Simplifying the VAT land exemption – Call for Evidence

Introduction

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £115bn to the UK economy in 2019 and supported 2.4 million jobs[1]. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

2. We welcome the Call for Evidence on simplifying the VAT land exemption – our detailed responses to consultation questions are in Appendix 1.

3. As we set out in our response to the OTS's review of VAT simplification back in 2017, applying VAT in a real estate context can be particularly complicated. A range of different rates and exemptions can apply depending on the facts and circumstances of individual situations and the precise treatment of a transaction or project is often open to interpretation. Real estate investment, and the jobs and economic growth that it brings, thrives on certainty.

4. At the same time, the VAT rules on land and property have been in place for a long time and are generally – that is, in the context of most property transactions – well understood and do not cause undue concern or complication. We would not want any simplification or reform to improve the situation for the 1% of very difficult cases to make things more difficult for the other 99% and have serious concerns about the "ideas for simplification" set out in the Call for Evidence. We do not think that any of them offer an improvement over the current system and do not feel that they should be taken further.

5. Instead, we suggest a number of areas where the existing rules could be improved subject to further consultation, including:

    5.1. Zero-rating residential property lettings.

    5.2. Reduced-rating refurbishment and repairs for residential property.

    5.3. Making OTT revocation available after 10 years, rather than 20.

    5.4. Introducing an optional reverse charge for property transactions.

    5.5. Extending recovery of pre-registration VAT for property developers.

6. Importantly, what we hear time and again from our members is that taxpayers want certainty. Simpler rules can of course help with this, but simplicity can in some cases also lead to greater ambiguity. To improve certainty for taxpayers, we would suggest (among other things) that HMRC:

    6.1. Develops and publishes a position on specific areas of current uncertainty, including trading concessions etc, dilapidations, call options and overage.

[1] https://bpf.org.uk/our-work/research-and-briefings/

6.2. Creates better, up to date guidance on land and property and construction VAT that both taxpayers and HMRC can rely on;

6.3. Develops an enhanced taxpayer portal that giving access to relevant information such as registrations, OTT notifications and previous HMRC correspondence.

7. We would be happy to discuss the contents of this response in further detail.

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Appendix 1 – detailed responses to consultation questions

1) What is your experience of the VAT rules on land and property?
As we elaborate further on in our response, the VAT rules on land and property have been in place for a long time and are generally – that is, in the context of most property transactions – well understood and do not cause undue concern or complication. That said, our members report that: • The VAT analysis of property transactions can take a disproportionate amount of time and effort. Much more than with other taxes, the correct VAT treatment of a transaction depends on the detailed facts and circumstances of a particular case and so a new piece of analysis needs to be carried out for every transaction. • There are also more "bear traps" – procedural requirements that – if not carried out correctly – can lead to adverse and unintended VAT outcomes These pose a particular risk to those less familiar with the rules such as small, unadvised businesses and those that only occasionally transact in land and property. Such "fiddlyness" is primarily a factor of how VAT works and is true for all areas of VAT. However, clear guidance can help considerably to overcome these issues. • Sadly, the VAT guidance for land and property is often far from clear, is incomplete in places and out of date in others. Our members also report that seeking clarity on VAT matters from HMRC is more difficult than with other taxes and that responses received are often evasive or provide less certainty than other areas of HMRC seem to be able to provide. • Linked to the above, HMRC's VAT specialists seem to display a lower level of understanding of the commercial drivers behind property investment than HMRC specialists in other areas of tax. In summary, our members' experience of the VAT rules on land and property sometimes leaves much to be desired. We acknowledge that applying the rules to real life transactions will inevitably be complicated from time to time, but feel there is more that HMRC could do to improve taxpayers' "user experience".
2) Are there any supplies that are particularly difficult to establish the correct liability for, leading to financial and administrative burdens? Please explain.
Yes. It is sometimes difficult to establish the position with: • The anti-avoidance rules for the option to tax, consideration of which can be a disproportionate burden in many cases where a commercial property occupier agrees to pay for certain internal works (e.g. installation of additional electric floor boxes). The rules also give rise to a circularity recognised in HMRC's guidance and that really should be legislatively fixed. • Short-term arrangements such as trading concessions, serviced offices, conference facilities, the hire of a hall etc, which may or may not be primarily of facilities rather than a licence to occupy. • Situations where there is split between legal and beneficial ownership, for instance in the context of paragraph 40 of Schedule 10 VAT Act 1994.

- Works on a site that incorporates both opted commercial and residential use, such as student accommodation with ground floor retail or leisure. In particular, how to attribute costs between the underlying land and the development that sits on top of it; and of the development as between residential and commercial.
- Cladding remediation works. We would make two points here. Firstly, putting right faulty cladding is an enormous endeavour that will cost billions of pounds. Sadly, HMRC's policy position on the liability of these works will make it even more expensive and difficult than it ought to be to carry out works that are urgently needed as a matter of public policy. A supportive and progressive VAT system would zero-rate all cladding works and associated fire safety works. Secondly, even where zero-rating may be available for cladding works under current policy, the evidential requirements for applying that rate can be very difficult to satisfy, particularly for older buildings or those that have had several owners over time.

Other areas have become problematic because HMRC's position is not known, and may have changed. Currently, these include:

- Dilapidations
- Call options
- Overage
- Rights to light

We note that many of the issues here, and also with short-term lettings, are not with the exemption itself, but with whether the transaction falls within the ambit of the property provisions – with whether the supply is of property or, indeed, whether there is a supply at all.

3) Do you think that the land and property VAT rules require simplification? Please explain why.

Some changes would be welcome and, as always, we would welcome the opportunity to discuss these. But we would remind HMRC that the basics of the exemption have been in place for nearly 50 years, and those of the option to tax for more than 30. They are familiar, and they have served well in many millions of transactions, many of high value, and many of them complex. In the vast majority, the VAT treatment is not a problem.

We see a real danger of HMRC trying to tackle uncertainty in 1% of cases, and in doing so creating uncertainty in the other 99%. Where change is needed, the appropriate instrument is a scalpel, and not the variety of sledgehammers suggested in the call for evidence; sledgehammers that would inevitably entail lengthy and difficult transitional periods during which even greater uncertainty would exist for taxpayers

We would also point out that, where there are problems, they are frequently not in areas that the call for evidence addresses. They might arise because HMRC have not processed an application for registration, or a notification of an option to tax; they might concern zero-rating, RRP/RCP buildings, TOGC treatment, or the CGS.

As noted above, our members feel it is their experience of the VAT system as a whole (of which the rules are but a part) that would benefit from greater certainty and administrative simplicity.

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4) What are your views on the options presented in the OTS report outlined above? Do you agree with their assessment?

Yes, the OTS was right to reject these ideas. It did so for good reasons, having engaged heavily with a wide range of stakeholders. We are surprised that HMRC think it worth reviving them.

Indeed, contrary to the suggestion at the beginning of the call for evidence, the OTS made no recommendation 'for the simplification of the VAT treatment of land and property'. It *did* recommend 'a comprehensive review of the reduced rate, zero-rate and exemption schedules', mentioning not property but construction. We look forward to assisting with that review, once it gets underway, and we would urge HMRC to progress it.

We will comment briefly here on the three ideas, none of which we support. But we would wish to do so further if HMRC are seriously considering pursuing any of them.

We would, however, make one further point here, since it seems particularly relevant to (a) and (b) below. HMRC will need to be mindful of 'subsidy control', the replacement for 'state aid'. Guidance is at https://www.gov.uk/government/publications/complying-with-the-uks-international-obligations-on-subsidy-control-guidance-for-public-authorities. A wholesale move to taxable status, or to exempt status, would disproportionately favour specific business sectors, and disadvantage others; it would also produce different outcomes between businesses in the same sector. The relevance of this may not be immediately obvious. But we understand that state aid was a concern in 2012, when the move to tax 'self-storage' was balanced, for the operators of large facilities, by a CGS benefit not available to the operators of small facilities, outwith the CGS, obliging government to introduce a temporary facility for these businesses to 'opt-in' to the CGS. This sort of issue could be magnified many times over with sweeping changes affecting the entire regime for property.

(a) Removing the ability to opt and making all relevant transactions exempt

This would significantly increase costs for landlords and developers, and therefore also for tenants. It seems unlikely that the idea is compatible with the assertion at para 1.2 of the call for evidence that 'the government wants UK businesses to operate in the best possible environment and remain both productive and competitive'.

The measure would also increase uncertainty. As noted above, most of the problems arise because it is unclear whether supplies are to be treated as property supplies, but this is not normally an issue where the owner has opted, because they are then taxable in any case. Without an option, the point would almost always make a difference.

(b) Removing the option to tax and making all land and property taxable at a reduced rate

This idea would have the advantage of making property businesses fully taxable, but we would be surprised if government was prepared to tax residential rents, so we doubt that it would even have this benefit. Beyond this, the actual impacts would, of course, depend on what the reduced rate was – whether, say, it was 5% or 15% – but there would clearly be additional costs for many tenants, even if residential lettings were excluded.

Like a), the measure would also increase uncertainty, again posing the question whether or not a supply was to be treated as a property supply. If it is currently unclear whether a trading concession, or a call option, is

exempt, the question now would be whether it was reduced-rated. And, also as at a), whereas now an option to tax resolves the matter, since the supply is then standard-rated in either case, this would no longer apply, so that there was always potential uncertainty with these transactions.

c) Making all commercial land and property taxable at the standard rate with an option to exempt

If the option to exempt was generally available, this might be little different from the current regime, with legal teams now needing to confirm that an option for exemption, rather than an option to tax, had been exercised. The work involved in making the switch, for taxpayers, advisers, and HMRC, would seem to be considerable, also extending to landlords who are not registered for VAT because their supplies are currently exempt. We cannot see how this could be justified.

If in fact the option was not always going to be available, this idea potentially increases costs, reduces flexibility and suggests new uncertainties. And, again, it fails to address the main current problem of whether supplies are of property at all: presumably the only could only be exercised if they were.

5) What are the advantages and disadvantages of making all minor and short-term interests in land and property subject to VAT?

This suggestion covers a wide range of possibilities: 'short-term' could mean anything from 24 hours to 25 years, and the implications would vary accordingly. We are also unsure whether the reference to 'minor' interests is to those that are not 'major interests', or perhaps to equitable interests and rights over land.

More fundamentally, HMRC do not say whether they would propose to retain the option to tax. We would see it as essential that the option is retained, for whatever is regarded as a 'long-term' interest. The inference, however, is that this would not be HMRC's intention.

Our views differ, however, depending on the meaning of 'short-term', so we consider three possibilities below.

24 hours

We do see some merit in a rule that a licence to occupy must be for at least 24 hours. This was actually Customs' view until the decision in *Tameside*. It would remove some of the uncertainty around lettings of a hall, a trading concession etc. Even here, however, there would be questions around whether the licensee had to be entitled to continuous occupation, about the treatment of a series of lets, and so on, which would need to be addressed. The measure would result in more complicated, not simpler, legislation.

Months

Much more tentatively, there may be an argument for a cut-off of a few months. Working with the OTS in 2017, we discussed in some detail the idea of a limit of a little more or less than three months. We saw some benefits in it, if it also meant that some of the existing mandatory exclusions from exemption could be repealed: examples would be those for parking and holiday accommodation, the letting of which for a longer period could then be exempt.

However, we would urge extreme caution in extending the definition of "short-term" because what is considered as such can differ widely between commercial and residential property. A six-month commercial lease would be seen as rather short-term (though lease lengths have shortened considerably over the years

and continue to do so), but a residential lease of the same duration can be quite normal, particularly in the context of student accommodation.

Indeed, extending "short term" beyond a few days could cause real headaches for student accommodation providers, particularly in the following circumstances:

- ***Summer lettings*** - Many student accommodation providers let out surplus accommodation on short term contracts over the summer months. The VAT treatment is broadly based on (i) whether it is held out as an alternative to hotel accommodation and (ii) what is being offered (i.e. a licence to occupy on the same terms as an Assured Shorthold Tenancy (AST) or bookings on a nightly basis).
- The risk in applying a definition to "short term" in these circumstances is that block bookings which are more akin to a hotel offering could fall to be exempt, while shorter residential stays, including those on a rolling contract, could become subject to 20% VAT (which businesses may not be able to pass to tenants).
- (We consider the VAT treatment of hotel and holiday accommodation, as opposed to short term residential lettings, in our response to Question 12 below).
- ***Short-term student accommodation bookings*** - student accommodation is generally let on an AST of between 43 and 51 weeks in length (i.e. an academic year). However, there are occasions where an AST is required to be shorter than this, such as when a student tenant moves into a room later in the year. Additionally, where a tenancy is less than 4 months long (for example, for a term rather than a year), an AST tends not to be used. Instead the tenant enters into a licence to occupy the room on identical terms to those within an AST apart from having a shorter term.
- As with the summer lettings scenario, applying a minimum stay to a residential tenancy for VAT exemption to apply, or applying standard rating to a licence where an AST is exempt, could therefore cause some of these shorter agreements to be subject to VAT, either increasing rents, or increasing the cost to the business where market forces preclude this.

Transitional issues, of the kind discussed below, could largely be avoided by the new legislation being introduced and publicised a year in advance.

Ten years

We see significant disadvantages in any more drastic measure. If, for example, we assume a model where exemption was confined to, and mandatory for, freeholds and leases of more than ten years:

- There would be a significant increase in costs for many short-term tenants of unopted properties. These would include businesses with exempt activities, small businesses not registered for VAT, charities and private individuals, including residential tenants. We assume that VAT on residential rents would not actually be acceptable, but continued exemption for these would immediately complicate the model, require clear definitions, and raise the question of what other rents deserved the same treatment, resulting in further complexity. (For similar reasons, we also assume that HMRC intend to preserve existing zero-ratings for the grant of a major interest, and so have not commented on the implications of any change here. We would welcome the opportunity to do so if we are mistaken.)
- Many more landlords would be required to register for VAT, whether or not the registration limit is reduced following the review recommended by the OTS. In these and other cases, there would also be new issues as to whether relatively casual property letting was a business activity. These do not arise while the activity is in any case exempt.

- In the absence of an option to tax, there would be significant adverse impacts for property developers. These will normally grant leases of 15-25 years, creating an asset with an income stream that can then be sold to an investor. They would now need to grant leases of ten years or less in order to recover input tax, making the asset less attractive to investors, and less saleable. Importantly here, property investment is not constrained by national boundaries, and many investors in UK property are from overseas. It could be assumed that they would be more likely to invest in other countries.
- There would be further issues for residential developers if HMRC were considering removing the zero-rating for the grant of a major interest. We have not understood this to be under consideration, so we have not commented on the implications.
- In order to deal with this problem, developers might be expected to enter into arrangements that ensured that what were in reality 'long' leases could still be treated as 'short'. We have already noted that any minimum period for exemption raises questions about whether the tenant needs continuous access, with break clauses and renewal provisions, and there would be further issues with whether a variation, or a change of landlord, was treated as a new grant. The legislation would need to be unambiguous about points such as this. It can also be assumed that, however they were dealt with, taxpayers would manipulate the rules in order to preserve the flexibility that the option to tax provides, in some cases to ensure that lettings were exempt, in other cases to ensure that they were taxable. HMRC would need to be clear about the extent to which this was acceptable, or whether it might be challenged as 'abusive'. In reality it would be difficult to determine whether the arrangements had been entered into for VAT reasons, since restrictions on access, break clauses, rights to renew etc are already normal features of the market. HMRC might think it necessary to introduce anti-avoidance provisions, adding another layer of complexity.
- Automatic taxation of short leases could also re-open the planning opportunities, such as 'lease and leaseback' arrangements for exempt occupiers, that the anti-avoidance rules for the option to tax were designed to address. We assume, however, that HMRC have considered this, and are content that they could now tackle these arrangements as 'abusive', in line with *University of Huddersfield* and para 6.20 of the OTS report.
- It is unclear whether leases would be considered in terms of their original length, or their remaining term. We have noted issues with break clauses, renewal etc, but leases are also assigned or surrendered. If a lease is granted for 20 years, and assigned or surrendered after 15, does it still count as long-term, or has it become short-term? Whatever the answer here, it is likely to distort the market, with transactions being accelerated or delayed in order to ensure a certain VAT treatment, or alternatively with leases being artificially prolonged. HMRC might, perhaps, see avoidance here, but securing optimum treatment would become more complicated for taxpayers.
- HMRC refer to removing exemption for 'minor' interests in land. If this means interests that are not major interests for the purposes of zero-rating, it does not raise significant additional points. If, as we suspect, it means interests that are not legal interests, together with rights over land, it clearly does. We are, of course, conscious that HMRC are no longer confident that these can be exempt anyway, even under current legislation, and we look forward to any clarification about this. Legislating actually to exclude them from exemption would at least provide greater certainty than there is at present.

  In practice, many rights over land are specifically excluded from exemption already, and their blanket removal might at least be worthy of discussion. The removal of interests such as a call option, would tend to have perverse results where the interest over which the option was granted was exempt: whereas, say, £1m for a 25-year lease would be exempt, £1m for a call option to take a 25-year lease for a peppercorn

would be standard-rated. We acknowledge that such an arrangement could, in the absence of an option to tax, be a very useful VAT planning device, but we doubt that this is what HMRC are seeking to achieve. The more logical treatment is for a right to any particular legal interest in land to be treated in the same way as the interest itself.

Transitional issues

HMRC have not indicated whether or not they would envisage the new rules applying to existing leases, so we consider both possibilities here, again looking at a model where exemption was confined to, and mandatory for, freeholds and leases of more than ten years.

- If the new rules applied immediately, this would of course mean that many exempt 'short' leases would become taxable for the rest of the term, creating unbudgeted costs for tenants, and disputes as to the effectiveness of clauses intended to preserve exemption. In some cases, the rent would become VAT-inclusive, so that the unbudgeted burden fell on the landlord rather than the tenant, and creating a potential windfall for taxable tenants. None of this is straightforward, as illustrated for example by *CLP Holding Company Limited v Rajinder Singh and Parvinder Kaur* ([2014] EWCA Civ 1103), and we would anticipate many disputes between landlords and tenants.

  Also if the new rules applied immediately, many taxable 'long' leases would become exempt. This might suggest that landlords and developers, together with investors who had acquired a property via a TOGC, needed to make repayments via the CGS. We are aware that the ECJ considered a similar situation in *Gemeente Leusden*, but that the judgment took account of the manner in which the legislative change had been introduced, thus providing no definitive answer.

  It is to be hoped that the legislation would provide for no CGS adjustment to be required in these cases, although this would, of course, add further complexity. In the absence of such a provision, however, property owners would face substantial unbudgeted costs, there would be uncertainty, and HMRC would have to anticipate litigation if they actually expected repayments to be made. Disputes would also be likely between landlord and tenant, since many long leases allow VAT costs to be passed on, although typically only if the option is disapplied because of some action of the tenant.

- There would be different issues if the new rules only applied to new leases, and the current treatment of existing leases was preserved. There would be immediate questions about what actually constituted the grant of a new lease for these purposes, and efforts to accelerate or decelerate transactions around the date of the change, in order to secure the desired result. Thereafter, taxpayers would again try artificially to preserve existing leases and a more beneficial VAT treatment, raising questions as to whether they were engaged in avoidance.

  A staged change would also involve a long period during which two entirely different regimes applied, and taxpayers, advisers and HMRC staff would need to be familiar with both. Since leases are often granted for 999 years, this transitional period could last as long as the new rules themselves. HMRC might think it appropriate to bring the transition to an end at a later date, perhaps after ten years once potential CGS adjustments had expired, but this too would add a layer of complexity.

- We would also point out that property developments typically take at least two years, and that many take far longer: we are aware of some large, phased, projects that are not expected to be completed for 30 years. Clearly developers entering into very long-term projects recognise that circumstances may change, but we would suggest that implementation needs to take account of realistic expectations. We doubt that developers would normally anticipate radical VAT changes which might make a project unviable, such as

the withdrawal of the option to tax, within five years. We would suggest that any such measure would need a corresponding lead-in time.

- Finally here, we should mention that the current rules are widely known, at least to an extent adequate for the vast majority of transactions, and particularly in the law firms that actually handle them. Individuals will have extensive experience, firms will have internal guidance and precedent documentation for sales and leases. Similar material is also available commercially, while standard enquiries (https://uk.practicallaw.thomsonreuters.com/6-502-2923, http://www.psglegal.co.uk/due_diligence.php) are routinely used to tease out potential problems. This learning and material has been built up, with little or no HMRC input, over decades. All of it would now need to be rewritten and relearnt. This suggests that the final form of the legislation, and HMRC guidance, would need to be finalised well in advance of any changes coming into effect. Even then there would be problems, and conflicting interpretations, but without an adequate notice period we would expect disruption to the property market, disputes as to the correct treatment, delays to transactions, and increased fees.

6) How should a minor and short-term interest be defined?

This question pre-supposes that the idea is a good one. There might be merit in excluding the shortest of lettings, though as noted above once you move beyond 24 hours complexity can quickly arise for residential property in particular. Any more radical proposal, particularly if this involved removing the option to tax, seems likely to have too adverse an impact on businesses.

7) What are your views on the option to make supplies of land and property subject to VAT apart from certain specified exceptions?

This does partly depend on the scope of the exceptions but, if these are to be more or less confined to residential and charity property, as 3.3.2 suggests, then the idea would result in additional VAT, stamp tax and compliance costs for a large number of businesses, and should not be taken forward for that reason. Disadvantages would be similar, *mutatis mutandis*, to those we have identified at question 5.

8) Which particular supplies of land and property should continue to be exempt from VAT if this option were to be considered further?

The option should not be considered further.

9) Are there any supplies that should be subject to VAT that are currently exempt or vice versa?

Possibly – see question 12.

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10) What are your views of linking the VAT liability of interests in land to those recorded in Land Registers in England, Scotland, Wales and Northern Ireland?
The suggestion has little merit, and many disadvantages – we would not recommend exploring this further.
11) What are the potential advantages and disadvantages of such an approach?
The idea might perhaps provide greater certainty, although we suspect that this would be undermined by exceptions for residential and other property, as HMRC themselves suggest at 3.4.5, and by uncertainty as to whether transactions were in the course of business. It seems to have nothing else in its favour. We note that, while 3.4.3 suggests that registered interests would be exempt, and other interests taxable, 3.4.4 suggests the complete opposite. It is also unclear whether (at, say, 3.4.3), exemption would only apply to the outright disposal of a registered interest, such as the sale of a registered freehold or the assignment of a registered lease, or also to the grant of a lease out of a registered title, or the transfer of an interest that was merely noted against someone else's title. There are clearly many possible variations, so that it is not possible to comment on the precise implications. We are, however, confident that any rules of the kind described here would mean additional costs for many occupiers, a loss of flexibility for owners, distortion of the property market and the land registration process, and different treatment between registered and unregistered land. People might seek to register, or not to register, if there were tax consequences, or to ensure that registered interests were or were not transferred outright. There would also be different outcomes amongst the constituent countries of the UK: the rules for leasehold registration differ markedly between England & Wales, Scotland, and Northern Ireland. The results would be arbitrary, and irrational. We would also point out that the Land Registries record only legal title, whereas VAT is concerned with economic or 'beneficial' ownership; beyond straightforward home ownership, the legal owner and beneficial owners are often different. It is unclear how HMRC's suggestion fits with economic reality, or whether the supply would be treated as by the legal or beneficial owner.
12) Do you have any other suggestions on how the land and property VAT rules could be simplified?
Simplicity should not be seen as an end in itself: it can lead to greater ambiguity. The objective should be a better user experience for taxpayers. Much of this comes down to providing greater certainty, whether this results in shorter or longer legislation. We do, however, see a number of points that could usefully be considered, in conjunction with relevant stakeholders and professional bodies, and we offer some suggestions for discussion below. Note – we are not necessarily recommending that these be taken forward.

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General

- *Zero-rating residential*. There could be considerable simplification benefits to zero-rating the letting of residential property. In particular, it would no longer be necessary for build-to-rent and student accommodation providers to carry out the commercially unnecessary grant of a major interest to a related party simply to recover VAT on construction costs.
- *Reduced-rating refurbishment and repairs for residential.* In a world where achieving net zero carbon emissions is at the top of the global agenda, it seems nonsensical for the VAT system to penalise refurbishment and repair work with a 20% rate while more carbon intensive new construction benefits from a zero rate. The tax system should support sustainability-enhancing retrofit work rather than punish it.

Sch 9 Group 1

- *Rights over land*. Is there a case for removing the exemption? HMRC seem reluctant to recognise it anyway, but its removal would also allow the repeal of specific provisions about game, fish and standing timber, and remove uncertainty over easements, restrictive covenants, and rights to light.
- *Freehold new buildings and civil engineering works*. Can mandatory taxation be repealed? Sellers who wished to do so could still opt to tax, and the provision was only included in 1989 in an effort to comply with the Directive.
- *Hotels and holiday accommodation*. Could a time limit replace the detailed provisions here, such that (say) bedded accommodation was taxable if provided for a period no more than a month, and otherwise potentially exempt? Could something similar be done with caravan pitches?
- *'Self-storage'*. Could mandatory taxation be confined to actual self-storage, rather than applying to any storage? And could the exceptions for animals, connected persons, charities etc then be repealed? Indeed, could the entire provision be repealed, given that it seems that self-storage would not be an exempt licence to occupy anyway?
- *Hairdressing facilities*. Similarly, and for the same reason, can this provision be repealed?
- *Sports grounds and places of entertainment etc*. Could the automatic taxation of seating etc at these be repealed? What is covered by this that would actually amount to an exempt licence to occupy anyway?
- *Sports facilities*. Could the series of lets rules be repealed?
- *Residential service charges.* Would it now be possible to provide greater clarity by legislating ESC 3.18?

Sch 10

- Can the exclusions for dwellings, charities, housing associations etc be improved?
- Could revocation be available after 10 years, rather than the current 20, in line with the CGS? It was only ever 20 because, when provision was first made for it (in 1995), there were proposals to extend the CGS to 20 years.
- Is the permission regime for the option actually needed? Are there specific rules that could replace it? Otherwise, can the automatic permission conditions be reviewed? Many people regard APC 3 as virtually unintelligible.

- There is currently little scope for appealing option to tax matters to the Tribunal. Can this be remedied?

Sch 10 – anti-avoidance

- Can the anti-avoidance rules be repealed? HMRC's suggestions for automatic taxation suggest that they would be willing to dispense with them, and to rely on 'abuse' where necessary.
- Otherwise, can the 'relevant transferee' provision be repealed? Its purpose has never been clear.
- Expected occupation by a development financier can be disregarded where it accounts for no more than 10% of the building. Could it also be disregarded where the finance accounts for no more than 10% of the development cost? This would resolve issues with tenant-requested modifications, etc. It would also give statutory cover for, and greater certainty around, HMRC's view that 'incidental or trivial payments' should be ignored.

Other possibilities

- An optional reverse charge for property transactions, allowing the buyer to account for any VAT. For buyers who were fully taxable, incorrect treatment would not result in any net error, making it less important to establish whether or not VAT was actually due.
- Basing SDLT, LBTT and LTT on the price excluding any VAT . For most businesses, this would remove the main driver for ensuring that acquisitions could be treated as TOGCs, or as exempt. A reverse charge, however, would have a similar effect.
- Extending recovery of pre-registration VAT. For commercial reasons, a property development often needs to be undertaken by a separately-registered SPV, which will start incurring VAT several years before it makes any supplies. It can be difficult to obtain registration at this stage and, when this is achieved, any claim for earlier VAT on building work or professional services is confined to amounts incurred within the previous six months. This should be extended to four years, in line with the treatment of goods. This is not a new proposal: it draws on both the OTS report (para 5.24) and the 2003 consultation on 'Making input tax recovery fairer'.

This, of course, is not an exhaustive list, but this sort of issue-by-issue approach seems more likely to achieve actual simplification, without unintended consequences.

13) Would you prefer to keep the VAT rules on land and property as they are? If so, please explain.

The current rules are vastly preferable to anything that HMRC appear to be contemplating, while the problems described at the beginning of the call for evidence seem exaggerated, given the volume, value and complexity of dealings in property. Against that backdrop, and overall, the current regime has served well for decades, and has the benefit of familiarity.

One of the strengths of the legislation has been that is rooted in land law. By choosing to exempt interests in and rights over land, together with Scottish personal rights, the draftsman was drawing on established concepts, which were already the subject of extensive case law and commentary. The scope of the exemption did not need to be articulated specifically for VAT purposes.

This is not to suggest that no changes are desirable. We do see some merit in exploring automatic taxation for very short lettings, and we have made some further suggestions at question 12. But any change has the potential to create additional costs and greater uncertainty, and to have unforeseen consequences.

Simplifying the VAT land exemption – Call for Evidence

Considerable care would be needed, not least around what might be quite lengthy and complex transitional periods moving from existing to new rules.

In the meantime, we would urge HMRC to prioritise:

- Developing a coherent position, likely to resist challenge before the Tribunal, on specific areas of current uncertainty, including trading concessions etc, dilapidations, call options and overage.
- Revising guidance to reflect current law and interpretation, and expanding it where they are aware of taxpayer uncertainty, working with taxpayers to ensure that the guidance provides sufficient clarity.
- Sticking to their guidance – both pending and following revisions to it – so that taxpayers can actually rely on it.
- Developing an enhanced taxpayer portal offer, where taxpayers can access online relevant documentation, including:
    - Correspondence with HMRC on VAT-related matters
    - VAT registrations (both single entity and VAT groups)
    - Option to tax notifications
- Specific changes, not to the property provisions, but to those for construction, where the OTS's observations about policy, social, economic and technological changes, noted at 2.3 in the call for evidence, are far more relevant. We have already drawn HMRC's attention to ways in which Sch 8 Group 5 Note 2(c) and (d) are a hindrance to public policy, and could be readily amended; we are, of course, happy to reiterate the points.