Tax Journal/2021/Issue 1531, 14 May/Articles/VAT focus — Balhousie: VAT on sale and leaseback arrangements – Tax Journal, Issue 1531, 19

Tax Journal
Thoughtful commentary - by tax experts, for tax experts.
Tax Journal, Issue 1531, 19

14 May 2021

VAT focus — Balhousie: VAT on sale and leaseback arrangements

Insight and analysis

Julia Lloyd

Norton Rose Fulbright

is a partner at Norton Rose Fulbright LLP. She specialises in tax structuring on complex real estate and fund formation matters, dealing with all aspects from VAT, SDLT and capital allowances to income and corporation tax. Email: julia.lloyd@nortonrosefulbright.com; tel: 020 7444 2491.

Will Scott

Norton Rose Fulbright

is an associate in the tax team at Norton Rose Fulbright LLP. He advises on a variety of corporate and financing transactions with a particular focus on the energy and renewables sectors. Email: will.scott@nortonrosefulbright.com; tel: 020 7444 2666.

Speed read: In Balhousie, the Supreme Court has held that a sale and leaseback which was used to finance the zero-rated acquisition of land did not have the result that the person entering into that sale and leaseback as vendor/lessee had disposed of its entire interest in the land for VAT purposes. The anti-avoidance legislation at VATA 1994 Sch 10 Part 2, which would otherwise trigger a self-supply charge, was therefore not engaged. Where taxpayers intend to hold property for a relevant charitable or residential purpose, it is essential that the structuring of the financing and acquisition of the property do not trigger an unexpected VAT charge. Confirmation that it should not be prejudicial from a VAT perspective to use a sale and leaseback arrangement over other forms of financing is therefore welcome news to taxpayers.

In *Balhousie Holdings Ltd v HMRC* [2021] UKSC 11 (reported in *Tax Journal*, 7 April 2021), the Supreme Court has provided the final instalment in the long-running appeal relating to the application of the self-supply charge (at VATA

1994 Sch 10 para 25–37) to the sale and leaseback of land. The Supreme Court's judgment follows on from the decision of the Court of Session in 2019 ([2019] CSIH 7), and the decision of the CJEU in *Mydibel SA v Belgium* (Case C-201/18) which was released shortly after the 2019 decision. The CJEU, in contrast to the Court of Session, acknowledged the composite nature of sale and leaseback transactions and chose to view the arrangements in aggregate rather than by reference to each of its constituent elements for VAT purposes.

The critical question in this dispute is whether a sale and leaseback of land should be treated as a single transaction, or two separate transactions, for VAT purposes.

The facts

The relevant property which was subject to a sale and leaseback in *Balhousie* was a care home that had been acquired by Balhousie Care Ltd (BCL) in 2013 from another company within the wider Balhousie corporate group. In order to finance the acquisition of the care home, BCL negotiated a sale and leaseback with Target Healthcare REIT Ltd. The intra-group sale of the care home to BCL had been zero-rated under VATA 1994 Sch 8 Group 5 item 1; this was not in dispute. The care home was then sold to Target Healthcare REIT Ltd in order for BCL to fund the cost of the initial, zero-rated supply of the care home and immediately leased back to BCL under a sale and leaseback arrangement. BCL continued to operate the care home.

In certain circumstances, the benefit of zero-rating on a supply of land intended for use for a relevant charitable or relevant residential purpose (such as a care home or certain types of student housing), can be clawed back from the recipient of the zero-rated supply or supplies (in this case, BCL) pursuant to VATA 1994 Sch 10 Part 2 if either of two stated events occur within ten years from the completion of the building (the relevant period). Care is always needed when restructuring or financing entities that have received such zero-rated supplies.

These two events are:

- where the recipient of the zero-rated supply (BCL) has, since the beginning of the relevant period, *disposed of its entire interest* in the building; or
- where there is a change in use of the building from a qualifying to a non-qualifying use (for example, if the property ceased to be used for a relevant residential purpose, such as a care home).

If either of these two events occurred, BCL would have been liable to a 'self-supply' charge to VAT, which was payable by BCL.

Disposal of the 'entire interest'?

The Supreme Court therefore had to determine whether the sale and leaseback effected by BCL amounted to a disposal by BCL of its 'entire interest' in the care home for the purposes of VATA 1994 Sch 10 Part 2.

To provide some history and context to the consideration of this question, in 2016 the First-tier Tribunal ([2016] UKFTT 377 (TC)) had found in favour of the taxpayer, holding that the sale and leaseback were interdependent and should be viewed as a single composite transaction. However, as the appeal progressed, HMRC succeeded at each stage. Both the Upper Tribunal ([2017] UKUT 410 (TCC)) and the Court of Session rejected the taxpayer's argument that the sale and leaseback should be viewed as a single transaction, choosing instead to focus on the transactional nature of VAT, concluding that the sale, on the one hand, and the leaseback, on the other, should be viewed as separate supplies for VAT purposes. In the words of the Upper Tribunal, endorsed by the Court of Session's approach, for VAT it is appropriate to 'look at transactions individually, component by component transaction by transaction'. As such, BCL would be treated as disposing of its entire interest in the property at the point of sale, regardless of the immediate leaseback. The VAT clawback provisions would therefore be engaged. This strict transactional approach distinguished the view for VAT of the transactions from a more holistic approach seen in direct taxes.

It is worth noting that the progress of *Balhousie* through the UK courts has occurred concurrently with *Mydibel* being considered by the CJEU. Although *Mydibel* concerned adjustments made to input VAT rather than the application of anti-avoidance legislation in the context of zero-rating and change of use, the approach of the CJEU to the question of whether a sale and leaseback should be viewed as a single, composite transaction or as two separate transactions for VAT purposes is at the very least informative to the similar question considered in *Balhousie*. Mydibel, a Belgian business, had recovered VAT incurred on supplies relating to the buildings it used for the purposes of carrying on its economic activity and subsequently entered into a sale and leaseback in respect of those same buildings. The Belgian tax authorities sought to adjust Mydibel's input VAT deduction on the basis that those VAT-able supplies had been used to make an exempt supply under the sale element of the sale and leaseback it made subsequently. However the CJEU decision, which was published after the decision of the Court of Session in *Balhousie*, found in favour of the taxpayer and endorsed a composite transaction approach, concluding that the two transactional elements of the sale and leaseback should be considered together as a single transaction.

Given the history of decisions going in favour of both the taxpayer and HMRC on *Balhousie*, and the contemporaneous consideration of similar issues by the CJEU in *Mydibel*, the decision of the Supreme Court has been long awaited as a grand finale to the *Balhousie* odyssey, with taxpayers wishing for some clarity on the application of the anti-avoidance legislation in VATA 1994 Sch 10 Part 2 and hoping for some additional clarity on how far the composite transaction approach could be taken in the VAT sphere.

The Supreme Court allowed the taxpayer's appeal, finding that the sale and leaseback did not have the effect of BCL disposing of its entire interest in the property and accordingly, as a basic matter, the self-supply charging provision at VATA 1994 Sch 10 para 36(2) did not apply.

The same findings but for different reasons

The leading judgment was provided by Lord Briggs, who considered that whether the sale and leaseback should be considered a single transaction, two simultaneous transactions or two successive transactions was not in point. What was required on the drafting of the legislation was that BCL had disposed of its entire interest in the property, whether via a single transaction or otherwise. As the sale and leaseback in fact occurred simultaneously, there was no period of time between the sale and the grant of the lease, and consequently at no point had BCL 'disposed' of its entire interest in the property. Lord Briggs considered this result to be consistent with the discerned purpose of the relevant legislation, being that the tax benefits granted to taxpayers through the zero-rating of the supplies should only be retained where the taxpayer continues to hold a long-term economic interest in the property. By focusing on a domestic interpretation of 'entire interest', Lord Briggs did not engage specifically with the question of composite transactions posed by *Mydibel*. The majority of the court agreed with him in coming to a conclusion based on a UK approach to statutory construction.

Lady Arden also considered that the appeal should be allowed, but on a different basis. The application of zero-rating conditions engaged principles of EU law and it was not, in her view, enough that the statutory provisions would, under domestic law, be interpreted as having the effect outlined by Lord Briggs. The key for Lady Arden was the question of whether or not the sale and leaseback should be construed as a single composite transaction. Here she considered that 'the normal single supply principle does not apply to a sale and leaseback transaction entered into for funding purposes'. Following the decision of the CJEU in *Mydibel*, a sale and leaseback for funding purposes is treated for VAT purposes as a single supply. Looked at as a single supply, there was no disposal of BCL's entire interest in the property. Therefore, she equally held that the taxpayer succeeded.

Where does this leave us?

This decision in relation to what amounts to a disposal of an 'entire interest' is welcome news for taxpayers in similar circumstances who are seeking to raise financing through a sale and leaseback arrangement. The property continued to be used by BCL as a care home throughout, and it has been confirmed that from a VAT perspective, BCL retained an ownership interest in the property at all times. For entities which receive zero-rated supplies due to the intended use of the property, for either a relevant charitable or residential purpose, having certainty that a sale and leaseback arrangement should not trigger a 'self-supply' for VAT purposes is key.

However, the decision is also of wider importance for taxpayers more generally when looking at the question of whether a sale and leaseback is itself a single transaction for VAT purposes (and not just in the context of zero-rating). It does seem to be a logical conclusion, albeit one that has required the taxpayer to take the matter to the Supreme Court.

* * * * * *

For related reading visit www.taxjournal.com

- Cases: *Balhousie Holdings Ltd v HMRC* (7.4.21)
- Holistic construction (A Savin & H Smith, 3.4.19)
- Cases: *Mydibel SA v Etat Belge* (25.4.19)

* * * * * *

* * * * * *

Most read on taxjournal.com

1. **News: HMRC withholds self-assessment repayments** (14.4.21)
2. **Notification of uncertain tax treatments: round two** (Gregory Price & Jack Slater, 29.4.21)
3. **The Biden administration's international tax proposals: will they fly?** (Jefferson VanderWolk, Matthew D. Cutts, Linda Pfatteicher & Robert O'Hare, 6.5.21)
4. **Capital allowances: s 198 elections** (Steve Watts & Sean Alexander, 28.4.21)
5. ***Danske Bank* upholds 'reverse *Skandia*': is EU VAT grouping a poisoned chalice?** (Mark Agnew & Philippe Gamito, 15.4.21)

* * * * * *

See also www.taxjournal.com — our mobile ready website for print subscribers.