FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 29
XA39/20
XA94/20

Lord President
Lord Menzies
Lord Doherty

OPINION OF LORD CARLOWAY,
the LORD PRESIDENT

in the Appeals under section 13 of the Tribunals, Courts and Enforcement Act 2007

by

DAVID MOULSDALE, trading as MOULSDALE PROPERTIES

Appellant

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellant: Simpson QC; Harper Macleod LLP
Respondents: DM Thomson QC, RG Anderson; Office of the Advocate General

20 May 2021

[1] I am grateful to Lord Doherty for setting out the facts, issues and submissions in this appeal. Ultimately, I consider that the Upper Tribunal correctly refused the appeal from the First-tier Tribunal and that therefore these appeals ought also to be refused.

[2] A central principle of Value Added Tax is that the incidence of tax should rest primarily with the final consumer in the supply chain. In May 2001 the appellant bought land, on which a block of offices had been built, from a developer. The land was in Cumbernauld and the price was £1,140,000 plus VAT of £199,500. In September 2001, the appellant leased the offices to Optical Express; a company with which he was connected. He opted to tax the land (Value Added Tax Act 1994 Sch 10 part I). It is a reasonable assumption that he did so with the intention of setting off the output tax, which he had paid to the developer, against the input tax, which he would receive on any rent and which, but for the offsetting, he would have to pay to the respondents.

[3] The effect of opting to tax would normally be that any grant of an interest in the land, such as the sale of the offices, would be liable to VAT (ie what would otherwise be an exempt supply would become taxable). However, in certain circumstances, the statutory provisions reverse that position by deeming the supply to be, once again, exempt.

[4] The services supplied by Optical Express are exempt from VAT. Optical Express would not be able to pass on any VAT which was charged on the rent to the consumers of optical services. This, in turn, would mean, in effect, that the VAT paid by the appellant at the start of the chain would not be passed on to the consumers either. In 2007, the respondents advised the appellant that he ought not to have been charging VAT to Optical Express since the rent was exempt. Although the appellant would thus be able to reclaim the VAT on the rent, which had been paid by Optical Express and for which he had accounted to the respondents, the practical effect was that he could not offset these payments against the VAT which he had paid on the purchase of the offices in the first place.

[5] In September 2014, the appellant sold the offices in an arm's length transaction to a third party company, subject to the continuing occupation of Optical Express under the

lease. The third party was not VAT registered. The appellant did not charge VAT on the sale. The question is whether he was correct not to do so.

[6] Since the default position is that the sale of land, on which an option to tax has been made, is subject to VAT, avoiding payment of that VAT can only be achieved if the appellant were able to bring himself within a statutory exception. He attempts to do so by relying on the provisions in Schedule 10 to the 1994 Act. These are described, in a general heading to paragraphs 12 to 17, as "Anti-avoidance" measures. The use of anti-avoidance measures to avoid accounting for tax is a curious, if not anomalous, situation indeed. It is one which, for the following reasons, is not a sound one.

[7] The anti-avoidance provisions are intended "to prevent an option to tax rendering supplies taxable where certain conditions are met" (*PGPH* v *Revenue and Customs Commissioners* [2017] UKFTT 782 (TC), Judge Falk at para 6). In the case of land, this is to prevent, for example, the opportunity to deduct input tax when a further supply of the land is made, but the supplier continues to occupy the land for exempt purposes. Thus, the price and rent in a sale/lease and leaseback arrangement involving a connected tenant (Corporation Tax Act 2010, s 1122), whose supplies were exempt, would not be taxable. This maintains the principle of VAT being levied on the final consumer.

[8] Against the background of the Capital Goods Scheme (VAT Regulations 1995 Part XV), which normally enables the VAT-bearing purchaser of land to offset the VAT on the price against that on the incoming rent over a specified period of years (reg 114), the anti-avoidance provisions cease to have a purpose once that period expires. The option to tax would then continue to operate.

[9] So far as relevant to the facts, paragraph 12 (which is headed "Developers of exempt land") of Schedule 10 provides that a supply is not taxable, as a result of an option to tax, if

two conditions are met. The first is that the grant giving rise to the supply is made by a developer. The second is that the "exempt land test" is fulfilled. In relation to the first, "developer" does not have an ordinary meaning. In terms of paragraph 13, a grant is made by a developer if, again, two conditions are met. The first is that the land is, or was intended or expected to be, a "relevant capital item". The second is that the grant is made at an eligible time in relation to that capital item. The question of time will be considered in due course, although it was not a matter of significance in the arguments presented to the FtT or the UT, nor did it feature in their decisions or in the submissions to this court.

[10] The exempt land test is met if the seller of the land "intended or expected" that it would become exempt land (para 12(2)(a)). In terms of paragraph 13 ("Meaning of grants made by a developer"), a supply is made by a developer (para 13 (2)(a)) "if the land is, or was intended or expected to be, a relevant capital item". Land is intended or expected to be a relevant capital item if the grantor "intended or expected" *inter alia* that it "would become a capital item in relation to the grantor or any … transferee" (para 13(4)). It was accepted before the FtT and the UT that, because the adjustment period in the Capital Goods Scheme had expired, the land was not a capital item in relation to the appellant. The question before the FtT and the UT was whether the appellant intended or expected that it would become a capital item in relation to the purchaser (the transferee).

[11] Before the FtT and the UT it was accepted that there was an inherent circularity in the application of the provisions. If the tax opted land was no longer in the Capital Goods Scheme, it would not be a capital item for the appellant. It would be such an item in the hands of the purchaser if the statutory conditions were met and the land reverted to being exempt. In that event, the supply would return to being taxable as the exemption would have been disapplied.

[12] All of this boiled down, before the FtT (para 31), to a fundamental question of whether the appellant intended or expected (that matter being subjective) the land to become a capital item in the hands of the purchaser at the time of the grant. The FtT considered that "capital item" was defined in Regulation 113 as an item on which the owner incurred VAT bearing capital expenditure. The prudent taxpayer who had opted to tax would first assume that tax would be due on the sale but would then check to see if it fell into one of the exemptions. The FtT considered that the appellant had carried out this exercise and had realised that Optical Express' occupation meant that the land was exempt. The purchasers would only incur VAT if they were charged VAT, which they had not been.

[13] The FtT held that:

> "43. As a matter of fact... at the date of the grant the appellant knew that the supply would not be, and could not be, taxable. … [G]iven the terms of Regulation 113(1)…, and knowing that no other relevant expenditure was likely, the appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser".

The option to tax was therefore not dis-applied as the appellant could not have intended the property to become a capital item in the hands of the purchaser. Put another way, if the appellant had intended that the item would become a capital item, it would be exempt.

[14] The UT considered that the FtT had correctly identified the question as being whether the land was intended or expected to be a relevant capital item in terms of paragraph 13(2). The UT's function was to deal with issues of law. The UT held that the FtT's findings were supported by the agreed facts and their conclusion was one which they had been entitled to reach. Their decision was therefore not wrong in law. As the appellant had opted to tax the property, any grant of that property would be taxable, unless it fell within an exception (ie the taxable option became dis-applied). As the property was no

longer a capital item for the appellant, it could only fall within an exception if it were to be a capital item in the hands of the purchasers.

[15] The appellant had led no evidence on the central issue. Given that the buyers were not VAT registered and the appellant knew that the supply would not be taxable, as he did not charge any VAT, he could not have intended or expected that the property would become a capital item in the hands of the purchaser. The UT determined that, on these facts, the only expenditure which could make the property a capital item was when it was bought. The UT observed that there was no evidence that the appellant had any intention or expectation that the property would become a capital item in the hands of the purchaser. The requirements for an exception could not be met where the appellant knew that the invoice which was to be issued would treat the sale as exempt. In reaching that view, they rejected a submission that the FtT ought to have taken into account the contents of a letter from the Optical Express Group's secretary, namely Graeme Murdoch, which said that the land was expected to be a Capital Goods Scheme item in the hands of the purchaser. The letter had not been founded upon as evidence before the FtT and, in any event, little weight could be attached to it.

[16] For the anti-avoidance provisions to apply, the appellant required to demonstrate that the option to tax had been dis-applied because, as a matter of fact, he intended or expected the land to be a capital item in the hands of the purchaser. The problem for the appellant is that he did not lead any evidence of his subjective expectation or intention in relation to the status of the land as a capital item in the hands of the purchasers. Although Mr Murdoch's affidavit made a passing reference to his letter of 22 December 2016, this letter was a request for a review of the respondents' decision. It sets out Mr Murdoch's understanding of the position and included a short sentence: "The property was expected to

be a Capital Goods Scheme item for the purchaser" together with a later explanation as to why, as a matter of law, that might be so. No adequate basis for this assertion, in the context of a non-VAT registered purchaser, was set out in the letter or in the form of any other information before the FtT. Even if the FtT could be legitimately criticised for assuming that the appellant's expectation or intention involved a consideration by him of the legislative provisions, the absence of any form of evidence on the critical point remains. This is what the UT identified and why the appeal was refused as not raising a point of law. There is no ground upon which this court would be justified in reversing the decisions of the two specialist tribunals on what was ultimately a matter of fact. On this basis, the appeals must be refused.

[17] It is worth observing, although the matter was not argued, that the alleged circularity may be avoided and the same result reached if regard was had, when determining whether the grant was made by a developer, to the provisions in relation to time. The second condition for determining this is that the grant must be made at an eligible time in relation to the capital item (para 13(2)(b)). The time limit is the end of the period "provided in the relevant regulations for the making of adjustments relating to the deduction of input tax as respects the capital item" (para 13(6)). For the purposes of paragraph 13, a "capital item" is "an asset falling … to be treated as a capital item for the purposes of the relevant regulations" (para 13(8)); being the regulations for "adjustments relating to the deduction of input tax to be made as respects that item" (para 13(9)).

[18] Put shortly, the anti-avoidance provisions apply to capital items during an intended, expected or actual adjustment period. Although regulation 112(2) of the Value Added Tax Regulations 1995 may assist in defining a capital item generally, regulation 113 does not. It is merely describing the types of item which will be considered to be part of the Capital

Goods Scheme. That has no relevance to the present situation. On this basis also, the present appeals ought to fail. The time limit is the end of the period "provided in the relevant regulations for the making of adjustments relating to the deduction of input tax as respects the capital item". That period had long since passed before the sale of the land to the third party.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 29
XA39/20
XA94/20

Lord President
Lord Menzies
Lord Doherty

OPINION OF LORD MENZIES

in the Appeals under section 13 of the Tribunals, Courts and Enforcement Act 2007

by

DAVID MOULSDALE, trading as MOULSDALE PROPERTIES

Appellant

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellant: Simpson QC; Harper Macleod LLP
Respondents: DM Thomson QC, RG Anderson; Office of the Advocate General

20 May 2021

[19] I too am grateful to Lord Doherty for his helpful summary of the facts and submissions in this appeal. I agree with your Lordship in the chair that the appeal should be refused.

[20] Senior Counsel for the respondents submitted to this court that there was a short answer and a longer answer to the question of how this appeal should be disposed of. The

short answer, he submitted, was that the appeal should be refused on the basis of the findings in fact of the FtT. The appellant had simply failed to prove that at the time of the grant he intended or expected that the property would become a capital item in relation to the transferee. The longer answer was that, on a proper construction of the anti-avoidance provisions in Schedule 10 to the Value Added Tax Act 1994, this transaction was not caught because the price paid by the purchaser was not a relevant capital item, and VAT was accordingly due by the appellant on the purchase price.

[21] I am persuaded that the short answer is correct. I agree with paragraph 16 of your Lordship in the chair's opinion. In order to succeed, the appellant had to satisfy the FtT in terms of Schedule 10 paragraph 13(4) that he intended or expected that the land would become a capital item in the hands of the purchaser. This involved a subjective test (see Judge Falk's remarks in *PGPH Ltd* v *Revenue and Customs Commissioners* [2017] UKFIT 782 (TC), referred to by the FtT), and the onus of establishing it rested with the appellant. The appellant had to show that he had an intention or expectation at the date of the grant. This was a matter of fact. He did not lead any evidence about it. The FtT is a specialist tribunal. In the absence of any evidence from the appellant on this critical issue, I consider that the FtT was entitled to make the finding in fact which it did at paragraph 43 of its decision. I also consider that the observations of the UT at paragraph 26 of its decision are correct – the function of the UT (and indeed of this court) is to deal with issues of law, and generally not to revisit findings in fact. On the basis of the evidence before it, the FtT was entitled to make the finding in fact which it made at paragraph 43 of its decision. The absence of any evidence on behalf of the appellant on this critical point is central to the issue, and standing this absence I do not consider that either the FtT or the UT can be criticised for refusing the appeal.

[22] The short answer is in my view the complete answer. In light of it, I see no need to consider the proper construction of the anti-avoidance provisions of the legislation, which are unnecessarily convoluted, and about which I prefer to express no view. For the reasons given above I would refuse this appeal.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 29
XA39/20
XA94/20

Lord President
Lord Menzies
Lord Doherty

OPINION OF LORD DOHERTY

in the Appeals under section 13 of the Tribunals, Courts and Enforcement Act 2007

by

DAVID MOULSDALE, trading as MOULSDALE PROPERTIES

Appellant

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellant: Simpson QC; Harper Macleod LLP
Respondents: DM Thomson QC, RG Anderson; Office of the Advocate General

20 May 2021

Introduction

[23] On about 3 May 2001 the appellant purchased commercial office premises at 5 Deerdykes Road, Westfield, Cumbernauld. In September 2001 he let the property to a company with which he was connected, Optical Express (Westfield) Limited ("Optical Express"). On 9 May 2001 he exercised an option to tax in respect of the property in terms of the Value Added Tax Act 1994 ("VATA"), Schedule 10, paragraph 2. On or around

2 September 2014 he sold the property to Cumbernauld SPV Limited ("Cumbernauld"). The property remained subject to the lease to Optical Express. The sale was an arm's length one - neither the appellant nor Optical Express were connected to Cumbernauld. The purchase price was £1,149,374.35. In the documentation relating to the sale no part of that price was attributed to VAT. The property became part of Cumbernauld's property leasing business.

[24] In terms of VATA, Schedule 9, Group 1, item 1, supplies of land and buildings are exempt supplies. However, the owner of land or buildings can opt to VAT in respect of a particular property (VATA, Schedule 10, Part 1). Where the owner has opted to VAT, generally a supply by him of the relevant property is not an exempt supply (VATA, Schedule 10, paragraph 2(1) and (2)). Schedule 10, paragraph 12(1) provides that a supply is not, as a result of an option to tax, a taxable supply, if (a) the grant giving rise to the supply was made by a person ("the grantor") who was a developer of the land (the "grant by a developer condition") and (b) the exempt land test is met. Schedule 10, paragraph 13 provides:

> "….
>
> (2) A grant made by any person ("the grantor") in relation to any land is made by a developer of the land if –
>
> > (a) the land is, or was intended or expected to be, a relevant capital item (see sub-paragraphs (3) to (5)), and
> > (b) the grant is made at an eligible time as respects that capital item (see sub-paragraph (6)).
>
> (3) The land is a relevant capital item if—
>
> > (a) the land, or
> > (b) the building or part of a building on the land,
>
> is a capital item in relation to the grantor.
>
> (4) The land was intended or expected to be a relevant capital item if the grantor, or a development financier, intended or expected that—

(a) the land, or
(b) a building or part of a building on, or to be constructed on, the land,

would become a capital item in relation to the grantor or any relevant transferee.

(5) A person is a relevant transferee if the person is someone to whom the land, building or part of a building was to be transferred—

(a) in the course of a supply, or
(b) in the course of a transfer of a business or part of a business as a going concern.

(6) A grant is made at an eligible time as respects a capital item if it is made before the end of the period provided in the relevant regulations for the making of adjustments relating to the deduction of input tax as respects the capital item.

…

(8) In this paragraph a "capital item", in relation to any person, means an asset falling, in relation to the person, to be treated as a capital item for the purposes of the relevant regulations.

(9) In this paragraph "the relevant regulations", as respects any item, means regulations under section 26(3) and (4) providing for adjustments relating to the deduction of input tax to be made as respects that item."

The "relevant regulations" are the Value Added Tax Regulations 1995 (SI 1995 No. 2518)

("VATR"). Regulations 112 and 113 provide:

"**Interpretation of Part XV**

112.

…

(2) Any reference in this Part to a capital item shall be construed as a reference to a capital item to which this Part applies by virtue of regulation 113, being an item which a person who has or acquires an interest in the item in question (hereinafter referred to as "the owner") uses in the course or furtherance of a business carried on by him, and for the purposes of that business, otherwise than solely for the purpose of selling the item.

…

Capital items to which this Part applies

113.

(1) The capital items to which this Part applies are any of the items specified in paragraph (2) on or in relation to which the owner incurs VAT bearing capital expenditure of a type specified in paragraph (3), the value of which is not less than that specified in paragraph (4).

(2) The items are—

(a) land;
(b) a building or part of a building;
(c) a civil engineering work or part of a civil engineering work;
(d) a computer or an item of computer equipment
(e) an aircraft;
(f) a ship, boat or other vessel.

(3) The expenditure—

(a) in the case of an item falling within paragraph (2)(a) or (d), is the expenditure relating to its acquisition;
(b) in the case of an item falling within paragraph (2)(b), (c), (e) or (f), is the expenditure relating to its—
(i) acquisition,
(ii) construction (including where appropriate manufacture),
(iii) refurbishment,
(iv) fitting out,
(v) alteration, or
(vi) extension (including the construction of an annex).

(4) The value for the purposes of paragraph (3) is—

(a) not less than £250,000 where the item falls within paragraph (2)(a), (b) or (c);
(b) not less than £50,000 where the item falls within paragraph (2)(d), (e) or (f)."

[25] The appellant did not account to the respondents for VAT output tax on the supply to Cumbernauld. On 25 November 2016 the respondents issued him with a decision notice and notice of assessment that VAT of £191,562 was due in respect of the supply and that his VAT return of 09/14 had been underdeclared in that amount. The assessment treated the purchase price of £1,149,374.35 as a VAT inclusive figure (*viz*. an output of £957,812.35 and

VAT of £191,562). On 7 December 2016 the respondents issued a confirmation notice of assessment confirming that VAT of £191,562 was due together with a further sum of £11,491.10 by way of default interest. On 22 December 2016 the appellant sought a review of the decision. The letter seeking a review was written by Graeme Murdoch, the appellant's financial controller. The letter stated, *inter alia*: "The property was expected to be a Capital Goods Scheme item for the purchaser." The respondents issued the review decision on 16 March 2017. It upheld the decision notice. The appellant appealed to the First-tier Tribunal (Tax Chamber) ("the FtT"), who dismissed the appeal. He appealed to the Upper Tribunal (Tax and Chancery Chamber) ("the UT") who dismissed the appeal on 12 March 2020. On 4 June 2020 the UT also ordered the appellant to pay the respondents £12,524.00 in respect of the expenses of the appeal to the UT. The appellant now appeals to this court against both of the UT's decisions.

[26] The appellant maintains that the UT erred in law in holding that the supply to Cumbernauld was taxable. It is common ground that the appellant was the "grantor" in respect of that supply (VATA, Schedule 10, paragraph 13(2)), but that at the time of the grant the property was not a capital item in relation to him because more than 10 years had elapsed since he purchased it (Schedule 10, paragraph 13(3), (6) and VATR, reg 114(3)). It is agreed that Cumbernauld was a "relevant transferee" because the property was to be transferred to it in the course of the supply (VATA, Schedule 10, paragraphs 13(4) and 13(5)(a)). It is also agreed that the exempt land test is met. The issue is whether the grant by a developer condition was met. In the present case that turns on whether the appellant intended or expected that the property would become a capital item in relation to Cumbernauld (VATA, Schedule 10, paragraph 13(4)). If he did, then it is accepted that the grant would have been made at an eligible time as respects that capital item.

[27] The parties are agreed that if the appellant succeeds in the main appeal he should also succeed in the expenses appeal; but that if he loses the main appeal he should also lose the expenses appeal.

The FtT's decision

[28] The FtT held (paragraphs 33 - 34) that it was the appellant's subjective intention or expectation at the time of the supply to Cumbernauld which was critical. It reasoned (paragraph 36) that Cumbernauld would only incur "VAT bearing capital expenditure" in terms of regulation 113(1) of VATR if VAT was charged on the expenditure incurred acquiring the property.

[29] Before the FtT the appellant and the respondents each proceeded on the basis that, read literally, paragraph 13(4) was circular where the subject of the supply is no longer a capital item for the grantor but will be a capital item for the transferee if it is intended or expected that VAT would be charged on the capital expenditure incurred on acquisition. The FtT described the circularity at paragraph 4 of its decision:

> "4. …(T)he circularity can arise where a taxpayer wishes to sell an opted building, or land, but at the point of sale the building or land is not a capital item in the Capital Goods Scheme ("CGS") for the seller. However, if the sale price exceeds £250,000 and is subject to VAT because of the option to tax, it has the potential to become a capital item in the hands of the purchaser and that is relevant in terms of the legislation. In circumstances such as where the "exempt land test" … is met the seller's option to tax is potentially disapplied rendering the supply exempt. However, that can result in circularity since, if the supply is no longer taxable … a capital item in the CGS would not be created and therefore the supply then becomes taxable."

The circularity issue is also discussed in *Scammell, VAT on Construction, Land and Property,* paragraph H16.4.4. Both parties agreed that paragraph 13(4) required to be construed so as to avoid circularity. Counsel for the appellant's submission was that the answer was for the appellant's intention or expectation to be assessed ignoring any disapplication which

paragraphs 12-17 might effect. Counsel for the respondents resisted that solution. He maintained that the way forward was to construe paragraph 13(4) in the way set out in "VATLP23500 Option To Tax, Anti-Avoidance Test: How does the anti-avoidance test work in practice" at Example 5, *viz*.:

> "To avoid circularity the CGS [Capital Goods Scheme] item created by the transfer (and under the grant subject to the anti-avoidance test) is ignored for the purposes of deciding whether the grantor's option is disapplied. As a result the sale of the property is a taxable supply".

[30] The only discussion by the FtT of the respondents' suggested construction comes in paragraph 20:

> "20. Two points arise out of that. Firstly, that is simply HMRC's interpretation of the position and, secondly, and more pertinently for this appeal, *Scammell* points out that that and the following example were only added in 2017 which is some years after the transaction with which we are concerned."

However, it is implicit in the FtT's reasoning that it rejected the respondents' construction. If the supply to Cumbernauld could never have qualified as a grant by a developer then there would have been no need for the FtT to ascertain the appellant's intention or expectation at the time of the grant.

[31] It is also clear that the FtT rejected counsel for the appellant's construction (paragraphs 41 and 42); and that in identifying the appellant's intention or expectation at the time of the grant it concluded that the appellant would have known that the supply would be exempt because paragraphs 12-17 would disapply the option to tax.

[32] Paragraphs 24 - 43 of the FtT's decision are headed "*The approach to the legislation based on the facts in this case*". At paragraph 27 the FtT adopted the analysis of the statutory provisions set out by Judge Falk (as she then was) in *PGPH Limited* v *Revenue and Customs*

Commissioners [2017] UKFTT 782 (TC), [2018] SFTD 546, at paragraphs 8 to 10. However, the crux of the FtT's approach is contained in paragraph 28 of its decision:

> "28. Taking matters linearly and chronologically, a prudent taxpayer who had opted to tax, would first assume that tax would be levied on any supply of the land but would then have to check if the supply fell into one of the restricted categories"

The FtT continued:

> "33. Returning to paragraph 13(4) the issue therefore is whether or not the appellant could have intended or expected that the property would become a capital item in the purchaser's hands. We agree, again, with Judge Falk in *PGPH* at paragraphs 116 to 118 where she states:
>
> > '116. It is clear that the references to intention or expectation in paragraphs 13(2) and (4) of Schedule 10 impose a subjective test. For the test to be satisfied the relevant person… must have had an intention or expectation at the date of the grant…
> >
> > 117. It is not the case that the capital item must exist at the date of the grant….
> >
> > 118. There is no indication …that Parliament only intended the rules to apply if the land did become a capital item…'
>
> In summary, it is a subjective test, as to what would be a genuine or real, not a hypothetical, intention or expectation as at the time of the grant.
>
> …
>
> 36. The phrase 'VAT bearing capital expenditure' is defined at Regulation 115(3) as being capital expenditure at the standard or reduced rate. The purchaser would only incur VAT if VAT was charged on the supply of the property. Therein lies the problem.
>
> 37. The appellant correctly, and conscious of its obligations in terms of VATA, considered the relevant taxing provisions. The starting point is that having opted to tax, the supply should bear tax. However, it can only do so if the option to tax is not disapplied. That is the relevance of the provisions of Schedule 10.
>
> …
>
> 40. Mr Simpson argues that in order to avoid circularity, having decided that the transaction was 'caught' by Schedule 10, the process should stop at that point.

41. As we indicate at paragraph 16 above, we find that although labelled 'anti-avoidance' the purpose of Schedule 10 is not limited to that and the purpose is rather to limit the circumstances where the option to tax can be used. Accordingly, we do not accept the ingenious argument advanced by Mr Simpson that when looking at anti-avoidance in the context of a taxpayer's intentions one must assess the position before the anti-avoidance provisions come into play…

42. We have some difficulty with his proposition that the process comes to a halt once it is established that the transaction is exempt in that that would mean that in cases where the sale price of the land and buildings was over £250,000 and the relevant person occupying it met the 'exempt land test' there would be no charge to tax. Although the purpose of the legislation is to limit the circumstances in which the option to tax can be deployed it is also aimed at anti-avoidance and to implement that approach would be to encourage the avoidance of tax.

43. As a matter of fact, we find that at the date of the grant the appellant knew that the supply would not be, and could not be, taxable. Accordingly, given the terms of Regulation 113(1) of the VAT Regulations …, and knowing that no other relevant expenditure was likely, the appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser.

Decision.

44. We observe that the general tenor of European VAT law is to make more supplies taxable and minimise exemptions. The unfortunate drafting of these legislative provisions can achieve the opposite result rendering a normal commercial transaction, where there is an option to tax, exempt. The circularity is to be deplored. However, in this case, we find that the disapplication provisions are not engaged and we must therefore dismiss the appeal for the reasons given."

The UT's decisions

[33] Before the UT counsel for the appellant submitted that the FtT had been wrong to reject the submission that the consequences of schedule 10, paragraphs 12-17 being applicable had to be left out of account when examining whether a grantor intended or expected that the transferee would incur VAT bearing capital expenditure. He also submitted that the letter of 22 December 2016 from Mr Murdoch stated that at the time of the grant the property had been expected to be a Capital Goods Scheme item for the purchaser. Rather than proceed on the basis of that evidence the FtT had reasoned that the appellant

should be taken to have known that paragraphs 12-17 would disapply the option to tax; and therefore that Cumbernauld's acquisition cost would not be VAT bearing capital expenditure and the property would not become a capital item in the hands of Cumbernauld. Counsel for the respondents renewed the submission he had made to the FtT that the approach to adopt to avoid circularity is that the reference to the creation of a capital item in relation to the transferee must be a reference to a capital item other than the one which would arise on the grant. He submitted that the disapplication of the option to tax provisions is intended to prevent the inappropriate recovery of input tax (*Principal and Fellows of Newnham College in the University of Cambridge* v *Revenue and Customs Commissioners* [2006] EWCA Civ 285, [2006] STC 1010, Chadwick LJ at paragraph 29). It was not appropriate to look at Mr Murdoch's letter. While it had been in the Joint Bundle, it had not been an agreed document and no evidence in relation to it had been adduced.

[34] Like the FtT, the UT rejected the appellant's suggested construction. It said nothing about the respondents' proposed construction, but once again it seems implicit that it did not accept it. It held (paragraph 29) that the intention or expectation of the grantor was to be determined at the date of the grant, and that on the evidence before it the FtT was entitled to find "that the Appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser" (paragraph 38). It continued:

> "39. … On the facts of this appeal, the only expenditure that could make the property a capital item is on the acquisition but no VAT was charged and there was no evidence before the F-tT that the Appellant had any intention or expectation that the property would become a capital item in the hands of the purchaser … That requirement cannot be met when the grantor knows that the invoice issued will treat the grant as exempt.
>
> 40. We reject the Appellant's submission that the F-tT made findings of fact as to the Appellant's knowledge of the relevant provisions. It is clear that the F-tT's approach applied the test by reference to the Appellant's knowledge as to the facts of the transaction and not by reference to his knowledge of the statutory provisions…

> [T]he F-tT … was entitled to reach the conclusion, on the basis of the agreed evidence, as to the Appellant's intention or expectation by reference to the facts of the supply…
>
> 41. Our conclusion is fortified by a consideration of the potential for tax avoidance were we to decide otherwise. We agree with the F-tT at [42]... [the terms of paragraph 42 were quoted].
>
> 42. It seems to us that in reaching its Decision, the F-tT applied the correct interpretation in its application of the law to the facts and bore in mind the object for which the provisions were enacted. In our view the F-tT correctly identified the test and applied it to the evidence; the submissions on behalf of the Appellant did not persuade us to the contrary."

The UT held that it was not legitimate for the appellant to found on Mr Murdoch's letter. If the UT had had regard to it it would have given it little weight because it was not contemporaneous with the grant; it was Mr Murdoch's view rather than the appellant's view; and its context was a challenge to the respondents' decision.

[35] It is clear that the UT agreed with the FtT that it was appropriate to consider whether the grantor foresaw disapplication when determining the appellant's intention and expectation at the time of the grant.

The appellant's submissions

[36] Counsel for the appellant submitted that the parties had treated the matter in issue as being a dispute which fell to be resolved by the FtT deciding which of the rival constructions of paragraph 13(4) of Schedule 10 was correct. There had been a statement of agreed facts and a joint bundle of documents. Neither party had led oral evidence.

[37] Somewhat to the appellant's surprise the FtT had not favoured either party's construction of paragraph 13(4). On the FtT's reading of the provision, if at the time of the grant the grantor intended or expected that the option to tax would be disapplied by paragraphs 12-17 then he did not intend or expect the property supplied would become a

capital item in relation to the transferee. Accordingly, the grant by a developer condition was not satisfied.

[38] The FtT, and in its turn the UT, had erred in law. Each tribunal ought to have accepted that for the purposes of paragraph 13(4) the granter's intention or expectation required to be determined leaving out of account any intention or expectation that the anti-avoidance provisions would disapply the option to tax and render the supply exempt. Otherwise paragraph 13(4) was circular. A necessary step on the way to concluding that the option to tax was disapplied was that the grant by a developer condition was satisfied. The grantor could only have expected or intended the option to tax would be disapplied by paragraphs 12-17 if he had intended or expected that the property would become a capital item in the hands of Cumbernauld. Mr Murdoch's letter confirmed that at the time of the grant the appellant intended or expected the property to become a Capital Goods Scheme item in relation to Cumbernauld. It made no sense at all for the FtT to say that the anti-avoidance provisions were not engaged because the appellant must have intended or expected that they would be. If he intended or expected that they would be engaged it could only have been on the basis that the grant by a developer condition was satisfied.

[39] The respondents' suggested construction had not been accepted by the tribunals. In any case it was not a tenable construction. No support for it could be garnered from the language of paragraph 13(4) or regulation 113, and indeed in some respects it conflicted with those provisions. Thus, for example, in the cases of land (VATR, reg 113(2)(a)) or a computer or item of computer equipment (VATR, reg 113(2)(d)), the only possible relevant capital expenditure is acquisition expenditure (VATR, reg 113(3)(a)).

[40] Paragraphs 12-17 of Schedule 10 are anti-avoidance provisions which should be construed broadly rather than narrowly (*cf*. *Principals and Fellows of Newnham College,*

Cambridge v *HMRC* [2008] 1 WLR 888, [2008] STC 1225, per Lord Hoffmann at paragraph 15). The appellant's construction of paragraph 13(4) accords with that principle. It gives the provision a wider ambit than the tribunals' construction or the respondents' suggested construction do.

[41] The FtT's findings in paragraph 43 were based on an incorrect view of the law. On a proper construction of paragraph 13(4) those findings could not stand. The appeal should be allowed and the assessment to VAT on the supply should be quashed. Failing which, at the very least, the appeal should be allowed and the case should be remitted to the FtT so that, properly instructed by the court as to the law, it could make findings in fact which were soundly based.

The respondents' submissions

[42] Counsel for the respondents submitted that the appeal should be refused. In his submission there was a short answer and a longer answer to the grounds of appeal.

[43] The short answer was that it was clear from the FtT's findings in fact that the appellant had failed to prove that at the time of the grant he had intended or expected that the property would become a relevant capital item in relation to Cumbernauld. In paragraph 43 the FtT found that at the date of the grant the appellant knew that the supply would not be, and could not be, taxable; and that he could not have intended or expected that the property would become a capital item in relation to the purchaser. Those findings were consistent with the fact that the appellant treated the supply as being exempt - he did not invoice Cumbernauld for VAT. He had not led evidence about his intention or expectation at the time of the grant. While Mr Murdoch's letter had been in the joint bundle, it had not been adduced in evidence. Even if it had been open to the FtT to consider it, the

FtT had not chosen to make findings which reflected the terms of the letter. The UT had been entitled to take the approach which it had taken in relation to the letter. There was no error of law on the part of the FtT or the UT.

[44] Reliance only required to be placed on the longer answer if the short answer was incorrect. The longer answer was that the respondents' construction of paragraph 13, and in particular paragraph 13(4), should be preferred to the appellant's construction.

[45] Paragraphs 12-17 are anti-avoidance provisions. Their purpose is to preserve the basic principle that an exempt business should bear input tax on supplies made to it; it should be denied the opportunity to obtain a VAT credit in respect of such input tax (*Principals and Fellows of Newnham College, Cambridge* v *HMRC* [2006] EWCA Civ 285, [2006] STC 1010, Chadwick LJ at paragraph 29). The provisions should be construed with that legislative purpose in mind. The respondents' construction is consistent with that legislative purpose. On the other hand, the appellant's construction involves founding upon anti-avoidance provisions in order to avoid accounting for output tax - an arbitrary and anomalous result (*cf. R (Edison First Power Ltd)* v *Central Valuation Officer* [2003] UKHL 20, [2003] 4 All ER 209, Lord Millett at paragraph 116; *Bloomsbury International Ltd and others* v *Department for Environment, Food and Rural Affairs (Sea Fish Industry Authority intervening)* [2011] UKSC 25, [2011] 1 WLR 1546, Lord Mance at paragraph 10).

[46] When construing "capital item" for the purposes of paragraphs 13(4), 13(8), and 13(9), the words "VAT bearing capital expenditure" in regulation 113 do not have their ordinary meaning. In the special context of their application to paragraph 13 (but only in that context) they should be construed as referring to expenditure incurred otherwise than in respect of the grant itself. In other words, in order to avoid circularity in paragraph 13(4) the capital goods item created by the grant must be ignored when deciding whether the

option to tax is disapplied by the anti-avoidance provisions. Land could only be expected or intended to be a relevant capital item in relation to a transferee if it was intended that relevant VAT bearing capital expenditure would be incurred subsequent to the transfer. The intention or expectation had to involve the creation of a relevant capital item at some time after the date of the grant. It could not relate to a capital item which was created by the grant.

[47] By contrast, the appellant's construction would result in the words "intended or expected" being devoid of content because at the time of the grant the grantor would be likely to know whether the land supplied would be a capital item in relation to the transferee - it would not be a matter of intention or expectation.

Decision and reasons

[48] I regret that I disagree with your Lordships in relation to the outcome of this appeal. In my opinion the FtT and the UT fell into error. I have considerable sympathy for both tribunals. The issue of construction which they had to resolve is a difficult one.

Construction of paragraph 13(4)

[49] It was common ground that the relevant transferee limb of paragraph 13(4) is not easy to construe, but that it requires to be interpreted so as to avoid circularity.

[50] It is implicit in the reasoning of both the FtT and the UT that the tribunals did not accept the respondents' proposed construction. In any case, in my view that construction is untenable. It is not the ordinary and natural reading of paragraph 13(4) and regulation 113; indeed it is at odds with an ordinary reading of regulation 113(2)(a) and regulation 113(2)(d). I am not convinced that regulation 113 ought to be given the special interpretation

which the respondents suggest. Nor do I find persuasive the suggestion that the intention or expectation test in paragraph 13(4) is devoid of content unless the respondents' construction is correct. The language of the provision (and, in particular, the words "would become a capital item") appears to me to be apt to encompass capital items created at the date of the grant or at a later date.

[51] Provided that it is accepted that the *punctum temporis* is the time of the grant as opposed to some time before it, the appellant's construction is an available construction of paragraph 13(4). It is a sensible construction which avoids the circularity which would arise if account were to be taken of an option to tax being disapplied because the grant by a developer condition was satisfied.

[52] The tribunals rejected the appellant's construction. They proceeded on the basis that the appellant believed that the option to tax would be disapplied. Plainly, he did. No element for VAT was identified as being part of the price to be paid by Cumbernauld, and the appellant did not include output tax in respect of the supply in his VAT return. However, in my opinion a necessary and integral element of the appellant's belief that the option would be disapplied was his belief that the grant by a developer condition was satisfied, *viz.* that he intended or expected that the property would become a capital item in relation to Cumbernauld. In my view these two matters are inextricably linked, and the tribunals erred in losing sight of that.

[53] If the tribunals' construction is correct it would have very odd consequences. Where all other requirements for disapplication of the option to tax were satisfied, whether there was disapplication would turn on whether or not the grantor intended or expected it to occur. If he did, there would not be disapplication. If he did not, there would be. That

seems both arbitrary and absurd. I do not consider that it can have been the legislative intention.

[54] In my opinion purposive considerations do not favour the tribunals' construction. It would give the relevant transferee limb of paragraph 13(4) a very narrow scope - much narrower than on the appellant's construction (*cf*. the FtT's (erroneous) view at paragraph 22 of its decision). That consequence is very difficult to reconcile with the fact that paragraph 13(4) is an anti-avoidance provision and, as such, should be construed so as to have a broader rather than a narrower effect (*cf. Principals and Fellows of Newnham College, Cambridge* v *HMRC* [2008] 1 WLR 888, per Lord Hoffmann at paragraph 15). The provisions in paragraphs 12-17 are directed towards preserving the basic principle that an exempt business should bear input tax on supplies made to it by being denied the opportunity to treat that input tax as an allowable VAT credit (*Principals and Fellows of Newnham College, Cambridge* v *HMRC* [2006] EWCA Civ 285, [2006] STC 1010, Chadwick LJ at paragraph 29). *Prima facie*, where the provisions are satisfied disapplication of the option to tax advances that purpose - there is nothing anomalous about that. Of course, the breadth of the provisions has the consequence that they will strike at some transactions which do not have the aim of avoiding or mitigating VAT liability as well as at transactions which do have that aim, but that is not a good reason to decline to construe them as having a broader rather than a narrower effect. In my view both tribunals misunderstood the true purpose of the provisions, and this led them into error. At paragraph 42 of its decision the FtT reasoned:

> "Although the purpose of the legislation is to limit the circumstances in which the option to tax can be deployed it is also aimed at anti-avoidance and to implement [the appellant's] approach would be to encourage the avoidance of tax."

At paragraph 41 of its decision the UT agreed with that reasoning and observed that its conclusion was fortified by a consideration of the potential for tax avoidance were it to

decide otherwise. Both tribunals treated (i) the purpose of limiting the circumstances in which the option may apply, and (ii) the purpose of anti-avoidance, as being opposing purposes, when in fact disapplication of the option to tax is the means by which the legislative anti-avoidance purpose is to be achieved.

[55] It follows for the foregoing reasons that in my opinion the FtT and the UT erred in law in their construction of paragraph 13(4) and in their application of that provision to the facts.

[56] In my view the respondents' "short answer" does not circumvent the tribunals' errors. The FtT's crucial findings were predicated upon its erroneous approach. The FtT's error engages the first, second, and possibly the fourth of the principles discussed in the opinion of the court delivered by Lord Drummond Young in *Advocate General for Scotland* v *Murray Group Holdings Ltd* 2016 SC 201 at paragraphs [42] - [43]. I am not persuaded that had the FtT directed itself correctly there would have been no proper basis upon which it could have concluded that the grant by a developer test was satisfied. First, Mr Murdoch's letter was among the documents which were before the FtT and its wide powers under the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 gave it very considerable scope as to how it dealt with its contents. The force of that point is not undermined by the UT's *obiter* view that it would have given the relevant statement in the letter little weight: the context in which that view was expressed was the UT's erroneous approach to the construction issue and its resulting error when it applied that construction of paragraph 13(4) to the facts. Second, and even more fundamentally, the FtT (and in its turn the UT) proceeded on the basis that at the time of the grant the appellant knew that the supply "would not be, and could not be, taxable" because the option would be disapplied. Since such disapplication was dependent upon the appellant intending or expecting that the

property would become a capital item in relation to Cumbernauld, it is difficult to see how the FtT could posit disapplication without also positing satisfaction of the grant by a developer test. The two were inseparable. Finally, it is not without significance that before the FtT both parties "agreed that the sole issue for determination by the Tribunal was the interpretation of the relevant provisions of Schedule 10 VATA because of the admitted circularity caused thereby" (paragraph 3 of the FtT's decision). The subsumption appears to have been that if the appellant's construction was correct he should succeed whereas if the respondents' construction was correct the appeal should be refused.

[57] I would have allowed the appeal and remitted the case to the FtT to reconsider it in light of the correct approach to paragraph 13(4).