SECOND DIVISION, INNER HOUSE, COURT OF SESSION

[2019] CSIH 7
XA13/18

Lord Justice Clerk
Lord Drummond Young
Lord Doherty

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in the appeal

BALHOUSIE HOLDINGS LIMITED

Appellant

against

A decision of the Upper Tribunal dated 20 October 2017

in an appeal by

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondent

Appellant: Simpson QC; Brodies
Respondent: Roxburgh; Office of the Advocate General

7 February 2019

[1] Schedule 8 to the Value Added Tax Act 1984 provides for the zero-rating of certain forms of supply. In that Schedule, item 1 of Group 5 applies zero-rating to the first grant by a person constructing a building intended for use solely for a relevant residential purpose of a major interest in the building. Use of a building as a care home counts as a relevant residential purpose. Where, however, the person to whom such a supply has been made

disposes of its entire interest in the property or changes the use of the property to non-residential within a period of 10 years from the date of completion of the premises, paragraphs 35-37 of Schedule 10 to the 1994 Act in effect reverse the benefit of zero-rating for that person, by providing that the original supply is to be treated as a taxable supply that is not zero-rated. This is achieved by imposing a self-supply charge at the date of the disposal or change of use.

[2] The appellant taxpayer is a company that carries on business as an operator of care homes. It operates 25 care homes, mostly in the north-east of Scotland, and has formed a VAT group with a number of subsidiaries. Those subsidiaries include Faskally Care Home Ltd ("Faskally") and Balhousie Care Ltd ("Balhousie Care"). In about 2010 the taxpayer decided to construct three new care homes, including one situated in Huntly. The land, and in due course the new home that was constructed in Huntly, belonged to Faskally. After the building had been completed it was acquired by Balhousie Care. On the supply to Balhousie Care, item 1 of Group 5 of Schedule 8 applied, and the supply was zero-rated. It was thought, however, that it might be difficult for Balhousie Care to obtain bank finance, and accordingly a sale and leaseback mechanism was used to finance the acquisition of the care home. In March 2013 Balhousie Care sold the property to another concern, Target Healthcare REIT ("Target"), and immediately thereafter leased it back from Target. Balhousie Care continued to use the property as a care home.

[3] Following that transaction, HMRC decided that the appellant taxpayer as the representative of the VAT group was liable to a VAT self-supply charge in consequence of the disposal of the home to Target. That was intimated to the taxpayer by letter dated 24 June 2014. HMRC further determined to issue a notice of penalty assessment to the taxpayer in consequence of its decision on the VAT liability, and intimated that decision to

the taxpayer by letter dated 9 February 2015. The present appeal arises out of those two decisions by HMRC. The critical question is, put shortly, whether a sale and leaseback transaction such as that undertaken by Balhousie Care and Target amounts to the disposal of the former company's entire interest in the relevant premises for the purposes of paragraph 36(2) of Schedule 10 to the 1994 Act. If it amounted to a disposal of Balhousie Care's entire interest, it would give rise to a self-supply charge under the foregoing provision. The taxpayer contends that it did not amount to a disposal of Balhousie Care's entire interest because, when the transaction was considered as a whole, its effect was to leave Balhousie Care with the lease of the property, from which it continued to carry on the business of a care home. HMRC, by contrast, contend that the transaction was a disposal of Balhousie Care's entire interest in the care home in consequence of the sale and disposition to Target. For VAT purposes, HMRC claim, the relevant transaction was that transfer of the property, and the fact that it was immediately followed by a leaseback was immaterial; the leaseback was a distinct transaction from the sale.

[4] The taxpayer appealed against HMRC's two decisions intimated on 24 June 2014 and 9 February 2015. On 31 May 2016 the First-tier Tribunal allowed the appeals. HMRC thereafter appealed to the Upper Tribunal, which on 20 October 2017 reversed the decision of the First-tier Tribunal and upheld the appeal. The taxpayer has now appealed to the Court of Session against the decision of the Upper Tribunal. We should note that the appeal to the First-tier Tribunal proceeded alongside two appeals by Faskally, but these do not form part of the proceedings before the Court.

The findings in fact made by the First-tier Tribunal

[5] The First-tier Tribunal made detailed findings in fact, the most important of which

have already been summarized. In about 2010 the taxpayer decided to build three new care homes, including the home at Deveron Way, Huntly, which forms the subject of the present appeal. The land on which the home was built, and after its construction the home itself, belonged to Faskally, but following its completion it was acquired by Balhousie Care. At the time it was considered that it would be difficult to obtain bank finance for the project, and it was therefore decided to use a mechanism whereby properties were sold to another entity, in the present case Target, and leased back by the operator of the care home. That mechanism had been used previously and was said to provide funding for growth. A funding arrangement of that nature was entered into in March 2013 in respect of the property in Huntly and the two other new care homes. All three properties were by then owned by Balhousie Care, and that company concluded missives with Target by means of an offer dated 8 March 2013 made on behalf of Target which was accepted on an unqualified basis by Balhousie Care on the same day. The missives provided for the sale of the properties by Dalhousie Care to Target; the consideration for the Huntly property was £4,007,561. The consideration was payable on 8 March 2013 or such other date as might be agreed. The missives provided that at the date of entry Balhousie Care should give Target entry to and vacant possession of the property, the giving of such possession being declared an essential condition.

[6] The missives further contained an obligation by Target to grant leases of the three properties to Balhousie Care with effect from the date of settlement; forms of lease were appended. The leases provided that the properties should be used for an "Approved Use", which was defined as "use as a residential care home and/or nursing home" for the provision of care as specified in certain legislation. The Huntly lease was for a term of 30 years. Balhousie Care had been in occupation of the three properties for some months

prior to the sale and leaseback; finance for the property during that period had in effect been provided by the main contractor who had built the property. The main contractor was repaid out of the proceeds of the sale to Target. Following the completion of the sale and leaseback transaction, Balhousie Care continued to occupy the care home and to use it for the purposes of its business. No visible change occurred in the mode of operation.

[7] On 9 July 2013 HMRC carried out an examination of the group's VAT records. This was followed by a request for details of sale and leaseback transactions during the period of the group's VAT registration. The group's agents, Grant Thornton, provided an analysis of sale and leaseback transactions that had been undertaken in relation to the group's design and build projects; this analysis gave the Huntly property as an example. Further correspondence ensued, and on 5 March 2014 HMRC stated that any further disposal of the property by the taxpayer or, presumably, a member of its VAT group during the period of 10 years from practical completion would make them liable to what was described as "a change of use 'self-supply' charge – on which they must account for VAT at the standard rate". Further correspondence ensued in which the parties' respective positions were set out. On 24 June 2014 HMRC issued their decision letter to the effect that, although the sale of the property by Balhousie Care to Target was linked to the subsequent lease by overriding agreement, the sale nevertheless constituted the disposal of Balhousie Care's entire interest in the property. While the taxpayer's group had regained an interest by entering into a long lease, that had to be viewed as a separate transaction. Consequently HMRC concluded that the taxpayer was liable to a VAT self-supply charge, calculated as the amount of VAT that would be payable on the purchase of the property by Balhousie Care from Faskally, subject to adjustment for the separate disposal of a part of the property not used for the purposes of the care home.

The relevant legislation

[8] Section 30(2) of the Value Added Tax Act 1994 provides that a supply of goods or services of a description falling within Schedule 8 to the Act should be zero-rated. Group 5 of Schedule 8 relates to the construction of buildings. Item 1 of that Group provides as follows:

> "The first grant by a person –
>
> (a) constructing a building –…
>
> (ii) intended for use solely for a relevant residential or a relevant charitable purpose;…
>
> of a major interest in, or any part of, the building, dwelling or its site".

"Major interest" is defined in section 96(1) as, in Scotland, "the interest of the owner, or the lessee's interest under a lease for a period of not less than 20 years". Thus the first grant of ownership of a residential building is zero-rated. Care homes are accorded the same treatment; note (4)(b) to group 5 provides that use for a relevant residential purpose means inter alia use as a home, residential accommodation with personal care for persons in need of personal care by reason of old age or disablement.

[9] Part 2 of Schedule 10 to the 1994 Act is headed "Residential and charitable buildings: change of use etc". So far as material, paragraphs 35-37 of that Schedule are in the following terms:

> "35. – Introductory
>
> (1) This part of this Schedule applies where one or more relevant zero-rated supplies relating to a building…have been made to a person ('P').
>
> (2) In this Part of this Schedule –
>
> '*relevant zero-rated supply*' means a grant or other supply which relates to a building… intended for use solely for –
>
> (a) a relevant residential purpose…

and which, as a result of Group 5 of Schedule 8, is zero-rated (in whole or in part);

'*relevant premises*' means the building (or part of a building) in relation to which a relevant zero-rated supply has been made to P;

'*relevant period*', in relation to relevant premises, means – 10 years beginning with the day on which the relevant premises are completed.

(3) Where P is a body corporate treated as a member of a [VAT group], any reference in this Part… to P includes a reference to any member of that group.

36. – Disposal of interest or change of use following relevant zero-rated supply

(1) Paragraph 37 applies on each occasion during the relevant period when –

(a) there is an increase in the proportion of the relevant premises falling within subparagraph (2) or (3), and

(b) as a result, the proportion of the relevant premises so falling ('R2') exceeds the maximum proportion of those premises so falling at any earlier time in the relevant period ('R1').

(2) The relevant premises fall (or part of the relevant premises falls) within this subparagraph if P has, since the beginning of the relevant period, disposed of P's entire interest in the relevant premises (or part).

(3) The relevant premises fall (or part of the relevant premises falls) within this subparagraph if –

(a) those premises do not (or that part does not) fall within sub-paragraph (2), and

(b) those premises are (or that part is) being used for a purpose that is neither a relevant residential purpose nor a relevant charitable purpose.

…

37. – Charge to VAT

(1) Where this paragraph applies, P's interest, right or license in the relevant premises held immediately prior to the time when the increase referred to in paragraph 36(1) occurs is treated for the purposes of this Part of this Schedule as –

(a) supplied to P for the purposes of a business which P carries on, and

(b) supplied by P in the course or furtherance of that business

immediately prior to the time of that increase.

(2) The supply is taken to be a taxable supply which is not zero-rated as a result of Group 5 of Schedule 8.

(3) The value of the supply is taken to be –

(a) in the case of the first deemed supply under this paragraph, the amount obtained by the formula –

$$R2 \times Y \times \frac{(120 - Z)}{120}, \text{and}$$

(b) in the case of any subsequent deemed supply under this paragraph, the amount obtained by the formula –

$$(R2 - R1) \times Y \times \frac{(120 - Z)}{120}.$$

(4) For the purpose of sub-paragraph (3) –

(a) R1 and R2 have the meaning given by paragraph 36(1)(b),

(b) Y is the amount that yields an amount of VAT chargeable on it equal to –

(i) the VAT which would have been chargeable on the relevant zero-rated supply, or

(ii) if there was more than one supplier, the aggregate amount of the VAT which would have been chargeable on the supplies,

had the relevant premises not been intended for use solely for a relevant residential purpose or a relevant charitable purpose, and

(c) Z is the number of whole months since the date on which the relevant premises were completed".

[10] In these provisions, the event that triggers a charge to VAT is found in either sub-paragraph (2) or sub-paragraph (3) of paragraph 36. They relate to P, who (paragraph 35(1)) is the person to whom the initial zero-rated supply has been made. Normally P will be the owner of the premises supplied, although the definition of a "major interest" in section 96(1) makes it clear that a long lease, in excess of 20 years, will be in the same position. In the present case Balhousie Care, a company within the taxpayer's VAT group (paragraph 35(3)), owned the Huntly care home following the initial supply by Faskally. Sub-paragraph (2) of paragraph 36 applies where P disposes of its entire interest in the relevant premises. By themselves, those words are relatively straightforward. Sub-paragraph (3) applies where

sub-paragraph (2) does not apply but the premises, or part of them, are used for a purpose that, had it been the original purpose of the premises, would not have attracted zero-rating. We consider the underlying purpose of these provisions subsequently (at paragraphs [25]-[34]). At present, it is sufficient to note that the two conditions are clearly distinct from each other, both as a matter of substance (disposal in one case, change of use in the other) and because of the wording of sub-paragraph (3)(a), which expressly differentiates between the two sub-paragraphs.

[11] If the condition in either sub-paragraph (2) or sub-paragraph (3) is fulfilled, paragraph 36(1) comes into operation in respect of either the whole of the premises or the part of the premises that has been disposed of or has had its use changed. Paragraph 36(1) brings paragraph 37 into operation. The effect of the latter paragraph is that a deemed self-supply takes place by P to itself of the part of the property that has been disposed of or whose use has changed, as the case may be. That supply is deemed to take place in the course of P's business, and it is a taxable supply which is not zero-rated (paragraph 37(2)). The effect is to deny P the benefit of zero-rating in respect of the part of the property that has been disposed of or whose use has been changed; as a result a charge to VAT will arise. That charge will, however, be reduced by application of the formulae in paragraph 37(3), which reduce the value of the deemed supply in proportion to the time that has elapsed between the original zero-rated supply and the time of the disposal or change of use. This is achieved by reference to the number of months, up to 120, that have elapsed following the original supply. Thus no tax will be charged on a disposal if 10 years have elapsed since the original zero-rated supply, and when a disposal occurs before the expiry of the 10-year period the tax will be reduced proportionately according to the length of the period during which P has retained ownership and preserved the original use of the property.

The proper approach to the interpretation of VAT legislation

General principles of interpretation

[12] Counsel presented detailed submissions on the approach that should be adopted to the construction of tax legislation. In large part this was based on the well-known line of authorities that begin with the decision of the House of Lords in *WT Ramsay Ltd* v *IRC*, [1982] AC 300, and continue with what is perhaps now the leading case in this area, *Barclays Mercantile Business Finance Ltd* v *Mawson*, [2004] UKHL 51; [2005] 1 AC 684, and a series of other cases until, most recently, *UBS AG* v *Revenue and Customs Commissioners*, [2016] UKSC 13; [2016] 1 WLR 1005 where the *Barclays Mercantile* principles were restated. Those principles were developed, however, in order to respond to complex artificial schemes that were generally devised to avoid the payment of income tax and capital taxes, and their detailed application has normally been in that context. The case law on income tax and other direct taxes is of limited assistance in dealing with VAT, which is an indirect tax levied in a very different manner from income tax. Furthermore, the charge to VAT is based on a number of fundamental principles, and respect for those principles is of great importance in the application of the tax. Those principles are quite distinct conceptually from the *Barclays Mercantile* principles; they are intended to secure the consistent imposition of tax on the value added by a taxpayer's economic activities. That requires a rigorously objective approach to those economic activities; it is in that way that the fundamental principle of fiscal neutrality is achieved.

[13] Nevertheless, certain basic features of the *Barclays Mercantile* principles are of importance in all tax cases, and indeed more generally. These are stated in the speech of Lord Nicholls of Birkenhead in *Barclays Mercantile*, at paragraphs [32]-[33]:

> "[32] The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first considering the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found….
>
> [33] The simplicity of this question, however difficult it might be to answer on the facts of a particular case, shows that the *Ramsay* case did not introduce a new doctrine operating within the special field of revenue statute. On the contrary… it rescued tax law from being 'some island of literal interpretation' and brought it within generally applicable principles".

The foregoing principles are restated in *UBS*, paragraphs [61]-[63]. Their effect is summarized in the classic statement by Ribeiro PJ in *Collector of Stamp Revenue* v *Arrowtown Assets Ltd*, [2003] HPCFA 46, at [35]:

> "[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically".

[14] The principle of purposive construction is of course applied more widely; it is probably not an exaggeration to say that it should be used in the interpretation of every sort of legal text. So far as VAT is concerned, however, it is established by case law that, while the legislation should be interpreted purposively, the transactions undertaken by the taxpayer must be construed objectively, and it is not appropriate to have regard to the taxpayer's underlying purposes or intentions, except obviously to the extent that those are manifested in the objective transactions that are carried out. The wording of a legal text must be applied to a factual situation, and in performing that exercise it is obviously essential to have regard to context. Context includes the legal context of the text, for

example the whole of the statute in which it occurs and the general principles of law that underlie that statute. It also includes the particular factual context in which that text is applied (for example the transaction under consideration), and it includes the general commercial or other context in which the text falls to be applied. Those principles are relevant to the application of VAT legislation. In considering such legislation, however, it also essential to have regard to the basic principles that underlie the tax.

General principles of VAT

[15] For present purposes, four general principles applicable to VAT are important. First, VAT is a tax on economic activity, an expression that has been given a wide and objective meaning. Consequently it is presumed that the tax will apply to every sort of economic activity unless there is a specific exemption or a specific provision for zero-rating. Secondly, the tax is transactional in nature: it applies to individual transactions in the chain of transactions that ultimately results in the supply of a good or service to a consumer. This is a fundamental feature of the structure of the tax, and it is of central importance to the present case. The third principle is fiscal neutrality: that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way. At a practical level, this means that, in the economic process of production and distribution of a good or service, VAT should be charged on each of the successive transactions involved in the process on the value added to the good or service by the particular taxpayer who is responsible for that particular transaction. In this way the ultimate burden of the tax is passed on through successive stages to the final consumer. It also has the result that it is immaterial how many stages are involved in the production process, as it is only the value added at each stage that is subject to tax. Largely because of these features, fiscal neutrality secures certainty and

consistency in the imposition of VAT. The fourth principle is objectivity: in analysing and construing the transactions at each stage in the process of production and supply of a good or service, the court must adopt a strictly objective approach. This applies both to the question of whether there is economic activity and to the analysis of the transactions that are used by the taxpayer. In this way the certainty and consistency of the system is promoted. Objectivity is of particular importance in the present case.

[16] VAT is charged on the supply of goods or services where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him where it is not an exempt supply and is not zero-rated: Value Added Tax Act 1994, sections 1(1), 4 and 30. The supply must be for a consideration: *ibid*, section 5(2)(a). This represents the first of the four general principles set out in the last paragraph: the tax is imposed on the economic activities of a taxpayer. The fundamental basis on which the tax is imposed is pithily expressed by the Advocate General in Case C-4/94, *BLP Group PLC* v *Customs and Excise Commissioners*, [1995] ECR 1-983, [1996] 1 WLR 174, at paragraph 30:

> "[T]he Community legislature, proceeding from an ideal image of 'chains of transactions'…, intended to attach to each transaction only so much VAT liability as corresponds to the value accruing in that transaction, so that there is to be deducted from the total amount the tax which has been occasioned by the preceding 'link in the chain'".

This is the fundamental principle of fiscal neutrality, which is a central feature of VAT.

[17] That approach was followed as a matter of substance by the Court of Justice at paragraphs 19-26 of its opinion, where it was held that for input VAT to be deductible the goods or services on which it was charged must have a "direct and immediate link" with the taxable supplies made by the taxpayer. Paragraph 30 of the Advocate General's opinion was referred to with approval in the House of Lords in *Commissioners of Customs and Excise* v *Robert Gordon's College* 1996 SC (HL) 6, at 11-12; [1995] STC 10 93, at 1099, *per* Lord Hoffman.

The Court of Justice in *BLP* referred to the terms of paragraph 5 of article 17 of the Sixth Directive (now article 173 of the Principal VAT Directive), which referred to "transactions" in respect of which VAT is or is not deductible, and continued (paragraph 19)

> "The use in that provision of the words 'for transactions' shows that to give the right to deduct [input VAT], the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in this respect".

That emphasizes that VAT is a transactional tax, and that consequently each transaction in the chain of supply must be examined separately to determine whether there is a direct and immediate link between the supply made to the taxpayer and taxable transaction in respect of which it is sought to deduct input tax.

[18] Furthermore, in *BLP* the Court of Justice held that the existence of a direct and immediate link is to be determined objectively, and that the ultimate aim pursued by the taxable person is irrelevant in that respect: *ibid*. The taxpayer in that case had contended that its subjective purpose in carrying out the transaction in question (arranging for the sale of certain of its shares) was material, but the Court held (at paragraph 24) that, if that were correct,

> "the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the system's objective of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question".

Thus the transactions that form links in the "chain of supply" must be examined individually and objectively in determining the application of VAT.

[19] In *BLP* the Court of Justice went on to consider the possibility of structuring transactions in different ways, and the consequences of that for VAT. It stated:

> "25. It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax on the services supplied by accountants or legal advisers for the person's taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. However, that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions.
>
> 26. In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case law of the court, does not have the scope attributed to it by BLP. That the common system of VAT ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way, presupposes that those activities are themselves subject to VAT".

This passage makes it clear that it is the form of transaction chosen by the taxpayer that is subject to VAT. The fact that a similar result could have been reached by structuring the transaction in a different way is irrelevant. This is material to the present case. Target provided finance to Balhousie Care using a sale and leaseback arrangement to provide security for its financial involvement. Balhousie Care could have granted a standard security in favour of Target in order to provide comparable security, and in that event the benefit of zero-rating would have been preserved because there would have been no disposal of the Huntly care home. That does not assist the taxpayer, however. Because for VAT purposes transactions must be treated objectively, it is the actual transaction that was carried out that must be considered, not a possible alternative.

[20] The discussion at paragraph 26 of the Court's opinion in *BLP* refers specifically to the fundamental principle of fiscal neutrality. It demonstrates the link between fiscal neutrality and the other basic features of VAT, the transactional approach and the principle of objectivity in the analysis of the transactions that make up the total economic process. It is by analysing the transactions found at each stage in the economic process that the value

added by any particular taxpayer is ascertained, and that is to be done consistently, in such a way as to ensure overall fiscal neutrality. For this reason a wholly objective approach must be taken to the analysis of each transaction. Thus *BLP* is a clear affirmation of the basic principles of VAT stated at paragraph [15] above.

[21] The fundamental structure of VAT, in particular its transactional nature, makes tax avoidance more difficult than with income tax, corporation tax and capital taxes. The transactional structure is strengthened by the principles of fiscal neutrality and objectivity. Nevertheless, attempts are made to avoid VAT through the structuring of transactions. These have not generally been dealt with using the approach found in *Barclays Mercantile Business Finance Limited* v *Mawson*, *supra*. Instead the particular transactions that have been employed are analysed on a strictly objective basis to discover whether they constitute economic activity and, if they are economic in nature, to discover exactly what they achieve. If, according to these criteria, the transaction amounts to the supply of goods or services, it is subject to VAT. Likewise, so far as input VAT is concerned, if the transaction between the taxpayer and its supplier is economic in nature and truly amounts to a supply of goods or services, the VAT will be deductible. (This assumes, of course, that the output transaction is not exempt).

[22] This approach is found in the important decision of the European Court of Justice in Case C-255/02, *Halifax PLC* v *Commissioners of Customs and Excise* [2006] ECR i-1609; [2006] Ch 387, a case that involved the analysis of a series of intra-group transactions that were designed to enable the deduction of input tax in a situation where most of the supplies made by the taxpayers were exempt. The Court began its analysis by considering general principles of VAT, including the notions of supply and economic activity. It held (at paragraphs 55 et seq)

> "55 [A]n analysis of the definitions of taxable person and economic activities shows that the scope of the term economic activities is very wide, and that the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or results…
>
> 56 That analysis and that of the terms 'supply of goods' and 'supply of services' show that those terms, which define taxable transactions under the Sixth Directive, are all objective in nature and apply without regard to the purpose or results of the transactions concerned….
>
> 57 As the Court held in… Case C-4/94 *BLP Group*…, an obligation on the tax authorities to carry out inquiries to determine the intention of the taxable person would be contrary to the objectives of the common system of VAT of ensuring legal certainty and facilitating the application of VAT by having regard, save in exceptional cases, to the objective character of the transaction in question.
>
> 58 It follows that transactions of the kind at issue in the main proceedings are supplies of goods or services and an economic activity… provided that they satisfy the objective criteria on which those concepts are based.
>
> 59 It is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices. The fact nevertheless remains that the question whether a given transaction is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity".

Thus a properly objective analysis of the transactions used should disclose whether or not VAT is payable or deductible, with an exception for tax evasion.

[23] A second question was presented to the Court of Justice by the national tribunal in *Halifax*: whether the taxable person has no right to deduct input VAT where the transactions on which that right is based constitute an abusive practice (paragraph 61). The Court referred to the general principle that Community law cannot be relied on for abusive or fraudulent ends, including transactions carried out "solely for the purpose of wrongfully obtaining advantages provided for by Community law", and held that those principles applied to VAT (paragraphs 68-70). Nevertheless, in the application of Community legislation certainty and foreseeability were important considerations, and a trader's choice between exempt transactions and taxable transactions might be based on a range of factors,

including tax considerations relating to the VAT system (paragraphs 72-73). The Court continued:

> "74 In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.
>
> 75 Second, it must also be apparent from a number of objective factors that the essential aim of the transaction concerned is to obtain a tax advantage …".

That is the general approach that should be followed to tax avoidance and evasion in relation to VAT. It is obvious that it differs substantially from the approach found in *Barclays Mercantile* and other cases on income tax and capital taxes. The reasons for this are found in the general principles that govern the system of VAT.

[24] Moreover, the difference between the two approaches is apparent from an important feature of the technique described in *Ramsay*, *Barclays Mercantile* and *UBS*. This is stated by Lord Wilberforce in *Ramsay*, at [1982] AC 323-324, a passage quoted with approval by Lord Nicholls in *Barclays Mercantile* at paragraph [30]:

> "It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded".

The technique involves the aggregation of transactions if the intention of the taxpayer is that they should operate as a series or combination. To do that, however, is fundamentally at variance with the transactional nature of VAT, which involves looking at a series of individual transactions and taxing them independently. Taxing transactions independently is the manner in which the fiscal neutrality of VAT is achieved. Furthermore, the case law in the Court of Justice is quite clear that the individual transactions must be considered

objectively, regardless of the intention or purpose of the particular taxpayer; that is apparent from both *BLP Group* at paragraph 24 and *Halifax* at paragraphs 55-58 (*cit sup*). Such an approach is inconsistent with the suggestion in *Ramsay* that a series or combination of transactions "intended to operate as such" should be treated as a unity. For these reasons we consider that the *Barclays Mercantile* approach is fundamentally inconsistent with the basic principles upon which VAT is assessed.

Analysis of the legislation and its legislative purpose

[25] It is accordingly the general principles that govern liability for VAT, including the right to deduct input tax, that must govern the present case. The particular legislative provisions with which this case is concerned are paragraphs 35-37 of Schedule 8 to the Value Added Tax Act 1994. The purpose of those provisions appears to us to be reasonably clear. They deal with zero-rating, a concept described in section 30 of the 1994 Act. Under the scheme of VAT in force in the United Kingdom certain categories of supply are zero-rated. In that event, no VAT is charged on the supply but it is in all other respects treated as a taxable supply. That has the effect that no VAT is payable on the zero-rated supply, but it is still treated as a taxable supply; consequently input tax may be reclaimed in the same way as for standard-rated supplies. This is a major difference from exempt supplies. The supplies that are zero-rated are set out in Schedule 8 to the 1994 Act. They include food (excluding products such as ice cream, confectionery, certain soft drinks and alcoholic drinks), books and newspapers, transport and children's clothing. Zero-rated supplies also include, in group 5 of Schedule 8 to the 1994 Act, the first grant of a major interest in a building intended for use solely for a relevant residential purpose; the latter expression includes use as a care home: see paragraph [8] above.

[26] Zero-rating is thus a form of exemption from VAT with the important advantage, by comparison with exempt supplies in the technical sense of that expression, that input VAT can be reclaimed by the supplier. In normal market conditions, that should result in a reduction in the price paid by the consumer as the VAT paid at stages of production and distribution prior to the final sale can be reclaimed. The choice of supplies that are zero-rated is obviously dictated by policy considerations. For example, food is a necessity and its cost can be said to fall disproportionately on the poor by comparison with the rich because it absorbs a greater part of their resources. Books promote learning and literacy; newspapers promote knowledge of current affairs. The cost of transport and children's clothing can be said, as with food, to represent a necessity the cost of which falls disproportionately on the poor. Residential property is another necessity, and it differs from commercial property in that it is not used for any form of economic activity. Care homes are accorded the same treatment as residential property because they amount in practice to the provision of residential accommodation for those who through age or disability are unable to care for themselves.

[27] Residential property and care homes differ in two important respects from most other categories of zero-rated supply: the property acquired is normally of greater value, and it remains in existence for many years. Those features give rise to a risk of abuse: a building originally constructed as residential property might be converted into commercial property relatively soon after construction. In that way a commercial enterprise, carrying on economic activity, would be able to acquire premises that had originally been provided free of any charge to VAT. The purpose of paragraphs 35-37 is in our opinion to prevent such potential abuse, and they should be construed with that purpose in mind.

[28] Part 2 of Schedule 10 to the 1994 Act, which contains paragraphs 35-37, is headed "Residential and charitable buildings: change of use etc". Notwithstanding the heading, it is clear from the terms of paragraph 36(2) that those provisions apply to the disposal of the taxpayer's interest in the building as well as to a change of use. Paragraph 35 states the essential condition for the application of the later paragraphs: a zero-rated supply relating to a building must be made to a person P. Paragraph 37 then imposes a self-supply charge on P if the conditions in paragraph 36 are satisfied; the result of that is that P is deemed to have made a taxable supply to itself which is not zero-rated: paragraph 37(2). Paragraph 37 goes on to describe the manner in which the tax charge on the self-supply is calculated. Paragraph 36 states the precise conditions that will trigger the self-supply charge. The critical provisions for present purposes are found in sub-paragraphs (2) and (3), which we have discussed in paragraph [10] above. Sub-paragraph (3) deals with use of the premises or part of the premises for a purpose that is not a relevant residential purpose. It does not apply to the present case because the care home continued to be used as such after the sale and lease back transaction. Sub-paragraph (3) only applies, however, in cases where the premises do not fall within sub-paragraph (2). Sub-paragraph (2) applies "if P has, since the beginning of the relevant period [the period of 10 years since completion of the building], disposed of P's entire interest in the relevant premises".

[29] The wording of sub-paragraph (2) appears to us to be quite clear. It applies to the disposal of the premises. There is no requirement of a change of use; the latter is dealt with separately in sub-paragraph (3), in cases where there has been no disposal. Moreover, there are in our opinion sound reasons for imposing the self-supply charge on P in the event of a mere disposal, without any change of use. Following disposal, the person who received the initial zero-rated supply will normally have no control over the premises or their use. It is

possible, therefore, that the transferee could change the use of the premises from a care home to an ordinary commercial purpose, such as an office or shop or warehouse. In that event, the self-supply charge would be imposed by paragraph 37(1) on the original transferee, but in respect of an act that was entirely outwith the control of the original transferee. That is evidently an unsatisfactory result.

[30] In any event, zero-rating on the supply of care homes and other residential property is an exemption from the ordinary rules of VAT. It is not surprising that the legislation should restrict such exemptions, in a manner that reflects the basic legislative policy underlying the system of VAT. If exemptions are not kept under control, the fundamental principle of fiscal neutrality may be threatened. Furthermore, the transactional approach requires that exemptions should be properly confined to the particular transactions to which they relate, and the principle of objectivity, with its attendant certainty, requires that effective criteria should be used to determine when an exemption does or does not apply. Paragraphs 35-37 of Schedule 10 to the 1994 Act were enacted by the Value Added Tax (Buildings and Land) Order 2011 to replace earlier provisions that had been found unsatisfactory and uncertain in operation. In these circumstances it is hardly surprising that an important legislative policy is that zero-rating should be clearly defined, to ensure consistent treatment of taxpayers.

[31] Counsel for the taxpayer placed some reliance on the fact that in the present case Balhousie Care was able to control the use of the property; in this way, he submitted, the fundamental mischief struck at by paragraphs 35-37, namely use of the property for a purpose other than a care home or other residential purpose, was not engaged. Consequently, it was said, the benefit of zero-rating could be permitted to continue without infringing the fundamental legislative objectives of those paragraphs. In our opinion that

submission should be rejected, for two reasons. First, paragraphs 35-37 are, as we have explained, a limitation placed upon a type of exemption from VAT, zero-rating, and effective criteria, complying with the basic VAT principles, must be used to determine the extent of the exemption. Paragraph 36(2) restricts the exemption in any case where the original transferee of a care home or other residential property disposes of its entire interest, regardless of any change of use. Secondly, a sale and leaseback transaction involves the disposal of the original owner's heritable (real) interest in the property, albeit in exchange for a lesser heritable interest in the form of a lease. The lease might nevertheless terminate for a number of reasons, and in that event the original owner's heritable interest would be lost. In that event the original owner, Balhousie Care, could no longer control the use of the property.

[32] We should also note one further aspect of the relevant legislation. Paragraph 37 deals with the calculation of the self-supply charge using the formulae in sub-paragraph (3). Sub-paragraph (1) states that P's interest in the relevant premises held immediately prior to the time when paragraph 36(1) comes into operation (in the form of the event triggering the deemed self-supply) is to be treated as supplied to P for the purposes of a business which P carries on and as supplied by P in the course of that business. The assumption is that P has supplied itself at the time of the original zero-rated transaction with the interest held immediately before the time of the chargeable event. The wording of paragraph 37 thus assumes that the person subject to the self-supply charge has held the property, or part of the property, throughout the period from the time of the original zero-rated supply until the event that triggers the charge to tax. That supports the view that paragraph 36(2) should be applied in a straightforward fashion, to deal with any disposal of P's entire interest in the property.

[33] Finally, on this topic, we should note that counsel for the taxpayer placed some reliance on HMRC's manual VAT Construction, VCONST21500, where it is stated that paragraph 36 was drafted as it is because the only person who can pay a "change in use" charge is the person who received the zero-rated supply. Counsel submitted that in the present case, because of the leaseback, the taxpayer would be able to pay the "change in use" charge if that arose in future. On this document, we observe that the manual is not a binding or authoritative statement of the law, and it is not binding on the court. Perhaps more importantly, paragraph 36 is concerned to state provisions of general application. For the reasons discussed in the last three paragraphs we consider that it is unsurprising that it applies to any disposal of the property, because a disposal will usually take the property outwith the control of the original transferee who obtained the benefit of zero-rating.

[34] For the foregoing reasons we are of opinion that the legislative purpose of paragraphs 35-37, namely restricting the benefit of zero-rating in defined circumstances, requires that full effect should be given to the terms of paragraph 36(2) and (3). The result is that any disposal of the entire interest in relevant premises will trigger a self-supply charge calculated in accordance with paragraph 37.

Application of the legislation to the facts of the present case

[35] We have set out the facts of the present case as found by the First-tier Tribunal at paragraphs [2] and [5]-[7] above. The central feature is that Balhousie Care, a member of the taxpayer's VAT group, acquired the Huntly care home and then concluded missives with Target. The missives provided for the sale of the care home to Target and the granting by Target to Balhousie Care of a lease for a term of 30 years taking effect from the date of settlement. The lease specified that the property should be used for an "Approved Use",

which amounted to use as a residential care home or nursing home. The missives specified a date of entry, and it was an essential condition that Balhousie Care should give Target entry to and vacant possession of the property on that date.

[36] The argument for the taxpayer was in essence that the sale and leaseback should be treated for the purposes of the VAT legislation, and in particular paragraphs 35-37 of Schedule 10 to the Value Added Tax Act 1994, as a single transaction. The result, it was said, was that Balhousie Care, the company that was in the position of P in paragraphs 35-37, had not disposed of its entire interest in the relevant premises. Consequently the essential condition in paragraph 36(2) was not satisfied.

[37] This argument was in large measure founded on the approach to the legislation governing income tax and capital taxes found in cases such as *Ramsay*, *Barclays Mercantile* and *UBS*. For the reasons stated previously, we are of opinion that this approach should not be applied to VAT, which is an indirect tax of an essentially transactional nature. Instead, an approach that is both transactional and objective must be followed in analysing transactions for the purposes of VAT; that is essential to achieve the important objective of fiscal neutrality. As a further basis for his argument, counsel for the taxpayer relied on the proposition that the purpose of paragraphs 35-37, and paragraph 36 in particular, was to deal with cases where the relevant premises were used for a purpose that was neither a relevant residential purpose nor a relevant charitable purpose. That is certainly the test in paragraph 36(3), but it fails to give effect to the distinct wording employed in paragraph 36(2), which refers expressly to the case where P has "disposed of P's entire interest in the relevant premises": see paragraph [10] above. It also fails to give effect to the wording of paragraph 36(3)(a), which expressly indicates that that sub-paragraph, dealing with change of use, does not apply in cases where sub-paragraph (2), dealing with disposal,

does apply: *ibid*. For these reasons we cannot agree that the overarching purpose of paragraph 36 is to deal with cases where premises are used for a purpose that is not a relevant residential purpose; paragraph 36 deals with disposal of P's entire interest in the relevant premises as well as use for a purpose that is not a relevant residential or charitable purpose.

[38] Nevertheless, there remains the question of whether the sale and leaseback transactions entered into by Balhousie Care amounted to the disposal of the entire interest in the Huntly care home; that is the essential condition for the application of paragraph 36(2). If the sale and leaseback were regarded as a single transaction, it could be said that its end result was that Balhousie Care ended with a lease of the care home, which did not involve the disposal of its "entire interest" in the premises. This raises the question: what for VAT purposes is the relevant transaction? As we have already indicated, a transactional approach is central in the application of VAT legislation, and determining the identity of each transaction is a vital part of that analysis.

[39] In our opinion the sale and leaseback should be regarded as two distinct transactions, the sale followed by the leaseback. As a matter of substance, considered objectively, it is obvious that the sale and leaseback are distinct transactions. One is an outright transfer of land made for payment of a consideration; the other is the grant of the exclusive possession of land for a limited period, 30 years in this case, in exchange for a series of periodic payments. Moreover, the lease could only take effect once the disposition had been granted, as until then the landlord had no interest in the property. That result was inevitable from the nature of the transaction, and it was in fact apparent from the terms of the missives, which provided that at the date of entry Balhousie Care should give Target, the disponee, entry to and vacant possession of the property (that being declared an essential

condition) and that Target should give Balhousie Care a lease with effect from the date of settlement. These provisions recognized that the lease was a different transaction, and that it could only take effect once Target was the heritable proprietor of the care home. Thus, considered objectively, the sale and the leaseback serve different purposes and achieve distinct results. The natural conclusion is that they represent separate transactions, as a matter of substance.

[40] In this connection, the intention or purpose of Balhousie Care in entering into the transaction is irrelevant. As we have already indicated, the legislative purpose is relevant to the construction of the legislation, but the purpose of the taxpayer (or relevant member of the taxpayer's VAT group) is not relevant. Instead the transaction entered into must be examined objectively. Thus it is immaterial that the taxpayer intended that the sale and leaseback should function as in effect a security arrangement designed to raise finance for the acquisition of the care home. We are accordingly of opinion that the sale and the leaseback are as a matter of substance two entirely different transactions, the second being dependent on the completion of the first. This would be reflected in the Land Register, where two distinct transactions would inevitably be separately recorded. After the grant of the lease, Balhousie Care continued to be entitled to occupy the property, but the right to do so was dependent on the lease, not on their former ownership of the property.

[41] Once the sale is regarded as a distinct transaction from the leaseback, the application of paragraphs 35-37 is straightforward. The sale of the property, and the consequent disposition in favour of Target, divested Balhousie Care of its entire interest in the property. Paragraph 36(2) therefore applies. Any other construction would in our opinion fail to recognize the transactional structure of VAT, and would fail to give effect to a properly objective analysis of the sale and leaseback.

Conclusion

[42] For the foregoing reasons we are of opinion that the taxpayer's appeal should be refused. We will accordingly uphold the decision of the Upper Tribunal.