VAT focus

VAT on real estate: TOGCs and other hot topics

Speed read

The availability of TOGC treatment remains an important and controversial area for real estate transactions. HMRC correctly accepts that a property which is only partly let can be a TOGC. But the authorities indicate that HMRC may well be wrong to continue to assert that TOGC treatment is unavailable on an indirect transfer or sub-sale. Similarly, HMRC's view that TOGC treatment is only available for a development site where physical works have started may be contrary to EU Law. Barter transactions raise difficult questions of characterisation and it is suggested that this should normally follow the economic realities rather than turning on quirks of domestic property law.

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The purpose of this article is to highlight some areas of topical interest for VAT and real estate. Probably the most significant current development in tax is HMRC's use of its Connect computer system to target groups of taxpayers and kinds of transactions. It has never been more important to get the technical analysis of transactions correct.

Transfers of going concerns

One area targeted recently by HMRC is the availability of transfer of a going concern (TOGC) treatment. Where this is available, there are both cashflow benefits and an absolute SDLT saving available to taxpayers. With SDLT chargeable at 5%, the SDLT saving can be considerable if a sale of land over which the option to tax has been exercised can be structured as a TOGC, e.g. £500,000 on a £50m transaction.

The availability of TOGC treatment on the sale of opted property has long been the source of some controversy. As a starting point, it might be viewed as generous that a single let investment property qualifies as part of a business, especially where only a small part of that property is let. Nevertheless, this is both well established and accepted by HMRC. The technical point here is that the issue is not the usual fundamental question for VAT, namely 'what is the nature of the supply?'. Rather, for TOGCs, two questions need to be asked:

First, is the taxpayer carrying on a business? This is a wide test because what is a business for EU Law purposes essentially means 'economic activity' and includes an intending trader (see *Rompelman v Minister van Financiën* (Case C-268/83)).

Second, is the relevant asset (in this case, land) part of that business? The upshot is that a building that is only partially let can qualify as a TOGC (see, for example, *Robinson Family Ltd* [2012] UKFTT 360 (TC)).

HMRC takes a less than generous position in other situations. For instance, is TOGC treatment available on a sub-sale or other indirect transfer of land? The orthodox answer is 'no' (see HMRC's view in *VAT Notice 700/9* and *VAT Transfer of a Going Concern Manual* at VTOGC4350). That view is supported by the decision in *Kwik Save Group Plc* (1994) VAT Decision 12749, where the VAT tribunal found that TOGC treatment was unavailable when Kwik Save purchased opted properties and sold them on immediately to a subsidiary.

Consider, however, the more recent decisions in *MPH Leisure Ltd* (2006) VAT Decision 19778 and *Sam's Bistro Ltd* (2007) VAT Decision 19973. Both of these cases had similar facts: a business was sold to a purchaser who acted as landlord and granted a lease to a new operator. Both cases concerned compulsory registration, and it was HMRC which successfully argued, contrary to *Kwik Save*, that there was a TOGC from the vendor to the new operator who took possession of a business as a going concern with no break in trading. In *Sam's Bistro*, the taxpayer unsuccessfully tried to rely on HMRC's guidance and *Kwik Save*. HMRC argued that a different legal test is in play where compulsory registration is the issue. This was accepted by the tribunal.

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Accordingly, there may be a good argument that the TOGC treatment should be available on sub-sales and indirect transfers. There is no basis for a different test being applied where TOGC treatment is sought for compulsory registration. HMRC's attempted explanation of *Sam's Bistro* (at VTOGC4350) that Scottish law is different is unpersuasive because a TOGC is an EU law concept, so its application should not depend upon quirks of national property law.

HMRC also continues to take a narrow view on TOGCs in relation to development sites. *The Golden Oak Partnership* (1992) VAT Decision 7212 (unreported) and *Gulf Trading* (2000) VAT Decision 16847 (unreported) are authorities for the proposition that a site must be in active physical development to qualify for TOGC treatment. HMRC continues to take this line. However, as HMRC recognises, this does not sit entirely comfortably with either *Rompelman* or *Dartford Borough Council* (2007) VAT Decision 20423. In the latter case, a TOGC was established for a development site on the basis that planning had been obtained, a pre-let with a supermarket entered into and some minor preparatory works carried out (see VTOGC6050). The purported requirement for active development to have taken place before a development site can qualify as a TOGC may very well be too restrictive and not a correct statement of the law.

The most significant case concerning property TOGCs in recent years is *Royal College of Paediatrics* [2015] STC 1243. In the substantive part of that appeal, HMRC successfully denied TOGC treatment on the basis that the relevant lettings business involved an agreement for lease being entered into by the seller with a tenant introduced by the purchaser. Critically, the grant of the lease was dependent upon the purchaser giving notice to complete and was only granted after the purchaser had acquired the property. Birss J denied TOGC treatment on the basis that the seller never really carried on a lettings business. Two positive points for taxpayers come from the decision. One is the statement by Birss J that: 'In a normal case of the transfer of a freehold, no doubt it is enough for the extra element [necessary to produce a TOGC] to be a transfer of a lease to a tenant or even an agreement with a putative tenant to do so'. This is duly followed in HMRC's guidance. The other is that HMRC did not argue that the arrangement fell foul of the abuse of rights doctrine, despite the fact that VAT planning had apparently been carried out.

However, it is also interesting to observe that HMRC's successful argument in *Royal College of Paediatrics* essentially depended upon a realistic view of the facts being taken. Although the need to view the facts realistically has been emphasised in recent years for direct taxes, it is just as applicable for VAT. A related point is that a favourite, and perhaps the favourite, line of HMRC attack is to challenge the implementation of any arrangement. These kinds of challenges also succeeded in relation to VAT in *Faskally Care Home Ltd* [2016] UKFTT 379 (TC) and *Lady Margaret Hall* [2014] UKFTT 1092 (TC). Further scrutiny of TOGCs, and indeed all other transactions, on this basis should be expected.

Finally on TOGCs, an ongoing area of contention is the extent to which the purchaser needs to use the assets to carry on the same kind of business as the transferee. UK law, through article 5 of the VAT (Special Provisions) Order, SI 1995/1268, provides that the assets must be used by the transferee to carry on the same kind of business as the transferor. However, that is not conclusive because in *Zita Modes Sarl* (Case C-497/01) the CJEU stated that the relevant transfer is one where the transferee intends to operate the business and not simply to liquidate the business or sell the stock. The CJEU also made clear that the application of the 'no supply rule' is a concept of EU law, and it can only be limited to the extent permitted by the Directive, namely to prevent either the distortion of competition or avoidance or evasion. Nevertheless, the Upper Tribunal in *Intelligent Managed Services Ltd v HMRC* [2016] UKUT 341 (TC) indicated that the UK requirement that the transferee carries on the same kind of business is consistent with EU law. This was followed recently in *General Distribution and Storage Ltd v HMRC* [2019] UKFTT 559 (TC). (Interestingly, in *General Distribution and Storage Ltd*, the TOGC treatment was denied for successive onward sales of an investment property, but the *Kwiksave* issue (outlined above) is not recorded as having been addressed and the taxpayer did not attempt to argue that there was an indirect TOGC by virtue of *Sam's Bistro*.)

Barter arrangements

Barter transactions are extremely important to the real estate industry. A commonplace example is where a developer acquires land in return for carrying out works and providing the vendor with a new building or unit. The fact that supplies will be made for VAT purposes, even though no cash may be passed between the parties, should not be overlooked. In the 2019 case of *A Oy* (Case C-410/17), the CJEU took a wide view of where a barter transaction exists. In that case, the attribution of a value to scrap metal obtained in the course of demolition and the resultant price reduction constituted a barter arrangement.

Where a barter is identified (and indeed lest one is overlooked), VAT gross up clauses should cover barter transactions. The value attributed to the supply in a barter transaction is the monetary equivalent placed on the transaction by the parties (see *Naturally Yours Cosmetics* [1988] STC 879).

The most challenging aspect of barter transactions is how these are characterised for both VAT and other taxes, which are not consistent. In *Sargaison v Roberts* (1969) 45 TC 612, the great property lawyer, Megarry J, held that, in a sale and leaseback situation, the CGT consequences should be determined by the economic realities, not the technicalities of English property law; in other words, what mattered was the end result. This approach notably pre-dated *Ramsay* by a decade, and it would seem to be consistent with EU tax law where the consequences should not be determined by the technicalities of national property law. An approach based on *Sargaison*, for the purposes of determining VAT on a sale and leaseback transaction, was rejected in *Balhousie Holdings Ltd* [2017] STC 2359. However, *Balhousie* is inconsistent with the later CJEU judgment in *Mydibel* [2019] STC 1342, which treats a sale and leaseback as a single transaction. It is questionable that HMRC's view that the VAT treatment of a surrender and regrant transaction differs depending on whether this is done expressly or takes place by operation of law (see HMRC's *VAT Land and Property Manual* at VATLP27000).

Domestic reverse charge

Finally, a quick comment on the postponement of the domestic reverse charge. The now much quoted survey by the Federation of Master Builders said that 69% of its members had not heard of the new measure and of those who had 67% were not ready to deal with it three months before it was due to take effect. This lack of response has a hint of civil disobedience: faced with yet more complexity, an industry sector apparently largely chose to ignore the announced change. Moreover, the tactic succeeded, at least in postponing the change. HMRC suddenly changed its position from saying that the change was definitely going ahead to postponing it. Whilst the postponement might have been welcomed by many, the minority who did take the action now find themselves having incurred unnecessary expenditure or at least having incurred costs needlessly early. There is an important credibility issue here for HMRC. Tax is a unique area of the law which is often effectively changed by press release. That system relies upon HMRC being trusted to deliver the announced changes. The rule of law requires that laws should be prospective, open and clear, so that citizens can order their affairs appropriately. Having a government agency announcing and withdrawing or postponing at short notice changes causes confusion and uncertainty. It is to be hoped that this kind of situation will not be repeated. ■