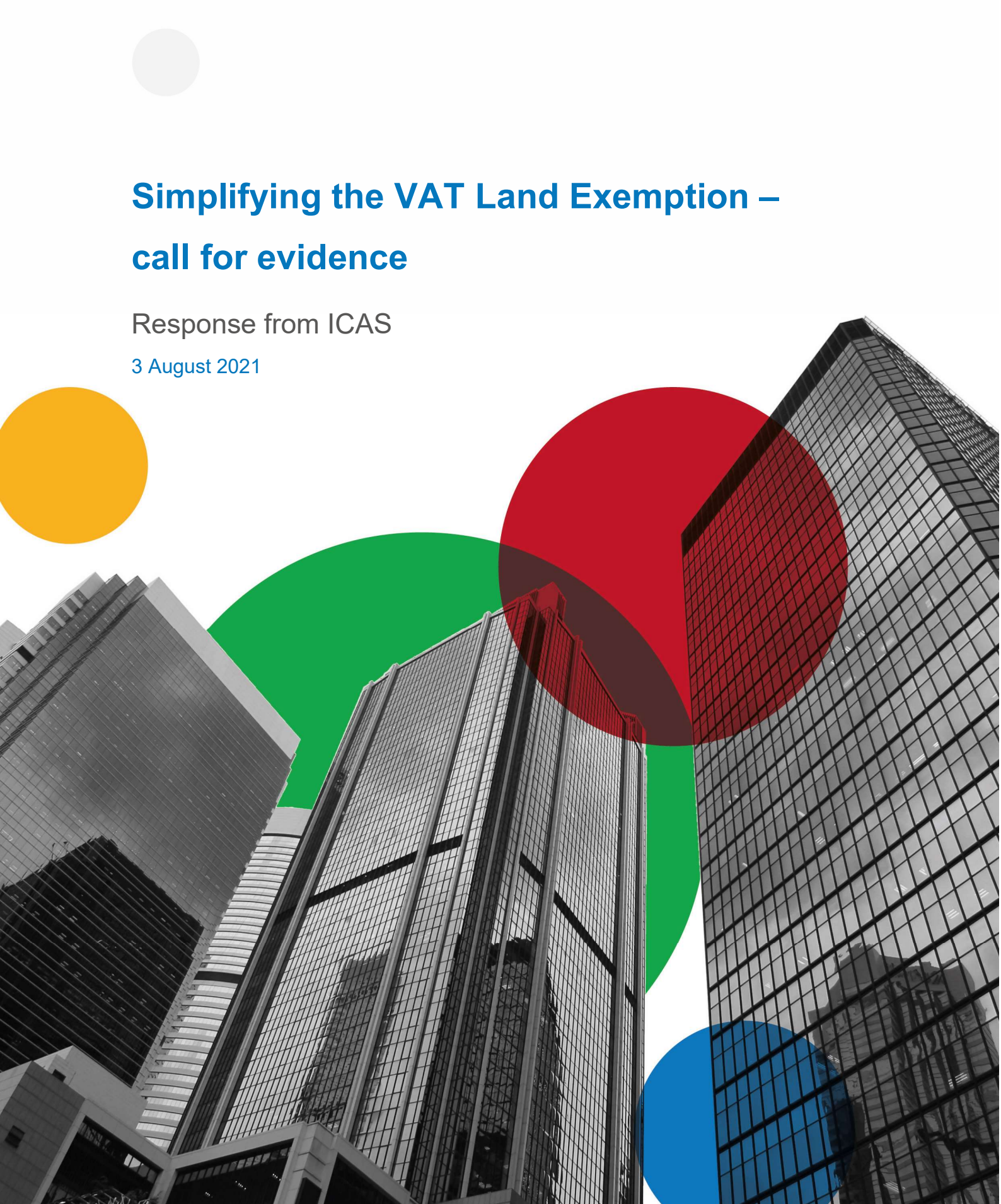




Simplifying the VAT Land Exemption – call for evidence

Response from ICAS

3 August 2021

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.
2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General comments

4. ICAS welcomes the opportunity to respond to the HMRC call for evidence on [Simplifying the VAT Land exemption](#), published on 12 May 2021.
5. The current regime has been in place for a long time, is generally well understood and works well for many transactions. The flexibility it provides is valuable and should be retained – to avoid adverse economic consequences. The focus should be on improvements which could be introduced to make the existing VAT regime for land and property run more smoothly.
6. We do not believe that the suggestions for significant reform mentioned in this call for evidence would improve the position in the majority of cases. Most of these proposals involve the removal of flexibility and a high likelihood of the creation of a different set of complications, boundary issues and difficulties (in some cases for different taxpayers) without any significant overall benefit.
7. However, we have various suggestions for improvements which could be introduced to make the VAT regime for land and property run more smoothly; these are discussed in our response to Question 12.

Specific questions

Chapter 2

Question 1: What is your experience of the VAT rules on land and property?

8. Our members work in a range of sectors, both as advisers and in industry. Their experience of the VAT rules on land and property therefore varies considerably.

Question 2: Are there any supplies that are particularly difficult to establish the correct liability for, leading to financial and administrative burdens? Please explain.

9. Yes, there are areas of difficulty, particularly where anti-avoidance legislation is concerned. However, some significant recent areas of uncertainty have arisen as a result of lack of clarity in HMRC's communications and/or changes in HMRC's approach. For example:
 - Dilapidations: considerable uncertainty has been caused by RCB 12/20 and related unexpected changes to longstanding and well understood guidance. Whilst the changes announced in RCB 12/20 will no longer be retrospective, the position remains unclear. Following discussions with stakeholders, further communications from HMRC are awaited.
 - Call options: uncertainties arising in view of the approach adopted by HMRC in the Landlink case, which was at odds with its longstanding guidance on options.

- Cladding: following the Grenfell tragedy the VAT treatment of work to replace cladding became of considerable importance. HMRC's view was unclear and shifted in discussions with stakeholder forums. Limited clarification was circulated to members of one forum but the absence of official published HMRC guidance has been problematic.
10. Issues of this kind do not require wholesale changes to the rules; HMRC could address them by improving its guidance, adopting a consistent approach and avoiding unexpected changes to longstanding guidance. Where HMRC's views do change, the details should be communicated effectively and in a timely manner. Official guidance should be published promptly on areas which become of wide significance, where the correct VAT treatment is unclear - or where new issues arise as a result of unexpected circumstances.
 11. Difficulties in establishing the correct liability could also usefully be addressed through improvements to HMRC's process for giving rulings. There will always be borderline issues and cases arising from novel circumstances where the correct VAT treatment is unclear. We discuss this further in our response to Question 12.

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

12. The current regime has been in place for a long time, is generally well understood (subject to particular areas of difficulty like those mentioned in our response to Question 2) and works well for many transactions. However, there are improvements which could be introduced to make the existing VAT regime for land and property run more smoothly – see our response to Question 12.
13. We do not believe that the suggestions for significant reform mentioned in this call for evidence should be considered further, for the reasons discussed in our responses to the relevant questions and summarised in our response to Question 13.

Chapter 3.1

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

14. The OTS set out their reasons for rejecting the three options mentioned in the call for evidence – we agree with their conclusion that none of the options should be pursued.

15. The options were:

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

We agree with the OTS that there would be adverse consequences arising from the irrecoverable VAT created by this approach. In particular the impact on the cost of new domestic dwellings is unlikely to be acceptable. Removing the ability to opt would also create uncertainty in cases where it was unclear whether a supply is an exempt supply of land or standard rated – currently opting to tax provides certainty.

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

Again we agree with the OTS comments. This would reduce the irrecoverable VAT arising from option a) but if the reduced rate applied to residential dwellings, it would be likely to increase the cost to consumers. However, excluding residential dwellings would reduce any simplification benefit. As with option a), removing the ability to opt would also create uncertainty in some cases.

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

This does not appear to be a simplification and it is difficult to see any benefits arising from this option. Many of the issues arising with the current regime would also arise with an option

to exempt, and a database of options to exempt rather than options to tax would be needed. Also, as the OTS pointed out, it would require considerable administrative effort and cost for both HMRC and businesses to unpick the existing system.

16. The OTS did recommend (Recommendation 4) that HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS. This was not directly related to land – but simplification of the rates and exemption structure might assist with some of the issues around land. It would also be helpful to consider some changes in relation to land and property to support the Government's plan to tackle climate change – we discuss this further in our response to Question 12.
17. We discuss other OTS recommendations (numbers 7, 8 and 20) in our response to Question 12.

Chapter 3.2

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

18. The call for evidence does not make any suggestions for a possible definition of 'minor' and 'short term'. It is also unclear whether the intention would be for the current rules to remain unchanged for any 'long term' interests which did not fall within the definition.
19. In the absence of any detailed proposals we are unable to provide detailed comments on possible advantages and disadvantages. However, we do have the following general comments.
20. Paragraph 3.2.6 hints at one problem – the difficulty of arriving at a definition of 'short-term' interests which does not create similar borderline issues to those the proposal is seeking to address.
21. Depending on the definition of short term there could also be issues around, for example, break clauses in leases, renewals of leases and assignments part way through the term of a lease. Similarly, there could be significant transitional issues depending on how any new rules would apply to existing arrangements.
22. It seems likely that complex legislation would be required – particularly if HMRC saw scope for manipulation of the length of an interest, which would require anti-avoidance provisions.
23. The call for evidence suggests that issues with the current rules include differing interpretations by businesses and frequent litigation – leading to unclear borderlines. Rather than introducing a new set of rules, where there is clearly potential for similar problems to arise, it would be preferable to consider whether clarification of existing legislation and improved HMRC guidance might produce better results.

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

24. See our response to Question 5. This would not be a useful simplification to consider further.

Chapter 3.3

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

25. We cannot see that this option would be beneficial. It removes the flexibility provided by the current system and (depending on the scope of the exceptions) would impose additional VAT and SDLT/LBTT/LTT costs on many, with likely adverse consequences.
26. It appears from paragraph 3.3.2 that the exemptions would relate to residential accommodation and charitable buildings. If these exemptions were extended, it would undermine the suggested benefits and increase complexity. However, restricting the exemptions would involve adverse

consequences for many who would prefer to be making exempt supplies. There would also be significant transitional issues.

27. The flexibility of the current system is preferable – and some of the practical difficulties associated with it could be addressed. See our response to Question 12.

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

28. See our response to Question 7. This option should not be considered further.

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

29. See our response to Question 12.

Chapter 3.4

Question 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?

30. This would also remove the flexibility provided by the current rules. We do not believe it should be considered further.
31. It might in theory provide more certainty but as noted in paragraph 3.4.5 there would still have to be exemptions, so in practice it is unclear that certainty would be achieved. Other obstacles include: the land registry records legal title rather than beneficial ownership and the law relating to leases is not the same in Scotland as in England and Wales. We are also concerned that linking the tax treatment to registration could distort behaviour. It is also unclear how any transitional issues arising from this approach could easily be dealt with.
32. In order to provide certainty for businesses, it would be preferable to retain the current rules and the option to tax but introduce a fully digital opting system and explore the creation of a database of options as suggested by the OTS. We discuss this further in our response to Question 12.

Question 11: What are the potential advantages and disadvantages of such an approach?

33. See our response to Question 10. This should not be considered further.

Chapter 3.5

Question 12: Do you have any other suggestions on how the land and property VAT rules could be simplified?

34. Yes – we set out some suggestions below. Not all of these involve simplification of the rules – it is important to consider other ways of improving the operation of the existing system whilst retaining the flexibility it provides. There could also be changes to improve the alignment of VAT policy with the Government's plan to tackle climate change.

Option to tax

Digital system for options and creation of a database of options (OTS Recommendation 8)

35. The option to tax provides valuable flexibility in the land and property regime. Many of the issues that arise tend to be practical ones with the process for opting (and obtaining HMRC confirmation) and around ascertaining whether an option exists. There is currently no central register of options so legal agreements relating to property transactions often include clauses to deal with the lack of certainty arising from the absence of a definitive record.

36. The OTS considered the opting process in its VAT review. It found that an automated digital system for dealing with options to tax would be useful to HMRC and businesses – and would address the practical problems which currently arise when initially opting. A digital system would enable efficient online notification and confirmation, and would also create an audit trail – with businesses able to access and print confirmations when later required for legal transactions.
37. A digital system could also be a starting point for the creation of a central database of options which would be very useful. It would prevent many queries to HMRC and address delays in obtaining HMRC responses - saving time and effort for business, advisers and HMRC. Clearly, a central database would not initially include past options – although businesses could be given the opportunity to add these. However, adding all new options going forward would gradually build up a reliable database
38. The OTS mentioned concerns about confidentiality arising from a publicly accessible database but considered that it would be worth exploring whether limited property-specific information could be made public. Much of the data would already be in the public domain for various reasons (for example, Land Registry, Registers of Scotland etc). We assume that the key information for the database would be the date of the option, VAT number and property – and in view of the benefits of having a database, we would expect widespread support. However, if a publicly available database proved to be impossible to implement, it would still be useful for HMRC to hold a database which would enable it to deal with queries arising around property transactions.
39. We strongly support the OTS recommendation for a fully digital opting system which would allow businesses to access and print confirmations. We also support their suggestion for further exploration of the creation of a database to record options. Implementation would further HMRC's ambition to become one of the most digitally advanced tax administrations in the world.

Revocation of options to tax

40. Revocation of an option to tax is currently only available after 20 years. It would be helpful if the 20 year period could be reduced, so that it would be possible to revoke an option after 10 years. This would provide greater flexibility and facilitate transactions involving previously opted property.

Automatic permissions for opting

41. Simplification of the automatic permissions for opting would be useful. If condition 1 is not met it can be very difficult to establish whether the other conditions apply, particularly condition 3.

Display of company names in option to tax and groups records

42. Our members report that difficulties arise because of the restricted number of characters available for company names in HMRC's option to tax and groups records. For example, companies in a group may have similar names: X Ltd London, X Ltd Edinburgh, X Ltd York. In HMRC's records for options and VAT groups, all the companies appear as shortened variations of 'X Ltd' due to the restrictions on the number of characters.
43. This can make it difficult to identify the precise VAT group company involved and is unhelpful, (and is particularly problematic in identifying a company that has notified an option when it leaves a VAT group, particularly to join an unrelated VAT group). It should either be addressed by extending the characters available generally for these fields in HMRC systems and in the existing opting records, or in the development of the new fully digital opting system discussed above.

Capital goods scheme (OTS Recommendations 7 and 20)

44. In our response to the OTS VAT review we noted that the capital expenditure threshold for land and property was set at £250,000 in 1990 and is now far too low. We suggested that if CGS remains in its present form the threshold should be brought up to date – and then regularly reviewed (at a specified interval, say, five years). This would mean that many taxpayers would no longer need to consider CGS.

45. OTS Recommendation 7 called for a review of the land and property threshold for CGS and the 2019 call for evidence 'VAT Partial Exemption and Capital Goods Scheme' included a question on the advantages and disadvantages of increasing the threshold. The summary of responses to the consultation in March 2021 reported that:

"Most respondents indicated that the threshold should be increased, with mixed views on the advantages and disadvantages of doing so. The main view was that it would reduce the number of qualifying assets falling under CGS, simplifying internal record keeping and reducing the administrative burden on businesses. However, respondents also stated the disadvantages, which include some taxpayers (and HMRC) losing out from future changes in usage and the VAT resulting, if they were not under the CGS mechanism.

Many respondents did not specify a specific value for the increase, although links to indexation and inflation were suggested. Some respondents specifically stated £1 million, again with many requesting indexing going forward or regular reviews. A smaller number of respondents suggested a value of between £2.5 million and £5 million.

The stakeholder meetings included similar discussions to the above. The general view was that an initial increase would be welcome, followed by regular reviews and increases in the future. Stakeholders also wanted any increases to be based on the economic life of assets."

46. The 'next steps' section of the response document stated: *"In terms of the de minimis and CGS, HMRC will also engage further with stakeholders to better understand the impact of any potential threshold and process changes which could be made in the future."*
47. We would like to see action taken to increase the threshold – preferably to £5 million – with indexing or regular reviews going forward.
48. The OTS also recommended (Recommendation 20) that the Government should consider introducing a de minimis level for capital goods scheme adjustments to minimise administrative burdens. The response document for the 2019 call for evidence noted that this was the most common suggestion made by respondents for improving the CGS.
49. Feedback from our members indicates that the administrative and record keeping burdens involved where there are only marginal changes in the use of a building are disproportionate to the VAT at stake. A multinational financial services enterprise may also devote considerable amounts of time to working out an annual CGS adjustment, which is of little benefit to anyone because the residual recovery rate is relatively static. A de minimis level for CGS adjustments would be helpful – but it would be important to ensure that it operated in a way which removed the need to complete full adjustment calculations.
50. We also suggested, in our response to the OTS review, a useful reform to address the problem with marginal changes in the use of the building. This would be only to require a CGS adjustment if the movement in taxable use of the building was, say, 5% either way – with the option for the taxpayer to opt to make an adjustment for smaller movements.

Rates – building renovations

51. As set out in our response to Question 4, the OTS recommended (Recommendation 4) that HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS.
52. It would be helpful for this review to be undertaken and to include consideration of changes in relation to land and property to support the Government's plan to tackle climate change.
53. Currently, the VAT system can disincentivise the renovation and repair of existing buildings. In some limited circumstances the reduced 5% rate may be available (for example, residential properties empty for 2 years or some residential conversions) but there is clearly scope to incentivise more refurbishment and reuse of older buildings through extending the availability of the reduced and zero rates. As RIBA has recently [pointed out](#) demolition and replacement with

new buildings causes carbon emissions – it would be preferable to refurbish old buildings rather than scrapping them, where possible.

54. Our response to Question 2 highlighted difficulties and uncertainty relating to the VAT treatment of replacement cladding. Leaving aside the lack of clarity around HMRC's policy in the aftermath of the Grenfell tragedy, it would be helpful if cladding remediation work always qualified for zero rating.

Other

SDLT/LBTT/LTT

55. SDLT/LBTT/LTT should apply to the VAT exclusive cost of properties – rather than the VAT inclusive cost.
56. The current position distorts transactions – leading to pressure for TOGC rules to apply, or to the purchase of exempt property. It also causes uncertainty – indemnities have to be put in place to cover scenarios where additional SDLT/LBTT/LTT could arise due to uncertainties around the VAT treatment.

Pre-registration input VAT

57. Currently pre-registration input VAT can be recovered if it was incurred on goods within four years of registration – but for services it can only be recovered if incurred within six months. This causes considerable difficulties in the context of construction services and property developers - property developments often take a number of years, and many are carried out by SPVs (due to banking requirements).
58. Whilst it may be possible to backdate VAT registration this requires HMRC's permission and creates uncertainty. Consideration should be given to aligning the rules for services with the rules for goods. Some large property developments take longer than four years so additional changes to provide certainty on input VAT recovery in these cases might also need to be considered.

HMRC guidance and rulings

59. As set out in our response to Question 2 some recent areas of difficulty have arisen from lack of clarity in HMRC's guidance and approach. There will also always be borderline issues and cases arising from novel circumstances where the correct VAT treatment is unclear.
60. HMRC could address many of these issues by improving the clarity of its guidance, adopting a consistent approach and avoiding unexpected changes to longstanding guidance. Where HMRC's views do change, the details should be communicated effectively and in a timely manner and official guidance should be published promptly on areas which become of wide significance, where the correct VAT treatment is unclear - or where new issues arise as a result of unexpected circumstances.
61. Difficulties in establishing the correct liability could also usefully be addressed through improvements to HMRC's process for giving rulings. Feedback from our members indicates that it can take a very long time to obtain a ruling - in some cases, it can be difficult to obtain one at all. Businesses are often referred to HMRC's guidance so it is very important that they can rely on it – the approach initially adopted in RCB 12/20 (those with a ruling were protected but not those who had relied on HMRC guidance) was unhelpful in this context.
62. The Government has announced that it intends to proceed with proposals to require large businesses to notify uncertain tax treatment and [draft legislation](#) has been published. This is likely to increase pressure for HMRC rulings on complex issues, including those relating to land and property. It also increases the need for HMRC to ensure that its guidance is clear and up to date, so that HMRC's 'known' position is clear for the purposes of the notification triggers.

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

63. Broadly, yes. There are many advantages to the current regime which has been in place for a long time, is generally well understood (subject to some particular areas of difficulty like those mentioned in our response to Question 2) and works well for many transactions.
64. As noted in our response to Question 4, the OTS considered (and rejected) some proposals for significant reform; we agree that these should not be pursued. Other suggestions for major changes, mentioned in this call for evidence should also not be considered further. It is unlikely that they would result in genuine simplification (due in part to the need for exemptions) or improve the position in the majority of cases. There is a high likelihood of creating a different set of complications, boundary issues and difficulties (in some cases for different taxpayers) without any significant overall benefit. The removal of the flexibility provided by the current regime would have adverse economic consequences.
65. However, there are improvements which could be introduced to make the VAT regime for land and property run more smoothly. We have discussed these in our response to Question 12. The flexibility provided by the option to tax is particularly valuable – but problems are caused by difficulties accessing information about historical options. We therefore see particular merit in the OTS suggestions for improving certainty through a digital online opting system (which businesses could access to print confirmations) and for exploring the possibility of developing a database of options.

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