VAT focus

VAT: from VADR to DOTAS

Speed read

The existing regime for the disclosure of VAT avoidance schemes (VADR) rarely rears its head in the context of everyday transactions. This is as it should be: why should disclosure be an issue where both HMRC and the taxpayer agree there is no VAT avoidance? However, the same may not be true for the new regime for the disclosure of tax avoidance schemes involving VAT (DOTAS: VAT), to be introduced by the Finance Act 2017. Not only are the new rules are significantly more convoluted than the VADR provisions, but also they intrude on one of the most common transaction types, such as the vanilla sale of a let commercial building.

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Consider the following scenario. Mr X owns a commercial building. He bought it in 2010 from a developer and paid VAT on its purchase. He opted to tax. In 2012, he let (the whole of) the building to Y Co. Mr X now enters into an agreement to sell the building, subject to the lease to Y Co, to an (unconnected) third party, Mr Z. Mr Z immediately opts to tax the building and notifies HMRC that he has done so. The sale by Mr X to Mr Z is treated as the transfer of a business as a going concern (TOGC) within article 5 of the Value Added Tax (Special Provisions) Order, SI 1995/1268, and, notwithstanding that the building is opted, no VAT is payable on the sale.

There is nothing out of the ordinary about this, and the VAT analysis is exactly what one would expect. So why are we talking about it – especially in the context of an article about disclosure of VAT avoidance?

Under the VAT avoidance disclosure regime (VADR) provided for in VATA 1994 s 58A and Sch 11A, a taxable person is required to provide HMRC with certain information in certain circumstances where he has been party to a is coming. And the position may never be as simple or straightforward again.

Clause 66 of and Sch 17 to the Finance Bill 2017–19 ('Finance Bill 2017') will (when it is enacted) introduce a new regime for the disclosure of tax avoidance schemes involving VAT (DOTAS: VAT or VADR 2).

Enter 'notifiable arrangements'

Instead of notifiable schemes, we will have 'notifiable arrangements'. A notifiable arrangement is an arrangement:

- that is described as such in regulations;
- that enables (or might be expected to enable) any person to obtain a VAT advantage;
- where the main benefit (or one of the main benefits) that might be expected to arise from it is the obtaining of that VAT advantage; and
- which is not excluded from the DOTAS: VAT regime by virtue of the grandfathering provisions in Sch 17 to the Finance Bill 2017.

For these purposes, what constitutes a VAT advantage is defined in Finance Bill 2017 Sch 17 para 6(1) and (4). The relevant circumstances include where:

- the amount by which a taxpayer's output tax exceeds his deductible input tax in any VAT accounting period is less than it would otherwise be; and where
- the taxpayer avoids an obligation to account for tax.

(Both of these circumstances are particularly pertinent when considering whether a TOGC sale is an arrangement that 'enables (or might be expected to enable) any person to obtain a VAT advantage'.)

A draftof the regulations that will describe what constitutes notifiable arrangements – the Indirect Taxes (Notifiable Arrangements) Regulations 2017 – was published on 20 March 2017 (and has not been updated). It contains descriptions of arrangements that are notifiable in relation to all indirect taxes falling within the new regime (such as IPT, customs duties and, of course, VAT); and descriptions of arrangements that are only notifiable in relation to VAT.

Notifiable arrangements that fall within the general category include arrangements that a promoter of which (or a party to which) might reasonably be expected to wish to keep confidential from HMRC. These recall the 'confidentiality condition' hallmark set out in Sch 2 to the 2004 Order. However, the DOTAS provisions (in regs 10 and 11 of the notifiable arrangements regulations) are significantly more convoluted than their VADR predecessors (in Sch 2 para 1 of the 2004 Order).

The general category also includes arrangements that have no antecedents in VADR; namely, standardised tax products (see reg 13 of the notifiable arrangements regulations). These are arrangements that are made available to more than one 'notifiable scheme'. A notifiable scheme is either a scheme designated as such in Sch 1 to the Value Added Tax (Disclosure of Avoidance Schemes) (Designations) Order, SI 2004/1933, or one that carries one of the so-called 'hallmarks' set out in Sch 2 to the 2004 Order.

The TOGC sale summarised above is not a designated scheme; nor does it carry any of the prescribed hallmarks. VADR is not engaged.

This is hardly surprising. The non-taxed treatment of the transaction is regarded not as avoidance – by either HMRC or the taxpayer – but as proper application of the provisions of article 5 of the 1995 Order. It follows that disclosure of VAT avoidance is not in point. This must be right, as after all the transaction is simply the vanilla sale of a let commercial building.

So – again – why are we talking about it? Because change person, where (it might reasonably be concluded, having regard to all relevant circumstances):

- the documentation used is standardised (or substantially standardised);
- the transaction (or series of specific transactions) that must be entered into to implement the arrangement is standardised (or substantially standardised) in form; and:

'(1) the main purpose of the arrangement is to enable a person to obtain a tax advantage; or

[(2)] it is unlikely that any person would enter into the arrangement were it not that the person or another person may obtain a tax advantage.'

What is contemplated here (in relation to VAT) would appear to be arrangements in the vein of those considered in HMRC v Pendragon plc [2015] UKSC 37. Perhaps curiously, if the arrangements were bespoke to a single client (and are

made available to that one client only), or the substance of the documentation used to implement the arrangements is so specific to that one client that it would need to be modified to a material extent to accommodate any other person in order for them to implement the arrangements, the arrangements would not be regarded as standardised tax products.

As for the category of notifiable arrangements specific to VAT, none of these have direct precursors in VADR. However, those in reg 4 of the notifiable arrangements regulations) – concerning transactions with retail customers where, rather than a single positive rated (or exempt) supply, two supplies are made instead (with the result that either less output tax is payable overall or more input tax is deductible) – do share a few strands of DNA with designated scheme 3 (value shifting) set out in Sch 1 to the 2004 Order.

Similarly, the arrangements involving offshore supplies (set out in regs 5 and 6 of the notifiable arrangements regulations) can be said to be distant – and more evolved – conceptual cousins of the 'offshore loops' hallmark set out in para 6 of the 2004 Order.

Regulation 4 would catch arrangements such as those considered in Bookit (Case C-607/14); and reg 5 would catch arrangements such as those considered in Newey (Case C-653/11).

None of this, however, is of any interest to Mr X or Mr Z. Their focus would be on reg 7 of the notifiable arrangements regulations, which refers to the following:

'(2) A person ("J") or a relevant associate of J where J is a body corporate has exercised the option to tax in respect of land which is a relevant capital item, as provided by paragraph 2 of Part 1 of Schedule 10 to the Value Added Tax Act 1994, except where that option has been revoked as described in paragraph 23 or 24 of that Schedule.

'(3) Fewer than 20 years have expired since the option had effect.

'(4) J makes a supply in respect of the relevant capital item such that the supply:

(a) is not a taxable supply, by virtue of paragraph 12(1) of Part 1 of Schedule 10 to the Value Added Tax Act 1994; or

(b) is not treated as a supply, by virtue of article 5 of the Value Added Tax (Special Provisions) Order 1995.'

Incredible as it may sound, the transaction between Mr X and Mr Z – the vanilla sale of a let commercial building – is a notifiable arrangement for the purposes of DOTAS: VAT.

Is there a VAT advantage?

incurring less deductible input tax. The TOGC sale does not, therefore, enable Mr Z to obtain a VAT advantage.

In the circumstances, the obtaining of the VAT advantage that actually arises (being less net VAT for Mr X to pay, or avoiding the obligation to account for tax altogether) should not be regarded as a main benefit of the sale, and DOTAS: VAT should not be engaged.

Are the arrangements excluded?

Even if the obtaining of the VAT advantage is regarded as a main benefit of the TOGC sale, query whether the arrangements are nevertheless excluded from the disclosure regime by virtue of the grandfathering provisions in Sch 17 to the Finance Bill 2017.

Paragraph 3(2) of the Schedule provides that an arrangement that would otherwise be notifiable is nevertheless not notifiable if it implements a proposal:

- in relation to which a promoter first makes a firm approach to another person before 1 January 2018;
- that a promoter makes available for implementation before that date; or
- where the time a promoter first becomes aware of any transaction forming part of the arrangements implementing the proposal is before that date.

> Incredible as it may sound, the vanilla sale of a let commercial building is a notifiable arrangement for the purposes of DOTAS: VAT

Given the almost universal awareness of the treatment of a vanilla sale of a let commercial building as a TOGC, it is inconceivable that a person constituting a 'promoter' for the purposes of DOTAS: VAT has not already made the proposal of a TOGC sale available for implementation, and will continue to do so multiple times before 1 January 2018.

Where does this leave us?

With the transaction between Mr X and Mr Z, therefore, one ends up in the same place with both VADR and DOTAS: VAT – no disclosure. The path with the latter, however, is significantly more twisted. This would be understandable

It is now necessary to consider whether the TOGC sale enables (or might be expected to enable) any person to obtain a VAT advantage. As the transaction is treated as a TOGC, with no VAT payable on the sale, the amount by which Mr X's output tax exceeds his deductible input tax in the relevant VAT accounting period is inevitably less than it would otherwise be. The TOGC sale does, therefore, enable Mr X to obtain a VAT advantage.

The question then is whether the main benefit (or one of the main benefits) that might be expected to arise from the TOGC sale is the obtaining of that VAT advantage. This is unlikely, if only because the standard TOGC clause would entitle Mr X to claim an amount in respect of VAT from Mr Z in the event that the sale is not a TOGC. Mr X ought, therefore, to be agnostic as to whether he obtains the VAT advantage.

Of the two parties, Mr Z is probably more concerned to secure TOGC treatment, as it would mean less SDLT for him to pay. Paying less SDLT than would otherwise be the case is not, however, a tax advantage in relation to VAT within reg 6(1) of the notifiable arrangements regulations; nor is if VAT avoidance using the arrangements described in the notifiable arrangements regulations were rife. There is, however, little evidence of this.

And all we have done in this article is to consider whether disclosure under the new regime will intrude on one of the most common transaction types (with one of the least controversial VAT analyses). As we have seen, the answer is not as straightforward as it should be. Much of this may be fixed in the near to medium term – HMRC may, for example, include TOGC sales (and other common, non-controversial transaction types) on a white list – but having solutions in guidance rather than law is hardly satisfactory.

In any event, it is inevitable that there will still be arrangements caught in the net that should not be (including TOGC sales where the facts are not quite as they are with Mr X and Mr Z). What needs to be done then to comply with the obligations, and avoid the penalties, imposed under the new regime is its own special circle of hell (being significantly more complicated and cumbersome than their counterparts under VADR). But that is another topic for another day. ■