



TC06249

Appeal number: TC/2016/01155

VAT – whether novation of a contract for the sale of land is an exempt supply of land within group 1 of schedule 9 to Value Added Tax Act 1994 – no – appeal dismissed – costs – whether the Respondents acted unreasonably in defending or conducting the proceedings within the meaning of rule 10(1)(b) of the Tribunal rules – no

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

HANUMAN COMMERCIAL LIMITED

Appellant

- and -

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

Respondents

TRIBUNAL: JUDGE ROBIN VOS

Sitting in public at Taylor House, London on 21 November 2017

David Scorey QC, instructed by Fieldfisher LLP, for the Appellant

Sarabjit Singh, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. On the face of it, this case is relatively straightforward. The only question is whether the appellant, Hanuman Commercial Limited (“HCL”) has made an exempt supply of land.

2. The analysis has however been complicated by the way in which the transactions have been undertaken and that is what has given rise to the dispute between HCL and the respondents, HMRC.

10 **The background facts**

3. The facts are not in dispute and are summarised below.

4. HCL was incorporated in order to undertake a specific property transaction (yet to be identified at the time the company was incorporated in 2012).

5. A suitable opportunity was identified in 2013 which would involve the conversion of an office block known as the Connect Centre in Portsmouth (the “Property”) into residential flats.

6. On 27 January 2014 the owner (and one of the occupants) of the Property, Sabre Insurance Company Limited (“Sabre”) entered into a contract with HCL to sell the Property to HCL for £2.8 million (exclusive of VAT) (the “Sabre contract”).

7. The Sabre contract was conditional on Sabre securing that two of the tenants of the office block vacated the Property and on the obtaining of satisfactory planning permission by HCL. Both of these conditions could be waived unilaterally by HCL.

8. HCL paid Sabre a 5% deposit (£140,000 exclusive of VAT) on exchange of contracts.

9. Sabre had opted to charge VAT on any supplies relating to the Property and so the sale by Sabre to HCL would be subject to VAT.

10. On 30 April 2014 and prior to completion of the Sabre contract, HCL entered into a contract to sell the Property to Connect Centre Limited (“CCL”) for £5.5 million (exclusive of VAT) (the “CCL contract”).

11. The CCL contract was unconditional. CCL paid a deposit of 5% (£275,000 exclusive of VAT) on exchange of contracts.

12. HCL registered for VAT on 12 May 2014.

13. On 16 May 2014, a number of additional agreements were entered into.

14. The first agreement was between Sabre and HCL under which the Sabre contract was varied in return for a payment of £20,000 (exclusive of VAT) paid by HCL to Sabre.

15. The main terms of the variation to the Sabre contract were as follows:

5 (1) A new clause was inserted which was intended to ensure that the transfer of the Property would qualify for transfer of a going concern (“TOGC”) treatment for VAT purposes. As part of this, HCL agreed to make an option to tax in relation to the Property, although it did not in fact do so.

(2) HCL waived the conditions precedent.

10 (3) The completion date was set for 16 May 2014 (i.e. the same day as the variation).

(4) Sabre acknowledged that HCL intended to assign the contract to CCL and consented to such an assignment.

15 16. The second agreement was an agreement between HCL and CCL which varied the terms of the CCL contract in return for a payment by CCL to HCL of £25,400 (although it does not say so specifically in the variation agreement, it appears that this sum was intended to be exclusive of VAT).

20 17. Although expressed as a variation to the CCL contract, the effect of the variation was to remove HCL’s obligation to sell the Property and CCL’s obligation to buy it and to replace these obligations with an agreement that, on the same day, HCL and CCL would enter into a novation agreement relating to the Sabre contract in an agreed form (the terms of which are explained below) and that CCL would pay to HCL a premium of £2.7 million (exclusive of VAT) less the £275,000 deposit which CCL had already paid to HCL when the CCL contract was originally entered into.

25 18. The final agreement which was entered into on 16 May 2014 was the deed of novation referred to above. Sabre, HCL and CCL were all parties to the deed of novation. To the extent relevant, the deed of novation provided as follows:

“WHEREAS:

30 (A) Under the terms of a contract dated 27 January 2014 between (1) SICL and (2) HCL as varied by a deed of even date herewith and made between (1) SICL and (2) HCL (the ‘Contract’) HCL agreed to purchase and SICL agreed to sell the Property described in the Contract on the terms set out in the Contract.

35 (B) HCL desires to substitute CCL as the buyer under the Contract and as such HCL wishes to transfer its rights and obligations under the Contract to CCL.

(C) The parties have therefore agreed to novate HCL’s rights and obligations under the Contract to CCL on the terms of

this Deed with effect from the date of this Deed (the 'Effective Date').

IT IS AGREED:

1. **Novation**

5 1.1 With effect from the Effective Date, HCL transfers all its rights and obligations under the Contract to CCL. CCL shall enjoy all the rights and benefits of HCL under the Contract, and all references to HCL in the Contract shall be read and construed as references to CCL.

10 1.2 CCL agrees to perform the Contract and be bound by its terms in every way as if it were the original party to it in place of HCL.

15 1.3 SICL agrees to perform the Contract and be bound by its terms in every way as if CCL were the original party to it in place of HCL.”

19. The net effect of these agreements was that instead of Sabre selling the Property to HCL for £2.8 million and HCL selling the Property to CCL for £5.5 million, Sabre would sell the Property to CCL for £2.8 million less the deposit which HCL had already paid and CCL would make a separate payment to HCL of £2.7 million less the
20 deposit which CCL had already paid to HCL. It is not at all clear from the documents in front of me how (if at all) HCL was reimbursed for the deposit of £140,000 which it had paid to Sabre when the Sabre contract was entered into but this point has no impact on the outcome of this case.

20. Completion of the novated/amended Sabre contract and the amended CCL
25 contract duly took place on 16 May 2014 and the relevant payments were made.

21. HCL issued CCL with two VAT invoices. The first was an invoice for the “sale of the interest in the contract dated 27 January 2014 made with Sabre Insurance Company Limited as varied” and was for the amount of £2.7 million with VAT of £540,000 being charged.

30 22. The second invoice was for “varying the contract dated 27 January 2014” (presumably intended in fact to refer to the variation of the CCL contract which was dated 30 April 2014) and was for an amount of £25,400 with VAT of £5,080 being charged.

35 23. For some reason, HCL failed to submit a VAT return for the period from 12 May 2014 to 31 July 2014 and so did not pay the VAT due. As a result of this, it also did not seek to recover any of the VAT it had suffered on the various invoices which it had paid in relation to the transactions.

40 24. HMRC became aware of the first invoice showing VAT of £540,000 when this invoice was presented to HMRC by CCL. As a result of this, it made a compliance visit to HCL’s place of business in September 2014 but was told that HCL had not started trading.

25. In July 2015, HCL decided that the VAT shown on the two invoices referred to above had been charged in error. HCL therefore issued two credit notes to CCL on 21 August 2015 for the amount of the VAT which had previously been invoiced. It also submitted a nil VAT return to HMRC for the 07/14 VAT period.

5 26. HMRC issued a VAT assessment for a total of £545,080 on 16 September 2015.

27. HCL appealed against the assessment and, following an unsuccessful request for a review, has now appealed to the Tribunal.

HCL's case

10 28. In a nutshell, HCL says that it acquired an interest in the Property under the Sabre contract and that it then sold this interest to CCL under the CCL contract. The fact that its obligations under the CCL contract were satisfied by way of a novation is, in its view, neither here nor there but was just one of the possible ways of ensuring that legal title to the Property ended up with CCL.

15 29. Mr Scorey identified three possible ways in which legal title to the Property could have been transferred to CCL:

(1) Both contracts could have been completed in accordance with their original terms with legal title passing from Sabre to HCL and then from HCL to CCL. This he says would clearly have involved an exempt supply of land by HCL to CCL.

20 (2) Both contracts could have been completed simultaneously in accordance with their terms but HCL could have directed Sabre to transfer legal title direct to CCL. Again, Mr Scorey submits that, in these circumstances, HCL would have made an exempt supply of the Property to CCL.

25 (3) The third alternative (which is what actually happened) is that HCL could have novated the Sabre contract to CCL (thus fulfilling its obligations under the CCL contract) and so that, as with option 2, legal title would pass direct from Sabre to CCL. The key point he says is that it is the Sabre contract which was novated and not the CCL contract (which remained in existence and was completed by the novation). There is therefore no reason in his view why the
30 nature of this supply by HCL to CCL should be any different to option 2.

30. In support of this, Mr Scorey took as his starting point the exemption in paragraph 1 of group 1 in schedule 9 to Value Added Tax Act 1994 ("VATA 1994"). This exempts:

35 "(1) The grant of any interest in or right over land or of any licence to occupy land, or, in relation to land in Scotland, any personal right to call for or be granted any such interest or right, other than –

...

(n) The grant of any right, including –

(i) an equitable right,

...

to call for or be granted an interest or right which would fall within any of paragraphs (a) or (c) to (ma) above.”

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31. Note 1 to group 1 in schedule 9 to VATA 1994 provides that:

“Grant’ includes an assignment or surrender ...”

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32. Mr Scorey submits that it is clear from the wording of these provisions that an exempt interest in land can include an equitable or beneficial interest as well as a legal interest.

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33. This is apparent he says, firstly from the reference to the position in Scotland where, on exchange of contracts, the purchaser does not obtain anything other than a personal right to call for a conveyance. This is why the exemption, as far as Scotland is concerned, includes a personal right to call for the grant of an interest in land. Mr Scorey submits that this is clear evidence that the exemption is intended to cover the equitable interest that arises under English law when a contract for the sale of land is entered into.

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34. Should authority be needed for the proposition that the purchaser of land obtains an equitable interest in the land under English law, Mr Scorey referred the Tribunal to the decision of the High Court in *Property Discount Corporation v Lyon Group Limited and Others* [1981] WLR 300 in which Goulding J said [at page 304G] that:

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“As appears from the classical judgment of Sir George Jessel M.R. in *London & South Western Railway Co v Gomm* [1881] 20 Ch.D. 562, 581 a contract for the sale or lease of a parcel of land gives the purchaser an interest in the land, because the right to call for a grant of land is itself an equitable interest in the land. The purchaser, on performing his side of the bargain, can demand the promised estate in the land, and if necessary enforce his claim by an action for the specific performance of the contract.”

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35. Mr Scorey accepts that, in this case, the Sabre contract was conditional but says that this makes no difference given that the condition could be waived unilaterally by HCL.

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36. In addition, Mr Scorey argues that paragraph 1(n) of group 1 in schedule 9 to VATA 1994 also makes it clear that an equitable right can fall within the scope of the exemption as it specifically removes an equitable right from the scope of the exemption if the right is to call for an interest in land which would be excluded by one of the other sub-paragraphs of paragraph 1 which are mentioned in the closing words of paragraph 1(n).

37. The exemptions in paragraph 1 of group 1 in schedule 9 to VATA 1994 implement the corresponding provisions of the principal VAT directive (Council Directive 2006/112/EC of 28 November 2006) (the “PVD”).

5 38. Article 135(1)(j) of the PVD in particular requires member states to exempt the supply of a building and of the land on which it stands. Mr Scorey’s position is that paragraph 1 of group 1 in schedule 9 to VATA 1994 properly transcribes into domestic law the requirements of article 135 of the PVD.

10 39. Although article 135 of the PVD does not refer to legal or equitable interests, Mr Scorey’s explanation for this is that it has to operate on a community wide basis and cannot therefore take account of the numerous different systems in each member state for the ownership and transfer of land under domestic law.

15 40. Mr Scorey invited the Tribunal to look at the economic reality. In his view, this is clearly that there was a transfer of an interest in the Property from HCL to CCL as HCL had acquired an equitable interest under the Sabre contract and had transferred its rights under that contract to CCL under the terms of the CCL contract. To put it another way, he posed the question as to whether CCL was in reality paying HCL to step away from the Sabre contract or whether it was paying HCL to acquire the Property.

20 41. Mr Scorey referred to HMRC’s apparent perception that the novation “infects” everything and emphasised that it was only the Sabre contract that was novated and not the CCL contract. He emphasised the fact that the CCL contract still required HCL to ensure that legal title passed to CCL and that the invoices in question were issued by HCL to CCL under the terms of the CCL contract.

25 42. Mr Scorey also referred to VAT Notice 742 which is a guidance note issued by HMRC in relation to VAT on land and property transactions. Paragraph 2.3 of this note makes it clear that, for the purposes of the VAT exemption in paragraph 1 of group 1 in schedule 9 to VATA 1994, an interest in land can be legal or beneficial (it was common ground that, for this purpose, a beneficial interest and an equitable interest are the same thing). The notice gives an example of what a beneficial interest might be (it refers to the right to receive the benefit of any supplies made of the land, such as sale proceeds or rental income). It also confirms that a beneficial interest can be held and transferred separately from the legal interest in the land. Mr Scorey agrees that the terms of paragraph 2.3 of the notice are correct and believes that the notice supports his view that the equitable interest in the Property which HCL transferred to CCL was exempt from VAT.

HMRC’s case

40 43. Unlike Mr Scorey, Mr Singh’s starting point was article 135 of the PVD. He pointed out that article 135(1)(l) of the PVD requires a Member State to exempt from VAT the leasing or letting of land. This, he says, shows a clear intention that the exemption for the supply of a building is only intended to cover the supply of a freehold interest.

44. HMRC's main argument is that HCL did not supply a freehold interest in the Property. Instead, Mr Singh submits that HCL supplied an unexercised contractual right to purchase the Property from Sabre.

5 45. Indeed, Mr Singh argues that HCL could never have supplied a freehold interest in the Property to CCL as it never had it. It went direct from Sabre to CCL.

46. Like Mr Scorey, Mr Singh agreed that the domestic legislation correctly transcribed the terms of the PVD as far as the exemption relating to land is concerned. However, he made the point that the domestic legislation must be interpreted in accordance with the PVD (see *Marleasing SA v La Comercial Internacional de Alimentación SA* case C-106/89 [1990] ECR I-4135 [at 7-8]) and that the exemptions in article 135 of the PVD should be interpreted strictly (see *Mirror Group Plc v HMRC* case C-409/98 [2001] STC 1453 [at 30]).

15 47. Bearing this in mind, Mr Singh says that it is not possible to extend the exemption provided for by article 135(1)(j) of the PVD by importing English law concepts of specific performance and equitable interests. It is domestic law that must be interpreted in conformity with community law and not the other way round.

48. In Mr Singh's view, the invoice issued by HCL supports his position. This refers to the sale by HCL of its interest in the Sabre contract. That, he says, is not the supply of a building. Rather, the building was supplied by Sabre to CCL.

20 49. In any event, Mr Singh does not accept that HCL supplied an equitable interest in the Property to CCL. Instead, Mr Singh submits that HCL's agreement with CCL to novate its rights and obligations under its contract with Sabre to CCL is best understood as HCL providing the service to CCL of stepping away from the purchase of any interest in land from Sabre so as to enable CCL to acquire that interest.

25 **Did HCL have an equitable interest in the Property**

50. As Mr Scorey has pointed out, under English law, the purchaser of land in most cases acquires an equitable interest in the land on exchange of contracts.

30 51. In this case, the contract was conditional but, as Mr Scorey has pointed out, the conditions could be waived unilaterally by HCL. I do not therefore think that there can be any doubt that HCL did acquire an equitable interest in the Property when it entered into the Sabre contract.

35 52. It was not entirely clear to me whether Mr Singh was arguing that HCL did not acquire an equitable interest or whether he was trying to say that HCL's interest was not the type of beneficial interest which HMRC had in mind in paragraph 2.3 of VAT Notice 742. If it was the former, he is wrong. If it was the latter, that does not really help us to answer the question which we must resolve in this case.

Is the transfer of an equitable interest within the exemption

53. I do not accept that the PVD must be interpreted in the strict way suggested by Mr Singh so that it cannot exempt the supply of an equitable interest in land.

54. In particular, I see no conflict between the domestic legislation in Group 1 of schedule 9 to VATA 1994 and article 135 of the PVD. There is no doubt in my mind that, for the reasons given by Mr Scorey, the grant of an equitable interest in land is capable of falling within the exemption in paragraph 1(j) of group 1 in schedule 9 to VATA 1994.

55. The ECJ itself has recognised that the concept of a supply of goods must be interpreted in a way which takes account of the many different ways in which land can be transferred in different member states (see *Staatssecretarías van Financiën v Shipping & Forwarding Enterprise Safe BV* case C-320/88 [1991] STC 627 [at 6-9]).

Did HCL supply an equitable interest in land to CCL

56. I am satisfied that, when HCL entered into the CCL contract, it supplied an equitable interest in the Property to CCL. Had that contract been completed in accordance with its terms, HCL would have made an exempt supply of the Property to CCL.

57. Mr Scorey attempted to characterise the variations to the two contracts and the deed of novation merely as matters of administrative convenience, although I have to confess I find it difficult to understand how entering into three new agreements was a more convenient way of arranging for legal title in the Property to be transferred from Sabre to CCL as opposed to simply completing the two existing contracts in accordance with their terms.

58. Mr Scorey explained that there were a number of different ways of achieving the same legal effect – i.e. that CCL would end up with the Property, that Sabre would have received £2.8 million and that HCL would have received £2.7 million. It is of course open to the parties to any transaction to agree the way in which it should be structured. However, there may well be different tax consequences depending on which structure they choose.

59. In this case, rather than completing the Sabre contract and the CCL contract, the parties chose to amend both of those contracts and to enter into a novation agreement in relation to the Sabre contract.

60. Although the deed of novation refers to the transfer by HCL of all of its rights and obligations under the Sabre contract to CCL, any law student will know that the effect of a novation is that the existing contract comes to an end and that a new contract comes into existence between, in this case, Sabre and CCL.

61. Mr Scorey invited the Tribunal to look at the substance of the matter. In my view, the substance is that Sabre has supplied the Property to CCL and that, in the

end, all that HCL supplied to CCL was the right or opportunity to enter into the contract with Sabre under the terms of the novation agreement.

62. I accept that CCL's ultimate objective was to acquire the Property for £5.5 million. However, I suspect CCL had no strong views as to whether the Property was
5 supplied to it by Sabre or by HCL as long as it (CCL) ended up with the Property.

63. Mr Scorey submitted that the CCL contract remained in existence and that HCL continued to have an obligation to ensure that legal title in the Property passed to CCL. I do not accept this. What purported to be a "variation" of the CCL contract effectively ripped up the original contract. The contract was initially a contract for
10 the sale and purchase of the Property. The variation agreement removed all of the provisions relating to the sale and purchase and inserted a completely new provision requiring HCL and CCL to enter into the novation agreement.

64. The result of this was, in substance, that the original CCL contract never existed and that HCL had, instead, agreed to procure a novation of the Sabre contract in
15 favour of CCL in return for a payment of £2.7 million.

65. In one sense, it might be said that HCL had assigned its interest under the Sabre contract to CCL given that, under the Sabre contract, HCL had an equitable interest in the Property and, following the novation, CCL also had an equitable interest in the Property.

66. However, as the parties chose to do this by way of a novation, what actually
20 happened was that HCL gave up its equitable interest and Sabre granted a new equitable interest to CCL.

67. This is effectively HMRC's case when Mr Singh says that CCL stepped away from the purchase of any interest in the Property from Sabre so as to enable CCL to
25 acquire that interest.

68. If, as Mr Scorey contends, HCL should still be treated as having made a supply of an interest in the Property to CCL, the result of this would be that both Sabre and HCL had supplied an interest in the Property to CCL. Sabre's supply would have been of both the legal and the equitable interest in the Property whilst HCL's supply
30 would have been of an equitable interest in the Property. It is however difficult to see how both Sabre and HCL can have supplied the equitable interest in the Property to CCL at the same time.

69. I would observe that it does appear to have been expected and intended that the result of the novation was to change the VAT treatment of the transaction in that the
35 amendments to the Sabre contract are clearly designed to ensure that TOGC treatment was available on the supply of the Property by Sabre to CCL. It was presumably anticipated that, as a result of the sub-sale from HCL to CCL, TOGC treatment would not be available if the Sabre contract and the CCL contract were completed in accordance with their terms. It is perhaps not therefore surprising that the changes
40 which were made have also changed the VAT treatment of the supply made by HCL

to CCL given that this ended up being a different supply to that which was originally envisaged under the terms of the CCL contract as initially drafted.

Conclusion

5 70. For the reasons explained above, my conclusion is that HCL did not supply an interest in land to CCL. Instead, HCL supplied to CCL the right or opportunity through the deed of novation to enter into an agreement with Sabre for the sale and purchase of the Property. This is not a supply of goods and must therefore be a supply of services which will be standard rated.

10 71. The original VAT invoices issued by HCL on 16 May 2014 were therefore correct and the assessment to VAT against which HCL appeals is upheld.

Costs

72. HCL have applied for costs to be awarded against HMRC under rule 10(1)(b) of the Tribunal rules (the case not having been allocated as a complex case) on the basis that HMRC has acted unreasonably in defending or conducting the proceedings.

15 73. Mr Scorey accepts that there is a high threshold to cross before the Tribunal will find that a party has acted unreasonably but submits that this threshold has been reached in this particular case.

20 74. Mr Scorey's main complaint is that HMRC have consistently failed to explain with sufficient clarity the legal basis on which the original appeal to HMRC was refused and the appeal to the Tribunal was defended.

25 75. Indeed, in October 2016, HCL applied to the Tribunal to bar HMRC from taking any further part in the proceedings under rule 8 of the Tribunal rules on the basis that there was no reasonable prospect of HMRC's case succeeding. The Tribunal declined to grant HCL's application and instead directed that the case should proceed to a full hearing.

76. The fact that I have found in favour of HMRC does not of course mean that the original arguments put forward by them in these proceedings had any prospect of success as they may have changed the basis on which the appeal was defended. However, that is not the case.

30 77. Whilst I accept that there was some confusion in the arguments put forward by and on behalf of HMRC and that some of the arguments put forward at certain times were hopeless, HMRC's initial statement of case in May 2016 clearly stated that HMRC's view was that HCL's supply was HCL's agreement to step aside and to allow CCL to step into its shoes as far as the Sabre contract was concerned. This was confirmed in the further information in respect of the respondent's case prepared by
35 Mr Singh in July 2016 as well as in Mr Singh's skeleton argument.

78. In my view, HMRC has not therefore acted unreasonably in defending or conducting the proceedings and I cannot therefore make any order as to costs.

79. 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.

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**ROBIN VOS
TRIBUNAL JUDGE**

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RELEASE DATE: 30 NOVEMBER 2017