VAT efficient development model for RSLs

High court victory for Community Housing Association

The recent High Court decision in Community Housing Association concerned the question of whether something is a supply for VAT purposes (which carries with it a right to recovery for VAT on related cost components, if the supply is taxable) or a mere movement of money/reallocation of costs which is not a supply, is one that causes much debate.

Background

Community incurred VAT on professional fees in the course of building houses which it intended to rent out on exempt short term lets. That VAT was therefore irrecoverable at the point that it was incurred. 4 Eyes Ltd assisted Community in setting up a professional fees company called CHA Ventures (Ventures). The intention was that Ventures would incur the professional fees and make zero rate supplies of design and build construction services to Community, allowing Ventures to claim the VAT on the professional fees.

Under the new arrangement, Community recharged the professional fees and building construction costs it had incurred in respect of all the unfinished contracts to Ventures and assigned the contracts to Ventures. It then claimed the input tax on the professional fees for the unfinished contracts on the grounds there had been a change of intention; the VAT had originally been intended for exempt use but before that intention was fulfilled and within six years it was used in making the taxable supply to Ventures. HMRC rejected the claim and the original VAT Tribunal dismissed Community's appeal, holding that the fact of the recharge was not enough to amount to a change of intention, permitting input VAT recovery. According to the VAT Tribunal it was appropriate to effectively ignore the creation of Ventures and the recharge and that therefore the professional fees originally incurred by Community would still ultimately be used in the making of exempt supplies by Community, so effectively nothing had changed.

Decision of High Court

The High Court has allowed Community's appeal and overruled the decision of the VAT Tribunal. The Court ruled that, contrary to what had been argued, Community had not supplied Ventures with professional services or building services. However what Ventures had paid Community was consideration for the benefit of the assignment/novation of the unfinished contracts; a sum equal to what Community had paid to the building contractors and professional advisers for their services to date. This was a taxable supply. The input tax incurred on the professional fees was a cost component of that taxable supply, it did not matter that the ultimate purpose of Community incurring this VAT was to secure the creation of houses that would

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generate exempt rent for it. There was a direct link between the input VAT and a taxable supply, making the VAT recoverable by Community.

There are two points that come out of this case:-

1) It now appears to be possible to make irrecoverable VAT incurred by one entity before assignment of a contract, recoverable by charging the new entity for the assignemnt, so long as the value of that charge reflects the value of the supplies received. The recharge of the earlier costs can be a taxable supply (which is however a charge for the benefit of the assignment not a resupply of the services received pre assignment).

This decision does however seem to be moving away from some earlier established principles concerning charges where contracts are assigned/novated, such as Roberts and Son. The Tribunal had not really concentrated on whether the charge to Ventures was consideration for a taxable supply or not, or indeed what if anything had been supplied to Ventures, as it had found for HMRC on the change of intention point (ie that there had been no change of intention as far as the use of this input tax was concerned).

Does this principle of creating a taxable supply of the benefit of the assignment hold true for contracts that involve goods as well as services? Presumably it does.

2) If there is a direct link to a supply then the VAT is a cost component of that supply for input tax deduction purposes, and the ultimate purpose of that expenditure is irrelevant. This is of course something we already knew but did HMRC effectively look to adopt the ultimate purpose approach they had previously argued against in cases like BLP by looking to ignore the charge to Ventures (this would however have been correct if the charge to Ventures was not a supply and did not consume the input tax, as in that case the only supply by Community to link the input tax to would have been the exempt rents).

Conclusion

A further appeal to the House of Lords by HMRC remains a possibility, however at this point it appears that only the VAT structure as implemented by 4 Eyes Ltd can offer the additional retrospective benefit which results in significant windfall savings.

Any developing RSL which has not yet implemented a similar structure to save VAT on new developments should contact 4 Eyes Ltd to discuss whether this would be suitable for them also.

WE HOPE YOU FIND THIS NEWS ARTICLE HELPFUL. IF YOU WOULD LIKE TO REGISTER TO RECEIVE FUTURE UPDATES BY EMAIL THEN PLEASE SEND A REQUEST TO

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