

TAXREP 12/06

VAT: “BENEFICIAL OWNERSHIP” OF LAND AND PROPERTY

VATA 1994, SCHEDULE 10, PARA 8

Memorandum submitted in February 2006 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in December 2005 by HM Revenue and Customs

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INTRODUCTION

1. We welcome the opportunity to comment on the consultation document published on 5 December 2005 by HMRC at http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_024839
2. HMRC proposes a change to the legislation following the judgment in *Abbey National plc v Customs and Excise Comrs* [2005] EWHC 831 (Ch). This was an appeal from the Tribunal’s decision in *Abbey National plc v Customs and Excise Comrs* (2004) VAT decision 18666. The consultation document sets out the draft text of a new VATA 1994 Sch 10 para 8.
3. Statutory references are to VATA 1994 unless otherwise stated.
4. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

KEY POINT SUMMARY

5. We consider that:
 - The *Abbey National plc* case will determine many of the issues in terms of European Law. The case is under appeal in the courts, and has yet to be finally decided.
 - It is questionable whether it is useful to undertake a review at this stage, since any change to UK law will need to comply with the final judgment in *Abbey*.
 - The policy aim behind the proposals is unclear. That makes appraisal difficult.
 - A recast of Schedule 10 para 8 should address also the exemption for land in Schedule 9, Group 1 of VATA 1994, section 51A (co-owners), and the prospective legislation Schedule 10 paras 8(2) and (3).
 - A statutory definition of beneficial ownership differing from the case law applicable elsewhere in the Taxes Acts would be unhelpful.
 - The position of pure occupiers where the beneficial ownership is in a different entity needs to be clarified so that the technical mismatch is overridden.
6. As to HMRC’s stated concerns, we question that the interpretation in *Abbey* goes beyond how Parliament intended the provision to work, is inconsistent with the Sixth Directive and has opened up the potential for tax avoidance.

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COMMENTS ON ISSUES RAISED

General observations

7. The policy aim behind the proposed changes is not clearly stated. It is difficult to assess whether the draft legislation achieves its intended purpose given this ambiguity.
8. It seems inappropriate to address this part of legislation in isolation from Schedule 9, Group 1 of VATA 1994, Section 51A VATA 1994 and Schedule 10 paras 8(2) and (3).
9. A broader issue arises in relation to the UK VAT treatment of land and property. Essentially, whether the UK legislative base should be drafted in accordance with and with regard to English Land Law, or a fundamental rewrite based on a Community approach be considered. This has a bearing when it is considered that Schedule 9 Group 1 is based on English land law, and Schedule 10 para 8 is required as a consequence of that approach.
10. We would question the merit of a consultation apparently triggered by the recent High Court decision in Abbey National plc. This case has been appealed, and it would therefore seem more appropriate to await the outcome of that appeal before engaging in the current course of action.
11. The argument that the Abbey National decision may open the potential for tax avoidance as a reason for legislative change is premature. No examples have been identified as yet of such avoidance, and the VAT avoidance disclosure rules give more than adequate warning of developing avoidance arrangements.

HMRC's concerns in relation to the current drafting of para 8

12. HMRC consider that recent litigation “has found that para 8 can apply in situations where there is no separation of legal and beneficial interests” (para 1.3) and that this interpretation of paragraph 8:
 - goes beyond how Parliament intended the provision to work,
 - is inconsistent with the Sixth Directive, and
 - has opened up the potential for tax avoidance.
13. As regards the first bullet point, it is felt that at the time of enactment of para 8 the types of transaction giving rise to recent litigation (“virtual assignments”) were unknown. Therefore Parliament had not considered such circumstances as part of the process of enactment.
14. In relation to the second bullet point, the High Court clearly disagreed, holding in Abbey National that the virtual assignment met the Sixth Directive requirements for exemption under Article 13B(b). The following is a quote from the judgement: “This bundle of rights, carefully constructed so as to reflect, so far as legally possible, the effects of a legal assignment, can and in my judgment should be equated with a legal assignment for the purposes of the Sixth Directive. They reproduce the essential

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features of a letting as identified by the decisions of the ECJ to which I have referred.”.

15. Clearly the concerns expressed by HMRC are inconsistent with this, and as stated above may be better resolved in the appeal against the Abbey decision to the Court of Appeal.
16. The third bullet refers to a concern in relation to tax avoidance that is as yet unfounded. As stated above, no examples have been identified as yet of such avoidance, and the VAT avoidance disclosure rules give more than adequate warning of developing avoidance arrangements.

The proposed changes to para 8

17. The proposed Sch 10 para 8(1) and (2) introduces “the beneficial owner of the relevant interest” as a replacement for “the person to whom the benefit [of the consideration for the grant of an interest in, right over or licence to occupy land] accrues”. The new term is defined in the proposed Sch 10 para 8(3)(b).
18. We believe that the introduction of a statutory definition of beneficial ownership differing from the case law one applicable elsewhere in the Taxes Acts is unhelpful.
19. The proposed provision looks at the right to benefit immediately before grant (not subsequently) whereas the current provision looks at the benefit of consideration accruing from the grant. This introduces potential anomalies should beneficial ownership change in nature immediately following the grant.
20. It seems anomalous that if a property interest is created meeting all conditions of para 8(3)(b) bar the last – the ability to compel the legal owner to make the grant – that Sch 10 para 8 will not apply. An example would be certain forms of life interest in property. This could restrict the provision to bare nominees, and leave legal owners responsible for VAT on transactions in which they have no economic interest.
21. We also feel that the rewrite does not deal properly with “pure occupiers”. The provision needs to be wide enough to allow input tax recovery by those who occupy property as a beneficiary with a distinct legal owner, eg professional partnerships with service companies, where technically there may be a mismatch but in reality the occupation is for the purpose of the business of the partnership (as in *Bird Semple & Crawford Heron* [1986] VATTR 218 (VTD 2171) and *Lester Aldridge* LON/03/1020 (VTD 18864)).

ANSWERS TO SPECIFIC QUESTIONS POSED

- Q1. Do you consider the current drafting of paragraph 8 is not sufficiently precise and leads to uncertainty about its application?
22. We do not agree that Sch 10 para 8 is not sufficiently precise, or that it leads to uncertainty of application.

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Q2. The Government considers that the current drafting of paragraph 8 causes uncertainty for certain supplies made in the finance sector, for example some types of securitisation. Do you agree or do you have any other examples whether in or outside the finance sector?

23. The current drafting of Sch 10 para 8 does not affect the uncertainties inherent in supplies in the finance sector. The new drafting does not remove these uncertainties and, arguably, makes things worse due to the limitations on qualification for Sch 10 para 8 treatment.

24. We are aware that problems arise on the sale of income streams, which have held to be an interest in land in England and Wales (but not in Scotland).

Q3. In what circumstances do you currently apply Sch 10 para 8? For example, is it only applied in “bare trust” situations or are there other arrangements in which the provision is applied? Where you apply it in other circumstances, please provide details – a description of the contractual arrangements would be helpful.

25. We have no comment.

Q4. If the proposed changes were made, what effect would this have on your business or on the current contractual arrangements you adopt? For example, would there be any circumstances in which you could no longer apply the provision?

26. Taxpayers would almost certainly find situations arose where the provision could no longer be applied due to its narrow focus. The proposed changes will create uncertainty as new provisions.

Q5. Under European law, the provision has to be narrowly drawn. Do you consider that the proposed changes would provide greater clarity for the property sector about the circumstances in which the provisions can be applied? If you consider the proposed changes should be drafted differently than proposed, please fully explain why and include any relevant examples if possible.

27. While we agree that the exemptions in art 13 of the Sixth Directive must be narrowly construed, this is more properly addressed at the drafting of Sch 9 Group 1 – which is discussed above as a cause of the need for Sch 10 para 8. The provisions should be reviewed and amended as a whole.

PCB
28.2.06

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ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at tdtf@icaew.co.uk or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

THE 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

http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.