



SIMPLIFYING THE VAT LAND EXEMPTION CALL FOR EVIDENCE

Issued 27 July 2021

ICAEW welcomes the opportunity to comment on the Simplifying the VAT Land Exemption call for evidence published by HMRC on 12 May 2021, a copy of which is available from this [link](#).

This response of 27 July 2021 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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KEY POINTS

1. We believe that simplification of the VAT system, as it is applied to land and property, is highly desirable. However, we recommend that the concept of VAT exemption be reviewed in its entirety, as land and property is only one aspect of the complications caused by the exemption regimes more generally.
2. There have been many reviews and consultations on specific areas of VAT. Having just left the EU, the UK is now in the best position since the introduction of VAT in 1973 to conduct a thorough review of its structure.
3. If exemptions were to be completely abolished, the difficulties encountered by HMRC and many affected businesses in having to deal with partial exemption (including adjustment schemes) would consequently be removed, although the question of the identification of business and non-business activities would remain.
4. In any event, we believe that most supplies of land and property should be subject to VAT at the standard or reduced rate. A simple method of avoiding any resultant additional stamp duty land tax costs would be to exclude stamp duty land tax from the value subject to VAT. However, one exception to this general rule should be in relation to domestic properties, which should always be zero rated, other than when being made for short term holiday lettings.
5. Whenever an option to tax is given to anything, it inevitably creates complexity and uncertainty, as there are then two possibilities for the VAT liability of what is essentially the same type of supply. We therefore recommend that no VAT options be given for anything, either options to tax or exempt, as a welcome simplification.

ANSWERS TO SPECIFIC QUESTIONS

Question 1: What is your experience of the VAT rules on land and property?

6. Many of our members have extensive experience of dealing with land and property transactions. Some examples can be seen by the comments made in response to question 2 below.

Question 2: Are there any supplies that are particularly difficult to establish the correct liability for, leading to financial and administrative burdens? Please explain.

7. A recent example raised by one of our members surrounds the exemption relating to lets for a series of sessions referred to in paragraph 5.4 of VAT Notice 742. The specific example applied to a small new company renting space from schools and subletting it to third parties. The space was used partly for sporting facilities and the business had many questions on the application of paragraph 5.4. The business did not feel comfortable reaching an opinion alone so engaged a professional adviser, who in turn had to refer to another adviser. One issue involved was in trying to decide what is meant by “a refund in unforeseen circumstances”. Given the financial circumstances of the new business, the adviser felt compelled to charge a discounted fee.
8. We understand that HMRC’s guidance in this area has evolved over many years, but even if no change in the law is deemed necessary, we would request the issue of a revised version of paragraph 5.4 to Notice 742 to improve the guidance offered.
9. It is sometimes difficult to establish whether an option to tax has been exercised, especially where the property in question has been used by a business for its trade.
10. Difficulties can be encountered when attempting to determine whether a particular supply should be treated as a use of facilities or a licence to occupy.
11. There appear to be some misconceptions as to the extent of the application of an option to tax. For example, a landlord can opt to tax its interest in a property and its tenant then incorrectly assumes that the option also applies to him.

12. Many businesses are unaware that an option to tax must be made by a purchaser before the time of purchasing a property if it is to be treated as the transfer of a going concern, in cases where the transaction includes a property where the vendor has opted to tax.
13. There is general confusion surrounding the option to tax disapplication rules that were introduced for anti-avoidance purposes. These rules often depend on intention rather than fact. An example is that an option is disapplied if there is an intention that the building is to be used as a dwelling. The option is subsequently disapplied even if the intended use is only very temporary, which seems counter-intuitive.

Question 3: Do you think that the land and property VAT rules require simplification? Please explain why.

14. The current rules are unnecessarily complex and could benefit from significant simplification.
15. The interaction between VAT and land law often confounds businesses and the courts (see for example *Royal and Sun Alliance Insurance Group plc v. Her Majesty's Commissioners of Customs and Excise* [2003] UKHL 29), particularly in areas such as surrenders, variations and reverse premiums for leases. A lot of these are terminations of an existing lease and the granting of a new lease, but VAT law makes it dependent on who has opted to tax, who is paying who and whether anyone is receiving consideration in return for the transaction.
16. Ascertaining whether an option has been exercised in the past is not always possible, as HMRC has not always kept records, or their records are not necessarily centralised. If the position is uncertain, it is left to the business to make a case that an option was or was not exercised, and the HMRC officer must then make a judgement. This is clearly unsatisfactory.

Question 4: What are your views on the options presented in the OTS report outlined above? Do you agree with their assessment?

17. We agree that simplification is appropriate, but there may be better and simpler alternatives to achieve a more streamlined and modern VAT system.
18. If all land and property transactions were subject to VAT at the standard rate, other than those relating to domestic property that should remain zero rated, many of the complexities would be removed. The zero rating should include the sale of houses that are converted into more units and houses that have been unoccupied for two years but less than ten years, as these disposals are currently exempt.
19. Any option, whether it be to tax or exempt a transaction, creates complexity and uncertainty, as there are then two possibilities for the VAT liability of what is essentially the same type of supply. Therefore, we recommend the removal of all VAT options as a welcome simplification.
20. For a recipient of a standard rated supply of land that may previously have been exempt, consideration should be given as to how that VAT incurred might be recovered. For example, a charity could be permitted to recover any VAT that it incurred on land and property transactions. In such circumstances, consideration should also be given to possible relief from the additional stamp duty land tax (and any devolved equivalent) incurred. The simplest method to achieve this would be to exclude stamp duty land tax from the value subject to VAT.

Question 5: What are the advantages and disadvantages of making all minor and short-term interests in land and property subject to VAT?

21. We agree that making all minor and short-term interests in non-domestic property subject to VAT at the standard rate would probably be simpler than the current treatment. However, as suggested in our response to question 4 above, we believe that this should not be restricted to minor and short-term interests. Making all such interests standard rated, other than in relation to domestic property, would be even more simple. In limited circumstances, such as non-business supplies by local authorities, it may be appropriate to still allow supplies to be made without the addition of VAT, but for reasons other than the land exemption.

22. There may be complications caused by limiting the standard rating to short term interests. What may initially be intended as a short-term interest could very easily turn out to become a long-term interest if the term is subsequently increased. There may be potential for VAT avoidance, such as increased input VAT recovery, by the artificial creation of multiple short-term interests rather than a long-term interest.

Question 6: How should a minor and short-term interest be defined?

23. Defining a short-term interest could be very simple, such as an agreement for occupation for under 30 days. However, this may not achieve the desired objective of taxing transactions such as meeting room hire for periods of 30 days or more.
24. A minor interest would potentially be more difficult to define, as perceptions as to what is minor may vary considerably.
25. By fundamentally changing the application of VAT to property transactions, i.e., they were not restricted to minor or short-term interests, this issue would become irrelevant.

Question 7: What are your views on the option to make supplies of land and property subject to VAT apart from certain specified exceptions?

26. We believe that most supplies of land and property should be subject to VAT at the standard rate, other than those made in relation to domestic properties. These supplies should always be zero rated, other than when being made for short term holiday lettings.
27. We understand that France operates a system which essentially states that all residential lets are exempt (which the UK could zero-rate) except if at least three hotel type services (out of four) are proposed in addition (i.e., the accommodation could then be seen as competing with the hotel sector). There are four in total being:
- Daily cleaning
 - Reception service
 - Offer of breakfast
 - Provision of household linens.

Question 8: Which particular supplies of land and property should continue to be exempt from VAT if this option were to be considered further?

28. We believe that no supplies of land and property should continue to be exempt from VAT. Any supplies that are not standard rated should be zero rated. Zero-rating should be limited to supplies relating to domestic properties.

Question 9: Are there any supplies that should be subject to VAT that are currently exempt or vice versa?

29. Supplies to charities of non-domestic property should become standard rated in common with all non-domestic land and property transactions. The additional potential cost to charities should be offset by allowing them to recover the VAT incurred in full. Additional provisions for VAT recovery should be also considered for other entities that may be impacted by a higher VAT cost. The main advantage here is that the supplier would not be affected by the nature of the customer and so should be able to determine the correct VAT liability of its supplies in isolation.

Question 10: What are your views of linking the VAT liability of interests in land to those recorded in Land Registers in England, Scotland, Wales and Northern Ireland?

30. The linking of VAT liability to Land Registry records would introduce new complications and burdens. If all non-domestic transactions were standard rated, there would be no benefit in creating the link. However, if the suggested simplifications are not made, the creation of an

electronic link between the HMRC option to tax register and the land registers should be considered.

Question 11: What are the potential advantages and disadvantages of such an approach?

31. There is a clear disadvantage in that the Land Registry would need to be consulted for all affected property transactions. This would place a possibly significant burden on Land Registry staff and create an additional burden and cost on any business involved with an affected transaction.
32. However, the creation of an online database that could be accessed by businesses to determine the VAT status of specific interests in land and property would be welcomed, but this would only be required if the option to tax continues.

Question 12: Do you have any other suggestions on how the land and property VAT rules could be simplified?

33. If the land and property exemption were to be removed, the complex regulations regarding payback and clawback applicable upon change of use would become obsolete, other than for changes from business to non-business use. The Capital Goods Scheme could also be abolished.

Question 13: Would you prefer to keep the VAT rules on land and property as they are? If so, please explain.

34. We are very much in favour of simplification. However, if only very minor changes were being considered, it may be better to leave things as they are to reduce the likelihood of any confusion and additional complications caused by insignificant changes.
35. Ideally, we would prefer significant change resulting in substantial simplification by fully removing the VAT exemptions, zero-rating all supplies of whatever nature of domestic property, other than short term holiday lettings, and ensuring full input VAT deduction by charities.
36. If the concept of exemption were to be abolished, in the VAT legislation for all sectors, businesses that currently suffer an input tax restriction due to partial exemption, such as those in the finance sector, would be able to recover any additional VAT incurred in full.

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 <https://goo.gl/x6UjJ5>).