EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (BUILDINGS AND LAND) ORDER 2008
2008 No. 1146

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. Description

2.1 This Treasury Order substitutes, with effect from 1st June 2008, a new Schedule 10 ("Schedule 10") to the Value Added Tax Act 1994 (c. 23) ("the Act") for the purpose of rewriting that Schedule (with amendments) into language that is clearer and easier to use.

2.2 The Order makes provision for additional rights of appeal to the independent VAT and Duties Tribunal in relation to Schedule 10.

2.3 Section 26 of the Finance Act 1995 (c.4) (co-owners etc of buildings and land) and section 51A and paragraph 8(2) and (3) of Schedule 10 are repealed. The Order also makes provision for consequential amendments to other legislation. In particular, the Order repeals, with effect from 1st June 2020, item 1(b) and note (7) in Group 1 of Schedule 9 to the Act ("Schedule 9) which excludes from exemption supplies made pursuant to a developmental tenancy, developmental lease or developmental licence.

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

3.1 The explanatory note to this instrument explains that-

"A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.".

3.2 This is because the accepted Government practice is that no IA will be published for HMRC and HMT tax measures for which:

(a) the total effect of the changes across all UK business is less than £100,000 of administrative burden costs/savings and/or £3m of compliance cost in total; ***and***

(b) the Department's Better Regulation and Policy team has confirmed that –

(i) there are no disproportionate impacts on any business sector; ***and***

(ii) there are no other issues which might make publication of an IA advisable.

This is such a measure.

3.3 HMRC are working with BERR to ensure that the next edition of the Statutory Instrument Practice reflects these changes.

4. Legislative Background

4.1 Schedule 10 has effect in relation to buildings and land by virtue of section 51 of the Act.

4.2 The Treasury may by order amend Schedule 10 by virtue of section 51(2) of the Act. However, section 17 of the Finance Act 2006 (c. 25) affords more extensive power to-

- substitute Schedule 10 for the purpose of rewriting it with amendments;
- amend sections 83 and 84 of the Act in connection with any provision of the rewritten Schedule 10;
- repeal item 1(b) and note (7) of Group 1 of Schedule 9 ;
- repeal section 26 of the Finance Act 1995 and section 51A and paragraph 8(2) and (3) of Schedule 10 (which were inserted by section 26 of the Finance Act 1995);
- make any provision that might be made by an Act; and
- make incidental, consequential (including amendment of any Act or instrument made under an Act), supplemental or transitional provision or savings.

4.3 This Order is the first use of the power afforded by section 17 of the Finance Act 2006.

4.4 Section 4(1) of the Act provides that Value Added Tax ("VAT") shall be charged on any 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 any business carried on by that person.

4.5 Subject to the exclusions mentioned therein, Group 1 of Schedule 9 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.

4.6 Paragraph 2 of Schedule 10 as it stood before being rewritten by this Order provided (subject to other provisions mentioned therein) that where an election under that paragraph had effect in relation to any land, any grant made in relation to that land at a time when the election had effect which would otherwise fall for exemption from VAT by virtue of Group 1 of Schedule 9 of the Act would not fall for exemption from VAT. The election to waive exemption, (more commonly referred to as "the option to tax") enables

taxpayers to charge VAT commercial property transactions that would otherwise be exempt from VAT. VAT paid in connection with the property ("input tax") and which is attributable to the supplies made taxable by virtue of the option to tax may be claimed by way of deduction from VAT otherwise payable by the taxpayer or, where the amount claimed exceeds the VAT payable for a particular accounting period, by a claim for repayment from the Commissioners for Her Majesty's Revenue and Customs ("the Commissioners").

4.7 The legislation relating to the option to tax contained in Schedule 10, paragraphs 2, 3 and 3A (paragraph 3A was inserted by section 37 of the Finance Act 1997 (c. 16)) as it stood before being rewritten by this Order became highly complex following amendments by Finance Act 1997 (c. 16), sections 35 (2), 36(1), 37(2) and (3) and Schedule 18, Part 4(2) and S.I. 1994/3013, 1995/279, 1997/51, 1999/593 and 2004/778. In addition, as explained below, paragraphs 5 to 7 and paragraph 8(2) and (3) of the Schedule as it stood had effectively become irrelevant and required repeal.

4.8 Quite apart from the complexity of Schedule 10 as it stood in relation to the option to tax, further amendment to it was necessary because paragraph 3(5) allowed an option to tax to be revoked (with the Commissioners' written permission) where it has had effect for more than 20 years. No option to tax had effect before 1st August 1989. Accordingly, the earliest time when an option to tax will be eligible for revocation will be 1st August 2009. In order to provide legal certainty and to meet taxpayers' expectations, the rewritten Schedule 10 specifies the conditions under which revocation of an option to tax will be allowed.

4.9 The requirement to amend Schedule 10 provided an ideal opportunity to rewrite the Schedule in a way that made it easier for taxpayers to understand the option to tax and to include further helpful amendments. These include-

- early revocation of an option to tax within a "cooling off" period of 6 months from when the option to tax first had effect;
- the automatic lapse of an option to tax after 6 years where an opter has ceased to have an interest in the opted property;
- the facility to make a "real estate election" whereby a property purchased after such election becomes opted automatically without further notification to the Commissioners;
- provision for "relevant associates" of an opter which is a body corporate to cease to be treated as relevant associates;
- new rules to allow an option to be made where the person wishing to make an option in respect of a property has previously made an exempt supply of it;
- new rules for a supply in respect of an opted commercial property to fall for exemption if it is intended that it will be converted to certain residential or charitable uses whether by the immediate recipient of the supply or another person to whom it will ultimately be supplied; and
- an amendment to the anti-avoidance provisions so that these are not brought into operation merely by a financial institution that provided

finance in relation to a development installing automatic teller machines in that development.

4.10 Paragraphs 5 to 7 of Schedule 10 as it stood (relating to deemed supplies by developers of certain non-residential buildings etc) were lengthy and complex and ceased to deem developers as having made supplies in accordance with those paragraphs after 1st March 1997 so that no developer has made a deemed supply under these provisions since that date.

4.11 Paragraph 7 of Schedule 10 as it stood required a developer who had leased the land upon which a building had been constructed to notify the landlord if the developer was treated as having supplied the building in accordance with paragraphs 5 to 7 of Schedule 10. Thereafter the landlord would be required to charge VAT on the rental supplies made by the landlord to the developer by virtue of item 1(b) and note (7) in Group 1 of Schedule 9.

4.12 Abolishing the VAT charge arising by virtue of item1(b) of Group 1 of Schedule 9 is considered necessary in the light of the omission of paragraphs 5 to 7 of Schedule 10 as it stood because the reason for the exclusion of such supplies from VAT exemption is effectively spent. However, the repeal of these provisions does not take effect until 1st June 2020 for the reasons explained in the next paragraph.

4.13 Before the making of this Order, a landlord may have purchased supplies or entered into a contract to purchase supplies upon which VAT has been or will be payable and which the landlord anticipated would be eligible to be claimed as credit for input tax incurred on supplies attributable to the rental supplies made taxable by virtue of item 1(b) of Group 1 of Schedule 9. Input tax incurred on certain supplies in excess of £250,000 falls to be adjusted over a period of up to 10 years by reference to taxable or exempt use of the building to which it relates. If item 1(b) and note 7 had been repealed with effect from 1st June 2008 so as to cause subsequent rental supplies to become VAT exempt supplies, a significant VAT cost could have arisen for a landlord who has incurred costs in connection with the buildings concerned. This could have arisen either by preventing a claim for credit for the input tax incurred being made or by requiring repayment of all or part of input tax previously claimed by virtue of the adjustment mechanism in respect of capital items required by Part 15 of the Value Added Tax Regulations 1995 (S.I. 1995/2518) (“the Regulations”). The Order provides that the repeal of item 1(b) and note (7) in Group 1 of Schedule 9 has effect from 1st June 2020 and ensures that claims for credit in respect of input tax incurred either before the Order comes into force (or in the period up to 1st June 2010) and subsequent adjustments required by Part 15 of the Regulations will not be affected by the repeal.

4.14 The Order also makes the necessary repeal of section 51A of the Value Added Tax Act and paragraph 8(2) and (3) of Schedule 10 to that Act. These provisions were inserted by section 26 of the Finance Act 1995 (c. 4). Section 26(3) of the Finance Act 1995 provided that section 26 should be brought into force on such day as the Commissioners may by order made by statutory instrument appoint. The Commissioners have made no order to bring section 26 into force. Section

51A and paragraph 8(2) and (3) were designed to deal with complex situations involving co-owners of land, but it has become clear that they are flawed and would have unwelcome consequences. If section 26 of the Finance Act 1995 had been brought into force, paragraph 8 of Schedule 10 as it stood before being rewritten would have become paragraph 8(1) of that Schedule by virtue of section 26(2) of that Act. It has been rewritten as paragraph 40 in the new Part 3 of Schedule 10 substituted by this Order.

4.15 Paragraph 1 of Schedule 10 as it stood and as amended by S.I. 2002/1102 has been rewritten as paragraphs 35 to 39 in the new part 2 of Schedule 10 substituted by this Order.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, Jane Kennedy MP, has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Buildings and Land) Order 2008 are compatible with the Convention rights.

7. Policy background

7.1 The option to tax land afforded by Schedule 10 is politically and legally important because of its relevance to the commercial property sector.

7.2 Schedule 10 as it stood was one of the most complex and difficult parts of the VAT legislation arising partly from the complexities of English and Scottish land law and partly because it had been amended on a number of occasions to counter tax avoidance.

7.3 In addition to introducing desirable amendments (especially in connection with the ability of the maker of an option to tax to request permission from the Commissioners to revoke it after 20 years have elapsed since it first had effect) and removing effectively spent legislation, the more modern style used in the rewritten Schedule 10 is intended to be more easily understood by readers.

7.4 A consultation document, “Future of the Option to tax” was published at the time of the Pre-Budget Report of 2004. After taking into account the responses received and consulting with various trade bodies, a Business Brief (23/05) was published at the time of the Pre-Budget Report of 2005. This outlined the conditions that would be applied by the Commissioners in granting written consent to revoke an option to tax that had been in place for 20 years. This provided the legal certainty that businesses were seeking and enabled them to plan for the future.

7.5 A consultation document illustrating how Schedule 10 would appear after being rewritten (but without any of the innovative amendments to the operation of option to tax mentioned at paragraph 4.9) was published at the time of the Pre-Budget Report in December 2005.

7.6 A number of connected issues raised during the consultation process by various trade bodies are also addressed by the rewritten Schedule 10 so that greater clarity and simplicity is provided. These issues deal with tax avoidance, the effects of revoking an option made by a body corporate which is treated as a member of a group under sections 43A to 43D of the Act or in respect of an option made by any person in respect of a large area of land.

7.7 In August 2007 the Commissioners undertook with all those who responded to the two public consultations mentioned above, a further informal consultation in connection with proposed rewritten Schedule 10 (which incorporated the innovations mentioned in paragraph 4.9), the legally effective conditions etc. which are to be included in a public notice issued by the Commissioners pursuant to that legislation, and proposed guidance to taxpayers. On the whole, these were favourably received as being an improvement on Schedule 10 as it stood before being rewritten by simplifying much of the language used together with providing some useful business facilitation.

8. Impact

A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.

9. Contacts

The following can answer queries regarding the instrument-

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