CIRCULAR VAT

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VAT throws up some strange quirks from time to time (Jaffa Cake anyone?) but the case of David Moulsdale t/a Moulsdale Properties is as peculiar as any.

Grants of an interest in land or property are generally exempt from VAT. But, where the property is non-residential it is possible to opt to tax the land or property concerned. Where such an option to tax is made it converts an exempt interest in land or property into a taxable interest.

That, in turn, allows the person granting the interest to recover VAT on any associated expenditure. So far, so (relatively) straightforward.

There are, however, anti-avoidance provisions which can disapply an option to tax turning the grant of an interest back into an exempt grant. These are complex but on a simplified level they kick in when the person granting an interest in opted land or buildings or a person who has financed their development intends or expects that the land or buildings, will be occupied by either the grantor, a person connected with the grantor, a person who financed the development, or a person connected with the financier, and they are occupying the property for purposes which do not allow them to recover at least 80% of the VAT they incur.

The provisions only apply to land or buildings which are in the Capital Goods Scheme.

The circularity arises in a situation when a taxpayer wishes to sell an opted building or land, but at the point of sale the building or land is not within the Capital Goods Scheme for the seller. But, if the value of the land or buildings is more than £250, 000 and VAT is charged by virtue of the option to tax, then the land or buildings will become a capital goods item in the hands of the purchaser.

But, where the anti-avoidance provisions kick in and disapply the option to tax the sale would be exempt. But where the circularity kicks in is that if the sale is now exempt, then no capital goods scheme item is created, the anti-avoidance provisions cannot apply and so the sale then becomes subject to VAT!

In Mr Moulsdale's case he acquired the property concerned, opted to tax it but subsequently let it to a connected party who could not recover 80% or more of the VAT they incurred. Mr Moulsdale's option to tax was therefore disapplied (though he did not realise it at the time).

Then at a later point in time he sold the property to an unconnected company. The question was whether the sale was exempt or taxable. HMRC's view is that in order to avoid the circularity you ignore the fact that the sale becomes a capital goods scheme item in the hands of the purchaser, the anti-avoidance provisions do not therefore apply and the sale is taxable by virtue of the original option to tax.

Mr Moulsdale's barrister argued that you looked at the intention before the supply is made and at that point the option to tax would apply meaning that a capital item is created in the hands of the purchaser. That in turns brings the anti-avoidance provisions into play which disapplies the option to tax meaning the sale is exempt.

The judge decided that the disapplication provisions were not engaged and therefore the supply was taxable, but the reason for coming to this conclusion is not entirely clear since at paragraph 43 of the judgment the judge says, "As a matter of fact, we find that at the date of the grant [Mr Moulsdale] knew that the supply would not be, and could not be, taxable [and] the appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser." That seems to indicate the supply would be exempt.

But, in the following paragraph 44 where the decision is given the judge says, "The unfortunate drafting of these legislative provisions can achieve the opposite result rendering a normal commercial transaction, where there is an option to tax, exempt. The circularity is to be deplored. However, in this case, we find that the disapplication provisions are not engaged and we must therefore dismiss the appeal for the reasons given [meaning that the supply was taxable].”

It is far from clear to me what those reasons are and so sadly the decision has not clarified a point of law which is much in need of clarification.

For the avoidance of doubt I should stress that whilst the disapplication provisions are an anti- avoidance provision, they are based on mechanistic tests and can catch situations where no avoidance is in point. That was the case here, HMRC and the Tribunal both accepted that no avoidance was in point here, it was an entirely normal commercial transaction with a third party at an arms-length price.

For more information or if you have any questions regarding Circular VAT, please speak to your usual haysmacintyre contact, or Phil Salmon, partner and head of VAT.

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