

CITY OF WESTMINSTER AND HOLBORN LAW SOCIETY
Revenue Committee

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VAT: Rewrite of Schedule 10 of the VAT Act
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Dear Mrs Pierce

Schedule 10 Rewrite

The Society represents a considerable number of property lawyers practising in Central London. These include those dealing with commercial property both in the City and elsewhere and also large agricultural estates. Both it and its predecessor, the Holborn Law Society, have responded to the consultations on, and corresponded separately in relation to the agricultural aspects of, the option to tax.

1. The concept of Rewrite

The Society and its predecessor have been supporters of the Inland Revenue's Rewrite programme and have contributed to the consultation processes in relation to that.

In relation to this particular legislation, the existing legislation is difficult to follow and the re-drafting exercise therefore to be welcomed. It is to be hoped (and suggested) that, in the course of this exercise, certain areas of uncertainty (set out below) can be clarified.

Four points need to be made in relation to this Rewrite:

- (a) Although it will, presumably, be carried out by means of a statutory instrument, it will be just as important for any changes (for whatever reason) to be identified clearly in the Explanatory Memorandum.

It has been agreed with the main Rewrite Committee staff that (where a statute is concerned) recourse may now be had to such material for the purposes of interpreting the rewritten text in the Courts subsequently.

- (b) Because the statutory instrument method of implementation will be used, it is doubly important that any changes be highlighted because, in relation to the main Rewrite programme, it has had to be accepted that such changes ought, first, to be implemented through a Finance Bill.

It will be seen, below, that some of the changes proposed in the Consultation document, although understandable, will give rise to difficulties for third parties whose legitimate interests should, presumably, be protected in legislation of this type.

Without such protection:

- (i) one of the *registered* parties to the transaction might not be able to satisfy himself that the *neutrality* principle, under which all taxpayers within the chain are entitled to transparency, was applicable to the transaction; or
 - (ii) a purchaser who was not able to recover the VAT element might not be able to satisfy himself that the option to tax was not in force in relation to the transaction about to be contracted.
- (c) The method of implementation ought, however, to enable other desirable changes (or clarifications of apparently inconsistent tribunal decisions) to be implemented without going through the Finance Bill process, provided (of course) that these are highlighted in the Explanatory Memorandum.

In the light of this possibility, we have addressed some additional areas where consideration needs to be given to the current position so that, if possible, the rewritten text can provide greater clarity: see para 4(i)(bb)(1) below.

In this context, attention is being drawn, also (in para 4(i)(bb)(2) below), to an issue which has been the subject of correspondence in the past where the official view diverges from the statutory text and seems to have been undermined further by recent decisions in the House of Lords and the ECJ.

- (d) The Committee agrees that the need to remove obsolete material from the Schedule justifies the application of the Rewrite technique in this case and at the present time.

But, as is pointed out in para 3(2)(iv) below, this exercise should also address the effect of the replacement, in 1995, of the single building extension and the abolition of the agricultural land extension on elections extant at that date.

2. **The changes to law and policy proposed in the Consultation**

- (i) right of appeal against refusal under para 3(9): this presents no problem;
- (ii) the use of tertiary legislation to create a framework for para 3(9) applications: the Committee feel that, where third parties are involved (as indeed they are as both purchasers and tenants), the use of tertiary legislation is not justifiable because it is extremely difficult to trace the exact texts of Public Notices some years back;

the same observation was, moreover, made under a previous Consultation (and should be treated as applicable to the rewritten text) in relation to para 3(6);

- in which connection one has to wonder what the outcome would have been had the challenger in *Marlow Gardner & Cooke Ltd Directors Pension Scheme v. HMRC*, LON/04/1147, chosen, in the alternative, to dispute whether the notification of the disputed election had been timeous;
 - and the area for dispute would be even greater under the proposed rewritten text because the certain concept of *election* is being replaced by the vague (and undefined) one of *exercise* - as to which see also para 3(2)(i) below;
- (iii) while it is understood why some parts of the property industry are anxious to have backdating introduced,
 - this cannot possibly be justified because the only purpose of so doing would be to change the extant relationship with a third party
 - ◆ and quite possibly to his detriment, e.g. if he were a partially exempt purchaser,
 - and it is considered, and suggested, that the Courts would be very reluctant to permit such an interference with an extant transaction:
 - ◆ e.g. where an application had been made to the Commissioners on 1 April, the property was sold on 5 April and, on 30 April, the Commissioners backdated their consent to 1 April, seemingly changing the price payable retrospectively; and
 - ◆ the obvious reaction of the Courts (i.e. to treat the sale as exempt) might well obtain the support of the ECJ: as to which, see
 - *Burtscher v. Stauderer*, C-213/04, as regards retrospection; and
 - Advocate General Maduro in *C & E Commrs and Attorney-General v. Federation of Technological Industries*, C-384/04, in relation to the overriding principle of legal certainty;
- (iv) the same objection applies, so that this proposed change should also be deleted.

3. The changes proposed in *Business Brief 23/05* and related issues

(1) *revocation*:

- (v) The position of tenants: the decision to ignore the “almost unanimous” Responses to question 37 in the Consultation is very hard indeed to justify.

As indication in para 2(ii) above, the position of third parties must be safeguarded.

- Presumably the underlying thinking is that inactivity by the landlord should not be allowed to affect the validity of the

discontinuance of the election (because that discontinuance would only be “nisi”).

- But surely the protection of third parties should supercede any facility permitting an elector to cancel his voluntary act?

(2) *other issues:*

(i) *global options:* the practice of permitting slapdash landowners to submit “global” options back in 1989 was extremely dubious as a matter of law and should never have been permitted to start;

- the opportunity of the rewrite should therefore be taken to require such of these as have not been “replaced” by lists of properties (alias “universal” options) to be deemed to have become ineffective; because
- third parties dealing with such proprietors are entitled to expect that they have their “option to tax” paperwork in the same apple pie order as, for instance, their
 - ◆ fixtures allowances claims;
 - ◆ planning permissions; and
 - ◆ building regulations consents.

This observation has to be made in this context – and it also applies to paras 2(ii) and 3(1) above – that **the Commissioners should expect taxpayers wishing to obtain the benefits of the option to tax to observe the same degree of strict compliance with the requirements of paras 2(1), 3(6) and 3(9) that they enforce elsewhere**, and especially in relation to:

- temporarily lost export documentation and the imposition of interest;
- Schedule 8, Group 5, Note (2) in relation to the minutiae of planning consents;
- Schedule 8, Group 6, Note (6) in relation to both the dating and the relevance of Listed Building consents; and
- Value Added Tax (Special Provisions) Order 1995, Art 5(2) where an opted property is sold at auction and (as is normal) provision made for the auctioneer to receive the deposit as the vendors’ agent.

Indeed, it would be to the benefit of all concerned for the rewritten text to require future elections to be made to the Commissioners rather than (under the current text) “to” the proprietor “by” himself and then notified to the Commissioners within a specified period under para 3(6).

- While this recommendation has been made by us in response to previous consultations, it is repeated because it seems such an obvious solution to some of the evidentiary problems faced by third parties under the present administrative arrangements.

Where, for instance, a CGT hold-over is to be made, the SAR provisions require the taxpayer not only to make the “claim” to the Commissioners but also to do so on a specified form.

- Consideration might therefore be given to including a provision enabling the Commissioners to specify a form for electing to them direct, so that third parties dealing with a purported opter can expect to be able to obtain a certified copy of this document in response to Preliminary Enquiries.
- Indeed, when the option to tax was first introduced in 1989, it was the practice of the Commissioners to issue official copies of notifications for submission to tenants.

Indeed, far from clarifying the present position, under which there must be an “election”, reference is made in the draft substituted text to the “exercise” of the option to tax without enlightening the reader as to how this is to be accomplished. It follows from this that it will often be unclear from what date the 30 days specified in para 19(2)(a) are to run.

Furthermore, in the context of the requirement for the Commissioners to act within the law, it would not be proper for the proposed para 19(2)(b) to be seen as giving an administrative loop-hole to slapdash proprietors. And in this context it should be mentioned that inattention to formalities is by no means confined to small traders. Indeed it tends to be the larger proprietor, through its professional advisers, who is most insistent upon the Commissioners granting it a “concession”.

- (ii) *elections made by a group member*: while the change is to be welcomed (and indeed is, in context, clearly inevitable),

the opportunity of the rewrite should also be taken to require all properties affected by such elections *both* to be identified to the Commissioners *and* the current owners; this is required for the protection of third parties;

whose advisers tend to be given the run around by, especially, the big pub groups, when asked for evidence that the election has been made and notified in accordance with the law;

- (iii) *demolished buildings*: as the official practice was clearly insupportable, in the context of the wording of para 2(1), in both English land law (which does not recognise the Roman Law concept of emphyteusis – a form of building “ownership”, which existed – like leases in Scotland – in contract only, albeit divorced from that of the land but which, for historical reasons, did not ever attain the status of

what we would regard as an “interest in land”) and European law, it is difficult to see how it is possible either to justify treating new options differently or to permit the erection of a new building to be the occasion of the opportunity to revoke the running election on the land; why should developers who have misinterpreted the law be permitted any concession? They should look to other remedies for any loss they suffer – although these might not be available to them, of course, where they made the election in full knowledge that the official practice was of dubious validity.

- (iv) *extensions*: attention needs to be given, in the rewrite legislation to the situations in which , under the original Sched 6A, paras 3(3) to (5), elections made before 1 March 1995, were treated before that date as extended to either:
 - (aa) a complex of buildings erected after the making of the original election but no longer covered by the reduced scope of para 3(3) after 28 February 1995; or
 - (bb) an election covering Blackacre farm which extended to Whiteacre farm by para 3(4) upon it being purchased subsequently, but which extension was no longer extant under the reformulation of para 3 on 1 March 1995.

Although, as originally enacted in 1989, a strict construction of the legislation should have meant that the extension (or, effectively, reduction in the event of Blackacre ceasing to be a farm) of the election could not take effect in relation to subsequent transactions, the Commissioners’ interpretation was that paras 3(3)-(5) applied on a situation then current basis.

It should have followed from this that properties not within the reduced scope of the extensions after 28 February 1995 should have ceased to be bound by the status of the adjoining property from 1 March 1995.

Although this point does not appear to have been addressed in official literature, it seems that taxpayers have operated on the basis that the extensions were “frozen” as at 28 February 1995.

As a matter of law, this must be wrong.

However, irrespective of the correct current legal position, if the text is to be rewritten, these situations will have to be addressed in it.

- (v) One of the issues which arose in relation to the agricultural extension was whether adjoining land which was either:
 - (aa) half owned under a tenancy in common; or
 - (bb) vested in the same proprietor as tenant for life under the Settled Land Act 1925;

was covered by the statutory extension. In both cases, the better view was that this was the case, and this gives rise to the need to address the following issues in the Rewrite:

- (1) in relation to undivided shares in the same *interest* in land, e.g. freehold or particular leasehold, the official practice is to require that all proprietors of the interest in question join in the election – while this is necessary in order to avoid administrative chaos in relation to leasing, it needs to be provided for specifically in the Rewrite; and
 - (2) where an individual has exercised the option to tax, better arrangements need to be made to enable his immediate successors in title to continue his election with effect from the death and it is suggested that this issue should be addressed specifically in the Rewrite:
 - (a) at the moment, it seems to be accepted that Executors may continue the election provided that they notify the LVO within a reasonable time of the death and continue to operate on the deceased's registration number; but
 - (b) their advisers may well prefer it if they were to take out a new registration, and there seems no reason why this should be objected to, although the legislation needs to facilitate this;
 - (c) where there is no Will, Administrators will not have authority from the date of death [title vests in the President of the Family Division, who has to be approached through the Treasury Solicitor, and insofar as is known has not been on this issue!] and cannot, therefore, in theory, avoid an open market value charge because they cannot achieve an immediate transfer of going concern; here again this should be permitted and provided for; and
 - (d) where a sole trader/owner is also a tenant for life under the Settled Land Act 1925, the trustees of the settlement (who had no management role or rights during his lifetime and, it has been agreed, could not participate in his registration) have to take out a separate Grant of Probate; although their authority would date from the death, they would not be able to continue to use the deceased's registration number and might therefore find themselves in the same technical position as regards TOGC as Administrators; this position needs to be provided for in terms.
- (vi) While the proposed para 14(9) reflects the current para 3A(13), it should be clarified whether it was actually intended that [by reference

to the proposed replacement format] (a) and (b) could be applied cumulatively. If X occupies part of Blackacre and Y another part and X and Y are not “connected”, how can X be regarded as occupying the whole property when Y is in occupation of part of it?

- (vii) In relation to the proposed para 17(1)(b), is it considered that HMRC would have power to permit the correction of a dating error (subject of course to there being *neither* a material net loss of tax *nor* detriment to third parties), e.g. a TOGC where the purchaser’s covering letter referred to election with effect from completion but the notice itself contained the date of *intended* completion and, in the event, this took place three days early?

4. **Proposed Rewrite changes described as to the law, but not policy**

It must be emphasised, in the context of paras 1(a) and (b) above, that if the law does not accord with policy, the Commissioners should seek a change to the former because they are obliged to apply (and enforce) the law. It was of the essence to the Glorious Revolution of 1688, that the “suspending and dispensing power” claimed by James II was seen as objectionable in principle, and in consequence treated as illegal. Indeed the Courts have upheld this objection since the War, not least in *Vestey (No.2) v. IRC*, [1978] STC 567.

- (i) As this is a possible construction of the legislation, it is desirable that the issue be clarified.
 - (aa) It would also be desirable, in this context, for the degree to which the purchaser needs to notify his intention to the vendor to be clarified. Although reference has been made to the *SEH* and *PJG* in para 9 of the Commentary, the degree of inconsistency between the approaches of the two tribunals needs to be addressed.

It is appreciated, of course, that, while a provision specifying the type of notification which would put the issue beyond doubt would be helpful, there might be circumstances in which the purchaser intended to occupy through an employee and was able to recover the VAT paid as input tax (e.g. ones similar to *Dean and Chapter of Hereford Cathedral v. C & E Commrs*, [1995] VATTR 159) in which the parties might “agree” that the relevant notice should not be served.

- (bb) That commentary does not, however, contain any reference to an issue which professional bodies (including the Holborn Law Society Revenue Committee) have raised with the Property VAT Team, namely the absence of legal justification for splitting farm rents between the farming parts and the residential parts.
 - (1) Previously, the correspondence has centred round the lacuna in the official interpretation which results from (and depends upon) an attempt to import a Schedule 8, Group 5 definition of “designed as” to include “intended for use as” when it is quite clear from Group 5 that the latter is a different concept.

- (2) Although reference has also been made to the need to interpret the legislation in accordance with the *Card Protection Plan* principle, i.e. that the residential element of the supply was ancillary to the agricultural element, under two recent decisions the totality should be seen as a single supply of a farm.

These decisions are those of the House of Lords in *College of Estate Management v. C & E Commrs*, [2005] UKHL 62, and the ECJ in *Levob Verzekeringen BV v. Staatssecretaris van Financien*, C-41/04.

The analysis of Advocate General Kokott in *Abbey National Bank plc v. C & E Commrs*, C-169/04, would also appear to be inconsistent with the official view.

It is, therefore, apparent that properties the letting or sale of which ought to fall within the single economic supply concept should not fall within para 2(2)(a) and that the rewritten provision should make that limitation clear.

Indeed, as the proposed para 4(1) is drafted currently, point (bb) would be “resolved” in favour of the official view when that form of wording would be inconsistent both with

- **the current text (when not noted as a change in the law but not practice); and**
 - **the overriding principles of European law.**
- (ii) While 80% certainly represents official practice, the normal dividing line in relation to this phrase, as interpreted in Inland Revenue cases, is 51%, and the Courts should be expected so to hold in any litigation under the current text.

Yours sincerely

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Chairman