEASE DATE: 25 OCTOBER 2016**

30

## Appendix

### VATA – Schedule 10 Paras 12 to 17

#### Anti-Avoidance: Developers of exempt land

12—

- 5 (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.
- 10 (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.
- 15 (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.
- 20 (6) If a supply is made by a person other than the person who made the grant giving rise to it—
- (a) the person making the supply is treated for the purposes of this paragraph as the person who made the grant giving rise to it, and
  - (b) the grant is treated for the purposes of this paragraph as made at the time when that
- 25 person made the first supply arising from the grant.
- (7) For a special rule in the case of a grant made on or after 19th March 1997 and before 10th March 1999, see paragraph 17.

(8) Nothing in this paragraph applies in relation to a supply arising from—

(a) a grant made before 26th November 1996, or

(b) a grant made on or after that date but before 30th November 1999, in pursuance of a written agreement entered into before 26th November 1996, on terms which (as terms for  
5 which provision was made by that agreement) were fixed before 26th November 1996.]<sup>1</sup>

### **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  
10 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)).

15 (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  
20 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 or any relevant transferee.

(5) A person is a relevant transferee if the person is someone to whom the land, building or  
25 part of a building was to be transferred—

(a) in the course of a supply, or

(b) in the course of a transfer of a business or part of a business as a going concern.



(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.

(7) But if—

5 (a) a person other than the grantor is treated by paragraph 12(6) as making the grant of the land, and

(b) the grant is consequently treated as made at what would otherwise be an ineligible time,

the grant is treated instead as if were not made at an ineligible time.

10 (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  
15 be made as respects that item.]<sup>1</sup>

#### **Meaning of “development financier”**

##### **14—**

(1) This paragraph explains for the purposes of paragraphs 12 to 17 what is meant, in relation to the grantor of any land, by a development financier.

20 (2) A “development financier” means a person who—

(a) has provided finance for the grantor's development of the land, or

(b) has entered into any arrangement to provide finance for the grantor's development of the land,

25 with the intention or in the expectation that the land will become exempt land or continue (for a period at least) to be exempt land.

(3) For the purposes of this paragraph references to finance being provided for the grantor's development of the land are to doing (directly or indirectly) any one or more of the following—

30 (a) providing funds for meeting the whole or any part of the cost of the grantor's development of the land,

- (b) procuring the provision of such funds by another,
  - (c) providing funds for discharging (in whole or in part) any liability that has been or may be incurred by any person for or in connection with the raising of funds to meet the cost of the grantor's development of the land, and
  - 5 (d) procuring that any such liability is or will be discharged (in whole or in part) by another.
- (4) For the purposes of this paragraph references to providing funds for a particular purpose are to—
- (a) the making of a loan of funds that are or are to be used for that purpose,
  - (b) the provision of any guarantee or other security in relation to such a loan,
  - 10 (c) the provision of any of the consideration for the issue of any shares or other securities issued wholly or partly for raising those funds,
  - (d) the provision of any consideration for the acquisition by any person of any shares or other securities issued wholly or partly for raising those funds, or
  - (e) any other transfer of assets or value as a consequence of which any of those funds are
  - 15 made available for that purpose.
- (5) For the purposes of this paragraph references to the grantor's development of the land are to the acquisition by the grantor of the asset which—
- (a) consists in the land or a building or part of a building on the land, and
  - (b) is, or (as the case may be) was intended or expected to be, a relevant capital item in
  - 20 relation to the grantor (within the meaning of paragraph 13).
- (6) For this purpose the reference to the acquisition of the asset includes—
- (a) its construction or reconstruction, and
  - (b) the carrying out in relation to it of any other works by reference to which it is, or was intended or expected to be, a relevant capital item (within the meaning of paragraph 13).
- 25 (7) In this paragraph "arrangement" means any agreement, arrangement or understanding (whether or not legally enforceable).

**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—

- 5 (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,  
10 (c) a development financier, and  
(d) a person connected with a development financier.

(3A) Where a person (“P”) is in occupation of the land at any time before the end of the relevant adjustment period as respects that land, P is treated for the purposes of sub-paragraph (2) as not in occupation of the land at that time if—

- 15 (a) the building occupation conditions are met at that time, or  
(b) P's occupation of the land arises solely by reference to any automatic teller machine of P.

(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  
20 relating to the deduction of input tax as respects the land.

(5) For the purposes of this paragraph any question whether a person's occupation of any land is “wholly, or substantially wholly,” for eligible purposes is to be decided by reference to criteria specified in a public notice.]<sup>1</sup>

### **Meaning of “exempt land”: the building occupation conditions**

25 **15A**

(1) For the purposes of paragraph 15(3A), the building occupation conditions are met at any time (“the time in question”) if—

- (a) the grant consists of or includes the grant of a relevant interest in a building, and

- (b) P does not, at the time in question, occupy—
  - (i) any part of the land that is not a building, or
  - (ii) more than the maximum allowable percentage of any relevant building.
- (2) For the purposes of sub-paragraph (1)(b)(i) and (ii) occupation by a person connected  
5 with P is treated as occupation by P if that occupation is not wholly, or substantially wholly, for eligible purposes.
- (3) For the purposes of sub-paragraph (1)(b)(i) occupation by a person of—
  - (a) land used for the parking of cars or other vehicles, or
  - (b) land that is within the curtilage of a building,
- 10 is disregarded if the occupation is ancillary to the occupation by that person of a building.
- (4) In sub-paragraph (1)(b)(ii)—
  - “the maximum allowable percentage” means—
    - (a) 2% where P is the grantor or a person connected with the grantor, and
    - (b) 10% where P is a development financier or a person connected with a development  
15 financier (but not also the grantor or a person connected with the grantor), and
  - “relevant building”—
    - (a) means a building any relevant interest in which is included in the grant, other than any part of such a building in which, immediately before the grant, neither the grantor nor any person connected with the grantor held a relevant interest, but
    - 20 (b) does not include any building P's occupation of which arises solely by reference to any automatic teller machine of P.
- (5) The way in which occupation by a person of a building is measured for the purposes of sub-paragraph (1)(b)(ii) is to be determined in accordance with conditions specified in a public notice.
- 25 (6) In this paragraph “relevant interest”, in relation to a building or part of a building, means any interest in, right over or licence to occupy the building or part.

(6A) Sub-paragraph (5) of paragraph 15 (determination of whether occupation “wholly, or substantially wholly” for eligible purposes to be by reference to criteria in public notice) applies for the purposes of this paragraph.

5 (7) Sub-paragraphs (4) to (7) of paragraph 18 (meaning of “building”) apply for the purposes of this paragraph.

**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.

10 (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—

15 (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.

20 (5) Any occupation of land by a body to which section 33 applies (local authorities etc) is occupation of the land for eligible purposes so far as the occupation is for purposes other than those of a business carried on by the body.

(6) Any occupation of land by a Government department (within the meaning of section 41) is occupation of the land for eligible purposes.

(7) ...

25 (8) If a person occupying land—

(a) holds the land in order to put it to use for particular purposes, and

(b) does not occupy it for any other purpose,

the person is treated for the purposes of this paragraph, for so long as the conditions in paragraphs (a) and (b) continue to be met, as occupying the land for the purposes for which the person proposes to use it.

(9) If land is in the occupation of a person (“A”) who—

5 (a) is not a taxable person, but

(b) is a person whose supplies are treated for the purposes of this Act as made by another person (“B”) who is a taxable person,

the land is treated for the purposes of this paragraph as if A and B were a single taxable person.

10 (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.

17—

(1) A grant in relation to land which was made—

15 (a) on or after 19th March 1997, and

(b) before 10th March 1999,

is treated for the purposes of paragraph 12 as made on 10th March 1999 if, at the time of the grant, the capital item test was met.

20 (2) The capital item test was met if the person making the grant, 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 or any relevant transferee but it had not become such an item.

25 (3) For the purposes of that test “capital item” and “relevant transferee” have the meaning given by paragraph 13.

## **Council Directive 2006/112 on the common system of value added tax.**

### **Articles Title IX – Exemptions:**

#### **Chapter 1 –General provisions**

##### Article 131

- 5 The exemptions provided for in Chapters 2 to 9 shall apply without prejudice to other Community provisions and in accordance with conditions which the Member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse.

##### Article 135

- 10 Member States shall exempt the following transactions:
- (a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;
  - (b) the granting and the negotiation of credit and the management of credit by the person granting it;
  - 15 (c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;
  - (d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;
  - (e) transactions, including negotiation, concerning currency, bank notes and coins used as  
20 legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest;
  - (f) transactions, including negotiation but not management or safekeeping, in shares,  
25 interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities referred to in Article 15(2);
  - (g) the management of special investment funds as defined by Member States;
  - (h) the supply at face value of postage stamps valid for use for postal services within their respective territory, fiscal stamps and other similar stamps;
  - (i) betting, lotteries and other forms of gambling, subject to the conditions and limitations  
30 laid down by each Member State;

- (j) the supply of a building or parts thereof, and of the land on which it stands, other than the supply referred to in point (a) of Article 12(1);
- 5 (k) the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1);
- (l) the leasing or letting of immovable property.
- 2. The following shall be excluded from the exemption provided for in point (l) of paragraph 1:
  - 10 (a) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites;
  - (b) the letting of premises and sites for the parking of vehicles;
  - (c) the letting of permanently installed equipment and machinery;
  - 15 (d) the hire of safes.

Member States may apply further exclusions to the scope of the exemption referred to in point (l) of paragraph 1.

#### Article 137

Member States may allow taxable persons a right of option for taxation in respect of the  
20 following transactions:

- (a) the financial transactions referred to in points (b) to (g) of Article 135(1);
- (b) the supply of a building or of parts thereof, and of the land on which the building stands, other than the supply referred to in point (a) of Article 12(1);
- (c) the supply of land which has not been built on other than the supply of building land  
25 referred to in point (b) of Article 12(1);
- (d) the leasing or letting of immovable property.
- 2. Member States shall lay down the detailed rules governing exercise of the option under paragraph 1.



Member States may restrict the scope of that right of option.

## **Part XV VAT Regulations 1995 (Capital Goods Scheme) Articles 112 and 113**

### **112 Interpretation of Part XV**

(1) Any expression used in this Part to which a meaning is given in Part XIV of these  
5 Regulations shall, unless the contrary intention appears, have the same meaning in this Part  
as it has in that Part and in particular, exempt supplies and taxable supplies shall be accorded  
the same meanings as defined in regulation 110 above.

(2) Any reference in this Part to a capital item shall be construed as a reference to a capital  
item to which this Part applies by virtue of regulation 113, being an item which a person who  
10 has or acquires an interest in the item in question (hereinafter referred to as “the owner”) uses  
in the course or furtherance of a business carried on by him, and for the purpose of that  
business, otherwise than solely for the purpose of selling the item.

(3) In this regulation and in regulation 114, an interest includes an interest which is treated  
as being supplied to a person under paragraph 37(1) of Schedule 10 to the Act provided that  
15 the numerator of the fraction in paragraph 37(3) of that Schedule is 36 or more.

(4) The reference to “owner” in paragraph (2) shall be taken to refer to—

(a) subject to sub-paragraph (b), the transferee where the whole or part of a capital  
item is transferred from one person to another and that transfer is not treated as a supply for  
the purposes of VAT; and

20 (b) the representative member of a group under section 43 of the Act if the capital  
item is owned by a member of the group.

(5) Where the owner is a transferee or representative member, that person shall be treated  
as having done everything that the transferor or group member (as may be the case) has  
done in respect of the capital item.

25

### **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;
- 5 (d) a computer or an item of computer equipment;
- (e) an aircraft;
- (f) a ship, boat or other vessel.

(3) The expenditure—

10 (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),
- 15 (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—

- 20 (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).