

## Abusive VAT planning

### *Lower Mill Estate Ltd [2009] UKFTT 00016 (TC)*

*The Tribunal has held that a trading structure, under which purchasers of holiday homes received separate supplies of land (standard-rated) and construction services (zero-rated) from two associated legal entities, constitutes an 'abusive practice'. The transactions were therefore redefined by the Tribunal to remove the VAT advantage. This decision, which sets out the Tribunal's views on the purpose of the VAT system and its analysis of the 'essential aims' of the structure, will be of interest to all businesses perceived to be engaged in 'VAT planning'.*

### **Background**

Tribunal found the facts to be as follows. The Taxpayers were companies wholly owned by a single individual. The first Taxpayer, Lower Mill Estate Ltd (LME) owned freehold land in Cirencester (the site) which benefitted from outline planning permission for the construction of a large number of holiday homes. LME operated a sales office on the site where prospective customers would make enquiries about plots of land and would be informed, at the same time, that construction services could be offered by the second Taxpayer, Conservation Builders Ltd (CBL). The Taxpayers gave evidence that those wishing to buy a plot of land on the site were free to elect whether or not to engage CBL to construct their holiday home, and indeed whether or not to build anything on the plot at all. However, the Tribunal found that the fact that they had an absolute right to do whatever they wished with the plot was not clearly pointed out to customers in the marketing and promotional materials, which evidenced a close business relationship between the Taxpayers jointly marketing the sales of holiday homes. It also found that, in practice, CBL constructed all of the houses on the site.

HMRC assessed both Taxpayers for output VAT. Its preferred decision was that LME had made a single, standard-rated supply of a fully constructed holiday home to each customer. HMRC's first alternative decision was that the Taxpayers had jointly made a single, standard-rated supply of a fully constructed holiday home to each customer. Finally, HMRC's second alternative decision was that the arrangement was an 'abusive practice' and should be redefined as a single, standard-rated supply of a constructed holiday home to each customer, made by either LME or CBL. The 'abuse' assessment included only the amount of output VAT that HMRC considered was due, and not any interest or penalties.

### **Decision**

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The Tribunal rejected HMRC's preferred and first alternative decisions, holding that the legal relationships between the parties showed that the transactions were independent, that the supply of construction services could not be considered as "ancillary" to the supply of land, and that the concept of a joint supply was not consistent with the VAT "time of supply" rules. However, the Tribunal accepted HMRC's second alternative decision that the structure was 'abusive' and must be redefined so as to remove the VAT advantage.

Applying the first part of the two-limb Halifax test, the Tribunal held that the purpose of the VAT system was that the tax should be applied in a fair, proportional and neutral manner, and that an inequality of treatment which created a distortion of competition would be contrary to that purpose. It considered that, as most commercial property developers would sell a completely built house and would not separate the sale of the land from the building of the house, the Taxpayers' contractual arrangements created a market distortion which was "against the objective of the Directive in guaranteeing uniformity of the taxable amount".

On the second limb of the 'abuse' test, the Taxpayers submitted that the commercial drivers behind the structure were that the self-build structure was itself attractive to customers (providing them with more control over the construction process and greater flexibility in ensuring that the house met their specific requirements), that the structure was a condition of obtaining third party funding, and that it achieved the ring-fencing of the land assets from the liabilities of the riskier construction business. However, the Tribunal held that the evidence indicating that the essential aim of the transaction was to obtain a tax advantage was strong when compared to the "weaker and limited evidence of commerciality". It reached this conclusion despite the Taxpayers' evidence that the initial corporate structure was not tax-driven and was agreed before any tax advice was obtained, stating that:

*"It would seem strange in structuring a transaction commercially for such a relatively large project that tax was not considered when it is well known in the self-build industry that a major VAT benefit was available if the transaction was properly structured."*

Having found that both limbs of the 'abuse' test were satisfied, the Tribunal considered that the transactions should be redefined as a single supply of a holiday home made by LME, the consideration for which was the sum of the amounts payable for the land and for the construction services. The Taxpayers' appeal was therefore dismissed.

## **Implications**

This decision will be of interest to all businesses engaged in any form of VAT planning and, in particular, those operating through arrangements under which two separate (but connected)

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entities make supplies (with differing VAT treatments) to a single customer at the same time. The ECJ established in Part Service Srl (C-425/06) that the 'abuse' principle is capable of applying in order to treat two transactions entered into by separate legal entities as a single supply for VAT purposes. This case is the first application in the UK of this principle, which perhaps casts some doubt on the ability of taxpayers to rely on the earlier decision in Telewest where the Court of Appeal held that the Card Protection Plan (C-349/96) principle does not permit the transactions of different legal persons to be 'bundled' in this way (the 'abuse' issue was not raised in Telewest).

The basis on which the Tribunal found that, on the facts, the 'abuse' test was satisfied is not entirely clear and it remains possible that the Taxpayers will seek leave to appeal this decision to the Upper Tribunal. In particular, the Tribunal's finding that the purpose of the VAT system is to prevent market distortions - so that all economically similar transactions must be taxed in the same way - does not sit well with decisions such as Lex Services plc. Furthermore whilst the ECJ held in Part Service Srl that the obtaining of the tax advantage need not be the sole aim of the transactions, provided that it is the principal aim pursued (notwithstanding the possible existence of economic objectives), it is unclear when a commercial objective will be deemed to be sufficiently "strong" to preclude an 'abuse' challenge.

This case exemplifies HMRC's current approach to arrangements perceived to involve VAT planning, where HMRC's preference is to challenge on VAT technical grounds and to apply 'abuse' only as a final alternative. This may perhaps be due to HMRC inability to apply penalties to assessments based on 'abuse' (and it is interesting that, in this case, HMRC did not seek interest either). However, the UK Tribunals and Courts have so far given a broad scope to the 'abuse' principle and, unless and until a more restrictive interpretation is imposed in future cases, businesses should consider the possible application of 'abuse' to any arrangement which results in a VAT advantage.

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