TAXREP 18/12

(ICAEW REP 74/12)

ICAEW TAX REPRESENTATION

VAT: ADDRESSING BORDERLINE ANOMALIES

Comments submitted on 18 May 2012 by ICAEW Tax Faculty in response to the HMRC consultation document *VAT: Addressing borderline anomalies* published on 21 March 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *VAT: Addressing borderline anomalies* published by HM Revenue & Customs (HMRC) on 21 March 2012.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

MAJOR POINTS

7. The consultation document sets out a series of VAT increases, effected by extending the current VAT base in a number of areas.

8. HMRCs statement in para 4. of the paper's Introduction says:

> "The Government is therefore introducing a number of simplifying measures which create new sustainable borderlines to address some of these anomalies, reducing uncertainty, and costs for business and HMRC."

9. We disagree. As explained further below, we think that these measures neither simplify nor reduce uncertainty. We do not believe that costs for business will be reduced. Many of the proposals do the opposite. In addition to the tax increases, they will add significantly to the costs and compliance burden of businesses, a result which is contrary to the Government's growth agenda and particularly unwelcome given difficult economic circumstances which face the UK.

10. We are very concerned that the implementation costs set out in the impact assessments (see Annex B) are far too low and lack credibility. For example, the estimated cost of implementing the VAT changes on hot food and premises is expected to be negligible at £50 on average. In view of the obvious implementation problems for business, many of which have been highlighted in the press, these figures appear completely unrealistic. Unfortunately, this is not

a new problem – we have stated repeatedly that the business costs of the proposed changes set out in impact assessments are far too low and lack credibility. We repeat our previous comments that these costings need input from business and advisers at the evidence gathering stage in order to ensure that they are realistic and do have credibility – and we repeat our commitment to work with HMRC to improve them. Unless they are improved significantly we see little point in including them as they are unreliable evidence and undermine the basis for the measures.

11. We see serious practical and other problems with:

Catering
- The use of ambient air temperature as the only definition.
- Different VAT liabilities for identical products sold at the same temperature.
- Freshly baked and cooling food.
- The UK definition of 'catering'.
- The difficulty of creating a legal definition of bread.
- The widened definition of premises, which we anticipate will lead to widespread (and simple) avoidance by consumers.

Sports Nutrition Drinks
- The legal definition of what constitutes 'marketed'.

Self-Storage
- The need for this change (other than as a tax-raising measure).
- The lack of clarity on what constitutes the storage of own goods.
- VAT recovery by lessors when business to business (B2B) leased properties move in and out of tax as the usage varies.
- The effect, costs and uncertainty on the B2B commercial property market for offices, warehousing and distribution centres until the above are resolved.

Hairdressers' Chair Rental
- Whether this measure is actually necessary.

Holiday Caravans
- The impossibility for suppliers to determine at the time of the supply whether or not to charge VAT – ie where the caravan will be placed by the purchaser.

Approved Alterations to Listed Buildings
- The effect of the imposition of 20% VAT on heritage property, both now and in the future.

RESPONSES TO SPECIFIC QUESTIONS

Catering

Q1: Does the proposed legislation meet its objective of ensuring that all hot takeaway food is taxed consistently at the standard rate of VAT? If not, why not and what changes are needed?

12. The proposed legislation fails to achieve the stated aim of simplicity and clarity. For the reasons we set out below, we expect the proposed legislation will create more inconsistencies, anomalies and practical difficulties than the current law.

13. ICAEW has received more comments in relation to this question than it has to any other VAT consultation question in recent years. As HMRC and government are well aware, there has also been considerable adverse comment in both the professional and general media.

14. HMRC has stated that they will operate the proposed law in a pragmatic way, which we welcome. But that is no substitute for properly drafted law at the outset, and is contrary to our Ten Tenets for a Better Tax System (summarised in Appendix 1).

Use of 'Ambient air temperature' as a definition

15. As HMRC states in its consultation, the current law (Group 1(a), Schedule 8, VATA 1994) taxes:

> "a supply in the course of catering" and Note 3(b) confirms that this includes the sale of hot food which is "food which, or any part of which -
>
> (i) has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature; and
>
> (ii) is above that temperature at the time it is provided to the customer".

16. The current law therefore standard rates the supply where there is the intention for the food to be consumed at above "ambient air temperature". The proposed new legislation will remove the intention requirement (ie the requirement for it to be heated) so that standard rating will apply to all food which, at the time of the supply is above that "ambient air temperature". As HMRC states:

> "Hot food will be defined in a new note 3B as follows:
>
> "For the purposes of paragraph (b) of Note 3, "hot food" means food which, or any part of which, is above the ambient air temperature at the time it is provided to the customer, other than freshly baked bread".

17. We note that the temperature test will apply to any part of the food, so that if the outside is cool but the centre is still hot, the supply will be standard rated.

18. The meaning of 'ambient air temperature' under the current law has itself been the subject of judicial comments. As Parker LJ said in the Court of Appeal case of *John Pimblett & Sons Ltd v C&E Commissioners*, CA 1987, [1988] STC 358:

> "It is apparent that what happened was that the draftsman foresaw that there would be endless argument about what food was 'hot' food, and sought to put the matter beyond doubt. The test is a precise one. It involves the remarkable result that frozen food would be regarded as hot food if the ambient temperature was one degree lower than freezing. A praiseworthy attempt to produce precision does not, in this instance, appear to me to have advanced clarity one wit."

19. The original intention when hot take-away food became standard rated in 1984 was for standard rating to apply only when it was the intention that it should be consumed whilst still hot, ie it had been heated above the ambient air temperature. The proposed legislation goes well beyond this intention and therefore extends the scope of VAT.

20. As a reason for the change, HMRC state that the problem with the current law is that it is "leading to similar products receiving different tax treatment". However, far from clarifying or simplifying the current position, the proposed law introduces a further set of uncertainties, as explained below.

Different VAT liabilities for identical products sold at the same temperature

21. The following examples highlight the difficulty in applying this proposed test:

- The sale of pasties, sausage rolls etc from an outdoor market stall on a cold winter's day (say 0 deg C) would appear to be standard rated unless they were at or below that temperature. Since the pasties etc would have been stored indoors overnight, one would

expect them to be above 0 deg C, at least initially. This may not be the intention, but the supply would be caught under the wording of the draft legislation.

- However, the sale of identical pasties, sausage rolls etc from a nearby baker's shop with an internal ambient temperature of 20 deg C would be zero rated if sold at or below that temperature. This result is inconsistent with the market stall situation.

- However, if the baker selling from his shop also sold the same pasties etc from a serving hatch opening on to the street, the question would arise as to whether the ambient air temperature to be measured was that in the shop or in the street itself. The VAT liability would then depend on legal argument as to the time of the supply and could hang, for example, on whether the pasties were handed to the customer before or after payment.

Freshly baked and cooling food

22. Serious practical difficulties will arise where food other than bread is still cooling down at the time that it is sold. Every affected business will need to monitor the temperature of its products to accurately determine if they have cooled down sufficiently to be zero rated. This can only be done by the use of thermometers, both for the area (eg shop) in which they are sold and for the product itself. For the product itself, the internal temperature can only be properly measured by means of probes into the centre. We do not have the expertise to know what hygiene and other regulations would apply to this procedure, but it is unlikely to be a simple matter for the business and tested products may have to be destroyed rather than sold.

23. Under the proposed law timing would be crucial as to when products were intended to be consumed after they had cooled down. A pasty or sausage roll might have to be standard rated if sold within, say, one hour of them leaving the oven, but zero rated if sold thereafter as they had reached the ambient temperature. A baker could easily be baking a dozen or more different products during the day, all at different temperatures and all switching from zero to standard and then back to zero all at different times. This is likely to go on for most of the day, according to the supply and demand.

24. Technically, this rule could lead to all sorts of absurdities. Consider a customer who wishes to buy a dozen sausage rolls. Batch 1 has now cooled to the ambient air temperature and so would be zero rated, but there are only eight sausage rolls left. Batch 2 has just come out of the oven and is still hot. So technically the baker would have to charge 20% VAT on the four sausage rolls from batch 2, but the eight from batch 1 would be zero rated. If the customer did not wish to pay the VAT, he or she could wait until the four sausage rolls from batch 2 had cooled down to ambient temperature.

25. A further typical example is a local baker selling pasties which are not baked on the premises but transported from the bakery a few miles away. If the pasty is purchased at lunchtime, when it is newly delivered from the bakery, it would still be warm and attract VAT. If purchased in the afternoon when it has cooled down, it would be a zero rated purchase. How can this be controlled in practice, both by the business and HMRC?

26. We should welcome clarification as to how a business can reasonably be expected to operate VAT correctly in such circumstances. We think it is wrong in principle to introduce such badly drafted and potentially unworkable rules.

27. It is also difficult to reconcile the situation of a rotisserie chicken purchased from a supermarket being liable to standard rated VAT because it is hot when purchased, but then taken on a picnic and eaten cold.

28. The VAT liability should not change, depending upon how warm a day it is at the time that the food is sold. If, when you put the food in your mouth, the temperature is lower than that of your

tongue, it is not hot. Consequently, we believe that any fixed temperature should be set above the normal body temperature of 36.9 degrees Celsius. The best temperature to use would probably be 63 degrees Celsius, being that stated in The Food Safety (Temperature Control) Regulations as the minimum temperature at which food should be retained if it is to be sold hot. A business would therefore be committing an offence if it sold food below this temperature, if it was intended that it be consumed whilst still hot.

29. Therefore, if we are to avoid unintended outcomes as a result of the use of this phrase, particularly for outdoor vendors selling in cold ambient temperatures, some clarification needs to be given in the legislation as to what ambient temperature is referring. We believe that this should be a universally standard definition, such as 63 degrees Celsius referred to above. To do otherwise would create the perverse result that outdoor vendors would have a different temperature threshold to indoor sellers.

30. If all food sold at more than the ambient temperature is to be subjected to standard rate of VAT then it will create a minefield for many small local businesses that do not have the resources, skills or staff to adequately control the situation. They will either face disproportionate implementation and compliance costs or have to apply 20% VAT to all their supplies whether or not is was technically due.

31. The draft legislation also appears to allow a retailer to sell a cold or frozen pie to the customer so it is provided to him cold at the time of sale. The customer could then take it to another part of the shop where, as owner of the pie, it will be heated for him. Alternatively, the customer could be allowed to place it in a microwave or other oven situated there. In such cases, the intention of the legislation would not be achieved.

Q2: Freshly baked bread which is cooling down will remain zero-rated. Bread will be defined in guidance. What types of bread are most likely to be baked on a retailer's premises and are therefore above ambient air temperature at the time they are provided to customers?

32. We believe that it would be difficult to define bread in legislation by a list of bread types, as there is a very wide range and in any event such a list would soon be overtaken by the creation of new types of bread. We therefore suggest a definition based on the essential ingredients of bread and, possibly, how those ingredients are cooked. A list of ingredients to specifically exclude from the definition of bread may also be appropriate.

33. However, whatever definitions are used, we consider it inevitable that there will be litigation on borderline cases which will run along much the same lines as the Jaffa cakes (cakes v biscuits) litigation. In addition, for the reasons given above, we do not believe that the zero rating of food whilst cooling down should be restricted to bread, in which case a definition of bread should be unnecessary and the difficulties avoided.

Q3: Does the proposed legislation meet its objective of ensuring that food courts, tables and chairs outside a café and similar eating areas are included within the definition of premises? If not, why not and what changes are needed?

34. HMRC states that the proposed new legislation by extending the reference to 'premises' in note 3(a) in a separate note 3A:

> "(3A) For the purposes of note (3), in the case of any supplier, the premises on which food is supplied include any area set aside for the consumption of food by that supplier's customers, whether or not the area may also be used by the customers of other suppliers".

35. We can see that the proposed change is likely to work where:

- the wider area is clearly defined,

- there is some contractual arrangement for its use between the supplier and the area owner, and
- the supplier can both see and easily supervise the area.

36. We would expect this to apply to tables and chairs on the pavement outside a café and, in some cases, to food courts in shopping centres.

37. But where these three provisos do not apply, the proposal is unworkable, both to understand and to operate, in particular where the supplier has no control over the area. We should welcome confirmation that the following examples are not included in the new definition of premises:

- At a railway station, passengers and others buy cold food for consumption. Departing passengers and 'meeters and greeters' may well choose to use a general eating area, but arriving passengers will be likely to take the food for consumption on their continuing journey. A supplier will find it impossible to distinguish at the time of the supply.

- If a van is selling hot food parks near or in a public car park which has picnic seating will that constitute 'an area set aside for the consumption of food by that supplier's customers', even though the supplier has no arrangement or contract with the owner of the picnic seating space for its use? If so, how near would the van have to be parked to that area? Would there need to be another retailer selling in the area at the time?

- At a motorway service station there are picnic areas for customers to use. These could be 100 yards away from the outlet inside the complex where the hot food is sold, well out of sight of the supplier. In some cases the picnic area could be sited over a bridge in the parking area for the other carriageway.

- There will be similar problems at airports where customers are moving anyway and will cease to use the designated areas when purchasing cold food, which may be consumed on an aeroplane.

Q4: We have considered impacts on businesses and consumers of the changes to catering and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

38. HMRC/HMT are creating major additional and, contrary to what is stated in the impact assessment, ongoing compliance and implementation costs for suppliers for these measures. Small businesses are likely to be proportionately adversely affected as compared to larger businesses.

39. For cold food suppliers, the problems will arise especially where the VAT liability of products varies according to the length of time they have been out of the oven and/or there are difficulties in determining the ambient air temperature.

40. On the premises changes, suppliers can ask consumers at the time of supply whether they intend to use the designated seating area, and where the consumer says yes, charge 20% extra VAT on the cold food purchased. This happens currently where cold food can be taken away or consumed at seating on the premises. The proposed changes to the rules will make compliance harder. It may be less of a problem where the designated seating area is adjacent to the supplier's outlet but where it is more distant it will be difficult if not impossible for the supplier to control. Even if a supplier sees a customer who has answered 'no' is in fact using the area, what is the supplier expected to do?

41. The more general effect will be to make designated seating areas less popular for the consumption of cold food which will be consumed elsewhere. We therefore do not expect much additional VAT to be collected by this measure, which will instead give rise to litter problems over a wider area.

Sports Nutrition Drinks

Q5: Does the proposed legislation meet its objective of ensuring that sports nutrition drinks are taxed consistently with other sports drinks at the standard rate of VAT? If not, why not and what changes are needed?

42. It appears that the proposed changes reverse court decisions based on what is written in the existing law.

43. We should welcome clarification of what constitutes "marketed" in the proposed law. We anticipate that court cases will be necessary to define the meaning.

44. In view of the relatively minimal amount of tax involved (HMRC estimates £5m-£10m per year) it is difficult to see that this measure is either necessary or worthwhile.

Q6: We have considered impacts on businesses and consumers of the changes to sports nutrition drinks and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

45. There is a potential impact regarding compliance for stock in hand at the time of the change in VAT rate, particularly where a business uses a retail scheme that assumes the VAT liability will be the same at the time of sale as when it was purchased. Again, this proposal is likely to have a disproportionate impact on smaller businesses. If HMRC decides to continue with the measure, then, in the interests of simplicity, we suggest that affected businesses be permitted to sell their stock of these drinks at the VAT rate applied at the time of purchase.

Self-Storage

Q7: We would welcome any views on whether the proposed law achieves the aim of taxing all self-storage. If not, why not and what changes are needed? Are there any other supplies which are not of self-storage that the changes would capture?

46. It is understood that the main aim of the new measure is to tax self storage provided to individuals for storing their own goods.

47. We consider the heading of 'self-storage' to be misleading since the measure is far wider than the term as normally understood. The proposals will affect many land-based business to business (B2B) commercial transactions, such as the lease of a warehouse or distribution centre.

48. We are concerned that the proposed changes to self-storage may be contrary to European VAT and case law. Previous judgments at the European Court of Justice support the view that such supplies are a supply of an interest in land. As such the supply is exempt, subject to the delegated right to Member States to allow options to tax, as happens in the UK. We are unable to see how HMRC or Parliament can define what is or is not a supply of land. We appreciate that HMRC consider that the provision in Art 132 of the Principal VAT Directive allowing Member States to narrow the scope of the exemption for land permits them to make this change, but we consider that the change is so wide-ranging and lacks proportionality that it is

likely to be challenged in court, whether by UK taxpayers or by the European Commission itself. Such an action would create some years of uncertainty for taxpayers and HMRC alike.

49. Reference is made at paragraph 27 of the condoc to the fact that removal firms providing storage facilities will charge VAT. Removal companies usually provide a single taxable supply of removal services whereby it is the removal company and not the end customer who is actually handling the goods and placing them in storage as part of their overall supply.

50. The proposed amendments to Group 1 of Schedule 9 VATA 1994 are too wide and would include much more than self storage for individuals. In particular the definition for self storage at proposed note (15A) would seem to capture all premises (or part premises) where goods will be stored. For example, this would appear to capture office premises where part of the premises will be used for the storage of records.

51. We think that the definition of self storage should be tightened. If this measure is aimed at individuals, for example:

- could a definition similar to that for holiday accommodation at note 13 which refers to accommodation **held out** as holiday accommodation; alternatively
- could the definition define the goods to be stored for example, household effects?

52. It is noted that note 15B(b) has been introduced to enable exemption for storage space rented by charities solely for a non-business purpose. It is probably very unlikely that goods will be used solely for a non-business purpose as any goods (including donated goods) exported by a charity to a non-EU countries is zero-rated under item 3 Group 15 Schedule 8 VATA 1994.

53. In the event that charities can benefit from exemption, there should be a certification process.

54. The consultation document refers to the fact that removal firms who also store goods charge VAT at standard rates. But removal firms are making a very different supply of services – they collect the goods and do not allocate a specific area to them in their storage facilities. They are often making a composite supply, in which the dominant element is the standard rated supply of removal services, so it is misleading to use them as a comparison.

55. It is open to any removal firm to restructure their business to have individual lockable areas in which goods could be placed and make a separate charge for this, exempt or opted as appropriate. As it is, goods are stored in a common depository and access to the goods is limited and controlled. This is different from the self-storage client who transports his goods, has locked access to them and, if he avails himself of other services, such as buying boxes or hiring labour, pays for them separately, normally with VAT added. Moreover, self-storage companies can if they wish opt to tax and, from the consultation document, it appears that 30% have done so.

56. Moving to warehousing and distribution centres, we would expect there to be considerable confusion and difficulty in the B2B commercial market. Whilst many business premises are supplied with the option to tax (where the proposals will make no change) others will be an exempt supply. Where the supply consists of both offices and a warehouse, both the lessor and the lessee will need to decide whether the principal supply is one of 'the grant of facilities for the self-storage of goods'. We should welcome clarification of this term, which we anticipate that term will be defined by the courts in future litigation involving HMRC.

57. We should welcome clarification of the VAT treatment in the following examples:

- If a business leases an office and (as most businesses will) uses part of that space to keep its normal business assets, such as records, computers, office equipment or stationery does that mean that it has been granted 'facilities for the self-storage of

goods'? This is certainly arguable and if so, then the lease should be taxed at 20%. Most offices will be affected.

Or will it rather depend on the proportion of space occupied by the business's own goods as opposed to that occupied by its staff? If so, then every business in the UK which leases exempt property (and their landlord) will need to carry out a measuring exercise.

If neither apply, then HMRC/HMT should amend the proposed legislation to make this clear.

- If a business leases exempt office and warehouse space in a single building, of which one third is a warehouse and two thirds office space, then presumably (subject to the first bullet above) the principal supply will be that of office space and so can continue to be exempt.

- If a business leases exempt office and warehouse space in a single building, of which say two thirds is a warehouse and one third is office space, then presumably the principal supply will be that of 'facilities for the self-storage of goods' and so the lease will become subject to 20% VAT. We should welcome clarification of what would happen if, at a later stage, the proportions were reversed and two thirds were used for office space and one third for warehousing? Presumably the lease would revert to being exempt.

- The same could happen in reverse with the example in the second bullet above. In both cases, the new rules would create considerable problems for the lessor (and HMRC) in determining what is the correct input tax recovery in any year of change.

Q8: Does the introduction of the connected parties test in Note 15B(a) cause any problems for fully taxable businesses? Would having to opt to tax a building in order for input tax to be reclaimed be undesirable?

58. It looks as if the wording at Note 15B(a) would be open to abuse as a third party could be inserted in the middle of the transaction. Could tests similar to those for the option to tax included at Schedule 10 be used as a basis?

Q9: We have considered impacts on businesses and consumers of the changes on self-storage and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

59. The summary of impacts suggests that the measure might lead to a small increase in the price of self storage. If suppliers pass the increase on in full, prices for the end consumer will increase by 20%. An increase in price by this amount would not be considered small to most people.

60. HMRC considers that the one-off compliance costs for implementing the change will be negligible. Our view is that the costs to businesses of implementing the change will not be negligible, one-off costs could be incurred on the following:

- VAT registration if not already registered;
- changing accounting systems to ensure all income treated as taxable in future this may include a change to all customer details on some systems;
- changing invoices; and
- notifying customers that VAT will be charged in the future.

61. HMRC also considers that the ongoing cost of dealing with VAT registration for those businesses that have to register for VAT will be negligible. Again our view is that the ongoing costs will not be negligible, costs will be incurred on:

- preparation and submission of VAT returns;
- dealing with VAT visits;
- dealing with partial exemption if the business is in receipt of taxable and exempt income; and
- consideration of the best method for VAT accounting and use of schemes e.g. flat rate scheme, cash accounting, annual accounting.

62. We understand that the majority of users of self-storage are small businesses or start-up businesses. They use self-storage for the convenience of flexible space, minimum commitment and high security etc. It is a modern business model which works well, but these small businesses and start-up businesses operating below the VAT registration threshold will now face an additional 20% tax charge on their storage bill. This appears contrary to government policy to encourage small businesses.

63. Most large businesses are registered for VAT and will not be affected as they will be able to reclaim the VAT. But where the supply is currently exempt, their landlords will suffer further compliance costs in determining whether the proposals apply. They will also have to bear future compliance costs in checking whether there has been any change of internal use by the lessee.

64. It is possible that some businesses could benefit from the proposed change as they may be entitled to refunds of VAT under the Capital Goods Scheme.

Hairdresser's Chair Rental

Q10: We would welcome any views on whether the proposed law achieves the aim of clarifying that hairdressers' chair rental is taxable? If not, why not and what changes are needed? Are there any other supplies that the changes would capture?

65. HMRC states at para 33 that:

> "….the supply to a hairdresser of the facilities to carry out a hairdressing business (commonly known as a "chair rental") is not a supply of land and is already taxable according to current policy and case law. However some salon owners continue to get this wrong and treat this as an exempt supply of land."

66. HMRC goes on to state (at para 34) that "a significant minority still seek to argue that this is an exempt supply". Since HMRC maintains that the law is clear, we question whether this amendment is needed, particularly when the amounts involved are minimal.

67. Taken literally, item (ma) and note 17 mean that any salon, shop or other establishment let to a hairdresser, whether or not for the purposes of hairdressing, would become subject to VAT. For example the legislation as written could apply to a hairdresser who rents a room at a nursing home where the home arranges the appointments and provides the towels as well. The legislation should make it clear that it applies to premises at a salon or similar establishment where the let will be to a hairdresser who will supply hairdressing services from those premises.

Q11: We have considered impacts on businesses and consumers of the changes on hairdressers' chair rentals and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

68. Litigation has already made the position clear regarding the treatment of hairdresser's chair rental, so the proposed change should have no undesired impact. However, any businesses that are ignoring the existing law are likely to continue to do so when the law is revised.

Static Holiday Caravans

Q12: Does the proposed new test adequately ensure that all caravans used for holiday purposes are standard-rated as intended? If not, how might the test be adapted? For example, do you think that it is necessary to introduce a second limb to the test to ensure that zero-rating only applies to caravans that meet the British Standard 3632 and which are also sited or to be sited on land which is not subject to an occupancy restriction (e.g. where use of the caravan as a principal place of residence is prevented by the terms of a covenant, statutory planning consent or similar permission)?

69. It does not seem unreasonable that a caravan manufactured to meet the British Standard 3632 could be used for holiday purposes. The single proposed test therefore appears inadequate to ensure that all holiday caravans are taxed.

Q13: If the test is adapted along the lines of question 12, what kind of evidence would a supplier of a caravan need to obtain in order to be satisfied that the caravan they are about to sell will not be sited on land on which there is an occupancy restriction? How easy will it be for them to obtain this evidence?

70. We can envisage significant difficulties for caravan manufacturers in obtaining evidence that is satisfactory to HMRC. We understand that a new static caravan currently costs at least £30,000, so VAT on that would be £6,000. This is a significant sum and is likely to result in widespread avoidance, if not evasion, by purchasers. We do not see how the manufacturer/vendor could reasonably be expected to police the tax system after the supply has taken place, with the result that the proposal is likely to be unworkable.

71. For example, a purchaser could require delivery to any piece of (non-restricted) land, which would not even need to be a site. After delivery and payment, the purchaser could then move it to a site with an occupancy restriction. Or the purchaser (once again after delivery and payment) could in turn sell it to a third party (perhaps prearranged) who could then move it to a site with an occupancy restriction.

72. On the evidence, a commercial vendor could be required to obtain a signed declaration from any purchaser to the effect that the purchaser did not intend to place the caravan on a site with an occupancy restriction. But that is only evidence of intention, and intentions, whether genuine or otherwise, can change through time. The declaration could only be valid at the time of sale and the vendor could not reasonably be held responsible if the purchaser acted differently after the purchase. Nor could HMRC reasonably expect the vendor to carry out enquiries after the sale as to the then location of the caravan. For example, how long would any declaration need to cover? What would happen if the conditions were initially met, but the purchaser moved the caravan to a site with occupancy restrictions after only a few weeks or months?

73. An alternative solution might be to tax all caravans and extend the DIY house builders scheme to allow refunds of VAT incurred on the purchase of qualifying caravans to be claimed directly from HMRC by the caravan householder. In such circumstances, what evidence would HMRC require to make the refund? The answer to that question might answer the original question 13. But such an approach would be likely to have an adverse effect on the commercial market since the initial funding requirement by the purchaser would be that much higher. We do not have the evidence on this but would assume that those purchasing these caravans for residential use are likely to be the less wealthy, so any requirement to pay an additional £6,000

in tax (using the figure in the above example) and then wait for a refund could well be a significant burden on them.

Q14: In VAT law it is not permissible to extend the zero rate to goods or services that are standard-rated. . If the current test in group 9 is replaced with a single test based on British Standard 3632, would the sale of any caravans that are currently standard-rated inadvertently be reclassified as zero-rated?

74. In theory, this situation would arise if a caravan meeting British Standard 3632 were to be sold for holiday purposes under the existing legislation. We have no knowledge as to whether or not this situation has occurred.

Q15: What would manufacturers of holiday static caravans have to do to make existing designs comply with BS 3632 or equivalent. How much would this cost and what would be the impact on the impact of static holiday caravans?

75. We have no knowledge in this area.

Q16: We have considered impacts on businesses and consumers of the changes on static caravans and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

76. Please see our reply to Q13 above.

Approved Alterations to Listed Buildings

General comments

77. The proposal represents a major change in government policy. When the law was introduced, it was on the grounds that zero-rating encouraged the protection of heritage property, and the UK used this argument when defending itself in the 1980s against the infringement proceedings on the zero-rating of housing taken against it by the European Commission at the European Court of Justice.

78. We are concerned that this unilateral reduction in the scope of zero-rating may prompt the European Commission to question the need for the UK to retain zero-rating on the supply of any property. Further, under European VAT Law, any UK zero rating, once surrendered, cannot be reinstated at a later date. So this would be a permanent change in the UK which cannot be reversed. For this reason we urge the Government to consider very carefully the advantages and disadvantages of this proposal before any decision is made.

79. Given present economic conditions and the additional cost pressures imposed by a price increase of 20%, we think that many projects, whether repair or improvement, may not take place. There is a danger that his measure will lead to a loss of revenue rather than an increase.

80. Aside from simplification and cost savings, the stated rationale for the move is that 'the current rules give a perverse incentive for change as opposed to repair. However, alterations to listed buildings are usually essential to make them suitable for modern use, for example by improving access and complying with modern regulations. Otherwise such buildings will fall into disuse and will not be repaired.

81. We appreciate that the Government has announced that churches will be fully compensated for extra costs incurred as a result of this proposal. However, the need to make heritage assets suitable for current use applies to a much wider category of buildings than churches.

82. Listed building work also tends to be labour intensive. Much the market is supplied by many small to medium sized specialist contractors. It is likely that this measure will result in the overall loss of revenue and perhaps skills used within the sector.

Q17: The current Note 4b allows zero-rating for substantial reconstructions where the reconstructed buildings incorporate no more of the original building than the external walls together with any other features of architectural or historic interest. HMRC would welcome comments on how frequently this element of the relief is used, and if it is seldom used, whether it would be a useful simplification to also remove this relief?

83. Although this relief is not used often, it is an important relief to retain to ensure that the reconstruction of a listed building remains on a par with new buildings with retained facades.

Q18: The transitional arrangements are intended to provide protection for contracts already in place on Budget day and allow sufficient time for the completion of work and the making of first grants by developers. HMRC would welcome comment on whether these transitional periods are sufficient and whether owners, builders and developers foresee any difficulties in their operation.

84. We do not think that the proposed transitional period of one year from Budget Day 2012 is sufficient. Listed building projects usually take much longer than normal building projects to complete. Listed Building Consent usually stipulates that work should be started within three ears of the consent being given. We believe that the transitional period should be consistent with the planning rule and set at three years.

Q19: It is possible that some substantial reconstructions may be already underway at Budget Day without a written contract being in place. The proposed transitional arrangements therefore also provide relief where 10% of the reconstruction of the building was completed (measured by reference to cost) before budget day and the reconstruction meets the original tests for zero-rating. We would welcome views on how likely this set of circumstances is to occur and whether this additional transitional relief is necessary?

85. It is quite likely that work may have commenced without a written contract in place. Could a trigger point be to look at the date upon which Listed Building Consent (or equivalent in the case of listed places of worship) was granted?

Q20: We have considered impacts on businesses and consumers of the changes to alterations for listed buildings and these are set out in the Table of Impacts in Annex B. We would welcome comment on these impacts (including any specific impacts on small businesses) and would particularly welcome details of any impacts we have not identified.

86. The estimates for the financial impact appear under-estimated.

87. With regard to listed places of worship the Listed Places of Worship Grant Scheme referred to above (http://www.lpwscheme.org.uk/) seems under-funded and we are concerned that this under-funding will continue. If this is the case, listed places of worship will not be compensated for the additional VAT through the grant scheme and will therefore be at a financial disadvantage. This is likely to lead not only to deterioration in the fabric but may well make it impossible to enable even listed buildings to be upgraded to present day standards so they can be used by the community.

Implementation Issues

Q21: Other than alterations for listed buildings are there any other cases where transitional arrangements are needed?

88. Self storage – we would suggest that self storage should be taxed to the extent that the storage takes place on or after 1 October 2012.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)