

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (BUILDINGS AND LAND) ORDER 2009

2009 No. 1966

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 This Treasury Order amends, with effect from 1st August 2009, Schedule 10 ("Schedule 10") to the Value Added Tax Act 1994 (c. 23) ("the Act"). The amendments made by this Order provide further facilitation in the use by businesses of the option to tax supplies of land and buildings that would, apart from the option to tax, fall to be exempt from Value Added Tax ("VAT") with consequential impact on their ability to claim credit for VAT incurred on supplies made to them that are used for the making of supplies of the land or building concerned.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- 3.1 None

4. **Legislative Context**

- 4.1 The Act and the subordinate legislation made under it implement the United Kingdom's obligation under EC law (principally now by virtue of Council Directive 2006/112/EC) to charge a turnover tax on supplies of goods and services made by businesses. Section 4(1) of the Act provides that VAT is chargeable on a supply of goods or services made in the United Kingdom where it is a taxable supply made by a taxable person in the course or furtherance of a business carried on by that person.

- 4.2 Subject to the exclusions mentioned therein, Group 1 of Schedule 9 to the Act ("Group 1") exempts from VAT the grant of any interest in or right over land or of any licence to occupy land or, in relation to land in Scotland, any personal right to call for or be granted any such interest or right.

- 4.3 For the purpose of rewriting the Schedule (with amendments) using easier and clearer language, Schedule 10 to the Act was substituted by the Value Added Tax (Buildings and Land) Order 2008 (S.I. 2008/1146) with effect from 1st June 2008 using a special power afforded to the Treasury for that purpose by section 17 of the Finance Act 2006 (c. 25). The amendments to Part 1 of Schedule 10 made by this Order are the first made to the Schedule since it was rewritten. Part 1 of Schedule 10 relates to the option to tax land. Where a business opts to tax land or a building, supplies of it made by the business (which would otherwise be exempt from VAT by virtue of Group 1) are chargeable to VAT at the standard rate of (currently) 15%. Part

1 of Schedule 10 contains the main rules for the operation of an option to tax including those relating to-

- the requirements for making an option to tax and the time from which the option has effect;
- its scope in relation to land, a building or part of a building and the circumstances in which a person may exclude a new building constructed on land already subject to an option from its effect;
- the means by which the need to opt individual buildings and parcels of land as they are acquired may be avoided by the making of a “real estate election” that causes all subsequent acquisitions to be treated as opted from a time immediately before their acquisition;
- it having effect to cause supplies of the land or buildings made by persons that have not made an option to tax in respect of the land or buildings to be taxable e.g. supplies made by a “relevant associate” of an opter;
- supplies that remain exempt from VAT notwithstanding the making of an option whether by reason of social policy e.g. in respect of residential property or to prevent abusive tax avoidance;
- the circumstances and time from which, whether at the choice of the person who made the option or by automatic operation of the law, an option is revoked so that it no longer causes VAT to be chargeable on supplies of the land or building previously subject to the option; and
- the circumstances and time from which a person (e.g. a “relevant associate” of an opter), whose supplies were rendered chargeable to VAT by virtue of an option that was made by another person, ceases to be affected by it.

4.4 This Order makes a number of discrete amendments to the scheme of the option to tax in order to facilitate its use by businesses and to reduce further the risk of an option to tax or its revocation being used for abusive tax avoidance purposes. In particular, the amendments made by the Order-

- tackle abusive tax avoidance by preventing the revocation of an option, or the circumstances in which a “relevant associate” of an opter ceases to be affected by it, where all or part of the consideration for the disposal of a relevant interest in the land or building remains unpaid (see the amendments made by article 3 of the Order to paragraph 3 of the Schedule and the substitution of paragraph 26 of the Schedule by article 6 of the Order whereby the former anti-avoidance provision in that paragraph is now condition C and the new anti-avoidance rules are contained in conditions A and B);
- provide greater certainty as to the time from which an option has effect in respect of land or buildings acquired after a real estate election has been made (see the amendment to paragraph 21 of the Schedule made by article 4 of the Order);

- enable the Commissioners for HM Revenue and Customs, when giving permission for revocation of an option that had effect at least 20 years before, to specify the day from which the revocation has effect by reference to the occurrence of an event specified by them and, at their discretion, to specify the time on that day from which revocation has effect (see the amendment to paragraph 25 of the Schedule by article 5 of the Order);
- extends the time limit by which a person must notify the Commissioners for HM Revenue and Customs that a new building constructed on land already subject to an option is excluded from its effect (see the amendment to paragraph 27 of the Schedule by article 7 of the Order).

4.5 In addition to the amendments described above, article 11 of the Order amends paragraph 34(2) of Schedule 10 and inserts paragraph 34(2A) and (2B). Paragraph 34(2) defines the circumstances where a person is “connected” with another person for the purposes of Part 1 of the Schedule. Whether a person is connected with another person is significant for determining-

- whether a body corporate ceases to be a “relevant associate” of an opter (see paragraph 3(4) of the Schedule); and
- whether land is “exempt land” for the purposes of the anti-avoidance rules (see paragraphs 14-17, in particular, paragraph 15(3) of the Schedule).

4.6 Paragraph 34(2A) and (2B) provide that a company is not connected with another company only because both are under the control of-

- the Crown,
- a Minister of the Crown,
- a government department, or
- a Northern Ireland department.

Similar amendments are made to regulations 84, 93 and 94B of the Value Added Tax Regulations 1995 (S.I. 1995/2518) by the Value Added Tax (Amendment) (No. 3) Regulations 2009 (S.I. 2009/1967).

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, the Rt. Hon Stephen Timms MP has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Buildings and Land) Order 2009 are compatible with the Convention rights.

7. Policy background

7.1 The option to tax land afforded by Schedule 10 of the Act is politically and legally important because of its relevance to the commercial property sector. It is also by its nature one of the most complex and difficult parts of the VAT legislation arising in part from the complexities of English and Scottish land law and because it contains extensive anti-avoidance legislation.

7.2 Following the substitution of Schedule 10 to the Act by the Value Added Tax (Buildings and Land) Order 2008, 2008 No.1146, which came into force on 1 June 2008, there has been constant dialogue and consultation with business to ensure that the re-written Schedule 10 is achieving its objectives and does not create unnecessary burdens on business. This being especially important as the first revocations of an option to tax 20 years after an option first has effect will be capable of being made from 1 August 2009.

7.3 As a result, a number of issues have been identified by business and HMRC within Schedule 10 to the Act which the following amendments address by seeking to simplify the working of the Schedule whilst ensuring that abusive tax avoidance opportunities are removed. These are,-

- relaxed time limits for businesses to notify HMRC if they wish to disapply an option to tax on the construction a new building;
- tightening the ‘automatic revocation’ rule, which applies where a business has not held an interest in a property for 6 years, in order to counter new tax avoidance opportunities that have been identified;
- changes to the ‘Real Estate Election’ rules, which allow businesses to make a single option to tax all future acquisitions of land and buildings, in order to reduce administrative burdens associated with notifying HMRC when purchasing property at auction;
- relaxing the rules permitting revocation of an option to tax after 20 years, in order to allow more businesses to use the ‘automatic permission’ regime instead of requiring prior permission from HMRC;
- ensuring that banks that fall under the control of the Crown, a Minister of the Crown, a government department or a Northern Ireland department are not disadvantaged by the anti-avoidance legislation. As a result, banks which are so controlled will not be seen as being “connected” for the purposes of VAT. They will be in the same position as they were before the Government took shares in them. This removes the problem of the “connected persons” test for property developers and the banks.

8. Consultation outcome

8.1 There has been continual consultation with business regarding Schedule 10 to the Act since it was substituted by the Value Added Tax (Buildings and Land) Order 2008 (S.I. 2008/1146) with effect from 1st June 2008. The current proposed minor

amendments are a result of suggestions put forward by business so that the intended benefits occur whilst the revenue is protected from future avoidance risks. The consultations also identified necessary changes following the Government's bail-out of the banks.

9. Guidance

9.1 An Information Sheet which will also contain tertiary legislation will be issued at the time the order is laid. A new revised Notice 742A – opting to tax land and buildings is to be issued and which will include the tertiary legislation as well as revised guidance.

10. Impact

10.1 An Impact Assessment has not been prepared for this instrument as it has a negligible impact on Business, charities, voluntary bodies or the public sector.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to simplify the mechanics of the option to tax as far as possible by granting automatic permission in as many instances as possible.

12. Monitoring & review

12.1 The working of this legislation will be monitored jointly with business and the legislation may be amended accordingly to ensure that it is fit for purpose.

13. Contact

The following are available to answer queries regarding the instrument,

James Ormanczyk
HM Revenue and Customs, CT&VAT
Property VAT Team, Room 3/34
100 Parliament Street
London SW1A 2BQ
Tel: 020 7147 0484.

John Egerton
HM Revenue and Customs, CT&VAT
Property VAT Team, Room 3/34
100 Parliament Street
London, SW1A 2BQ
Tel: 020 7147 0238.