Hilary Term
[2023] UKSC 12
On appeal from: [2021] CSIH 29

JUDGMENT

Moulsdale t/a Moulsdale Properties (Appellant) *v* Commissioners for His Majesty's Revenue and Customs (Respondent) (Scotland)

before

Lord Reed, President
Lord Briggs
Lord Sales
Lord Hamblen
Lady Rose

JUDGMENT GIVEN ON
22 March 2023

Heard on 17 January 2023

Appellant
Philip Simpson KC
David Small
(Instructed by Harper Macleod LLP (Glasgow))

Respondent
David Thomson KC
Elisabeth Roxburgh
Ross Anderson
(Instructed by the Office of the Advocate General (Scotland))

LADY ROSE (with whom Lord Reed, Lord Briggs, Lord Sales and Lord Hamblen agree):

1. It is a fundamental feature of the Value Added Tax regime that traders who carry on an economic activity which is exempt from VAT have the advantage that they do not have to add VAT on to the prices that they charge their customers. But they also have the disadvantage that they are denied the opportunity to deduct or claim back the input VAT that they pay when buying in the goods and services they use in their business. As Lord Hoffmann put it in *Principal and Fellows of Newnham College in the University of Cambridge v Revenue & Customs Commissioners* [2008] UKHL 23, [2008] 1 WLR 888, para 1 "Making exempt supplies is all very well for the recipients, because they pay no VAT. It is less attractive if you are the supplier, because you are not credited with the input tax on the goods and services on which you have been charged VAT."

2. For that reason, the Respondents HMRC, and HM Treasury are alert to mechanisms which taxable traders running exempt businesses might use in order to get that benefit without bearing that burden. The legislation that the court must analyse in the present appeal is aimed in part at preventing that kind of mechanism being used in respect of transactions in land.

3. Drafting tax legislation is a difficult and complex task so it is not surprising that sometimes the legislation does not quite work. It is common ground that this appeal arises because of one such occasion. Problems can arise in particular where, as here, provisions that were drafted in an enactment for one purpose are incorporated by cross-reference into a different enactment dealing with something else. The drafter does not spot that there might be a circumstance in which the imported provisions which work perfectly well in their original setting, create a conundrum in their new setting. If that circumstance arises, it falls to the court to decide how the legislation applies, giving effect to Parliament's intention and the purpose for which the provisions relevant to the appeal were enacted.

4. The dispute between HMRC and the Appellant, Mr Moulsdale, arises over whether Mr Moulsdale ought to have charged VAT on the sale price of a property which he sold to an unconnected purchaser in September 2014. The legislation which determines whether VAT is chargeable on that sale of his land is Schedule 10 to the Value Added Tax Act 1994 ("VATA") ("Schedule 10"), given effect by section 51 VATA. Very broadly, the effect of the provisions as drafted appears to be that if Mr Moulsdale intended or expected to add VAT to the price he was charging for the land, then VAT was **not** chargeable on the sale so he did not need to add VAT. But if Mr Moulsdale did not intend or expect that the purchaser would pay VAT on the price, then the

transaction **was** liable to VAT and so he ought to have added VAT to the purchase price.

5. Mr Moulsdale in fact did not charge VAT on the price of the land charged to the purchaser but HMRC subsequently assessed him to VAT as if the sale price had been inclusive of VAT. HMRC took the view that the way out of the problem generated by the provisions resulted in VAT being payable. Mr Moulsdale appealed against that assessment. His appeal was refused by the First-tier Tribunal, by the Upper Tribunal and by a majority in the Court of Session Inner House. He now appeals to this court.

The background facts

6. Mr Moulsdale bought a building in Westfield, Cumbernauld on 3 May 2001 for a purchase price excluding VAT of £1,140,000. Generally, transactions in land are exempt from VAT in accordance with VATA 1994, Schedule 9 Group 1. However, para 1 of Schedule 10 gives a taxable person an option to tax transactions relating to a particular parcel of land. Para 1 of Schedule 10 provides that if a person exercises the option to tax any land under Part 1 of Schedule 10, and a grant is made in relation to the land at any time when the option to tax it has effect, then the grant does not fall within Group 1 of Schedule 9. Para 20 of Schedule 10 provides that an option to tax has effect only if HMRC are notified within the specified time. It can be revoked under para 23 during a six month "cooling off" period provided that no tax has become chargeable as a result of the option and if certain other conditions are met.

7. Where the option to tax is exercised VAT must be charged and accounted for to HMRC. However, the option to tax is not effective if the grant of land falls within paragraphs 12 to 17 of Schedule 10. If the option to tax is disapplied, then the grant is exempt and no VAT can be charged by the person even though they exercised the option to tax in relation to that land.

8. The person who sold the land on 3 May 2001 to Mr Moulsdale had exercised the option to tax the land and so charged Mr Moulsdale VAT of £199,500 in addition to the net sale price of the property. On 9 May 2001, Mr Moulsdale himself exercised the option to tax transactions relating to the property and he successfully claimed back from HMRC almost all of the VAT he had paid to the vendor in his VAT return for the period ending June 2001.

9. In September 2001, Mr Moulsdale leased the property to Optical Express (Westfield) Limited ("Optical Express"). Optical Express operated a business as an optician from the property. That business is a VAT exempt business so that Optical

Express did not charge VAT on the sales it made to its customers. From the start of the lease, Mr Moulsdale charged Optical Express VAT on the rent payable under the lease, reflecting, he thought, the fact that he had opted to tax the property. He accounted to HMRC for the VAT collected from Optical Express. However, in 2007 there was a VAT inspection and Mr Moulsdale was told that even though he had opted to tax the property, the lease to Optical Express was still an exempt supply because the option to tax was disapplied in these circumstances. That was because Optical Express was a person connected with Mr Moulsdale for the purposes of Schedule 10 so that the lease fell within one of the paragraphs of Schedule 10 which disapply the option to tax on particular transactions. Mr Moulsdale ought not to have been charging Optical Express VAT on the rent.

10. In early September 2014, Mr Moulsdale sold the property to Cumbernauld SPV Ltd ("Cumbernauld SPV"). The property was sold subject to the lease in favour of Optical Express. The price was £1,149,374. Mr Moulsdale did not charge Cumbernauld SPV VAT on the sale price. Cumbernauld SPV is not connected with Mr Moulsdale for the purposes of Schedule 10. Cumbernauld SPV was not VAT registered at the time it bought the property and did not notify HMRC that it was exercising the option to tax the land. The property became part of Cumbernauld SPV's property leasing business.

11. The reason why Mr Moulsdale thought that he should not charge tax on the sale price of the land to Cumbernauld SPV, even though he had exercised the option to tax the land, was because he was advised that the transaction fell within one of the exceptions in Schedule 10. This disapplied the option to tax so that the transaction reverted to being an exempt land transaction. HMRC disagreed and told Mr Moulsdale that the transaction did not fit within the provisions that disapply the option to tax. They assessed Mr Moulsdale for output VAT as if the sale price of the land included VAT. HMRC issued Mr Moulsdale with a decision notice and a notice of assessment of VAT of £191,562, treating the purchase price of £1,149,374 as a VAT inclusive figure.

The statutory provisions

(a) Schedule 10 VATA: the exception for developers of exempt land

12. The present version of Schedule 10 was re-written in 2008: see the Value Added Tax (Buildings and Land) Order 2008 (SI 2008/1146). That did not affect the continuity of the law.

13. The starting point is para 2 of Schedule 10 which provides that the effect of the exercise of the option to tax is that the grant is no longer exempt, that is to say, it

becomes a transaction subject to VAT if it would be taxable, but for that land exemption:

> **"2.— Effect of the option to tax: exempt supplies become taxable**
>
> (1) This paragraph applies if—
>
> (a) a person exercises the option to tax any land under this Part of this Schedule, and
>
> (b) a grant is made in relation to the land at any time when the option to tax it has effect.
>
> (2) If the grant is made—
>
> (a) by the person exercising that option, or
>
> (b) by a relevant associate (if that person is a body corporate),
>
> the grant does not fall within Group 1 of Schedule 9 (exemptions for land).
>
> (3) For the meaning of 'relevant associate', see paragraph 3."

14. These provisions implement the United Kingdom's obligations under Council Directive 2006/112/EC on the Common System of Value Added Tax. Article 135(1)(j) to (l) provides that supplies of land or buildings are ordinarily exempt from VAT, and that includes the leasing or letting of immovable property. Article 137 provides that Member states may allow taxable persons a right of option for taxation in respect of the supply of buildings or parts of buildings, of the land on which the building stands, the supply of land that has not been built on or the letting and leasing of immovable property. Article 137(2) provides further that Member states must lay down detailed rules governing the exercise of the option and that they may restrict the scope of that right of option.

15. The purpose of paras 12 to 17 of Schedule 10 is to prevent businesses which provide exempt supplies from recovering the input VAT they incur on capital items by using the option to tax land as a means of creating a VAT bearing output supply (i.e. the VAT bearing supply of the opted land) in addition to the exempt supplies of their ordinary business so that they have some output tax against which to set their input credit. The availability of an option to tax land can easily create opportunities for businesses to get at least some of the advantages both of making exempt supplies and of being able to manipulate their liability to account for VAT incurred on this major expenditure. That can be illustrated by what happened in *Robert Gordon's College v Customs and Excise Comrs* [1996] 1 WLR 201, ("*Robert Gordon's College*"). Simplifying the facts slightly, the College's business in that case was providing exempt educational services to pupils. But it wished to recover the input VAT it paid on building materials and services incurred when it developed its playing fields. The College's ordinary business of charging school fees collected no output tax from which the input tax on the costs of the works could be deducted. The College therefore incorporated a subsidiary to which it leased the land; the College then exercised the option to tax the land and so charged VAT on the rent to the subsidiary. It thereby made some taxable supplies and collected VAT from its subsidiary from which it could deduct all the input tax that had been paid on the construction works.

16. Tax avoidance of a different kind can be achieved where businesses enter into arrangements which are designed not necessarily to recover the VAT paid on the input supplies, but at least to mitigate the burden of that irrecoverable input VAT having to be paid all at once. This is in fact what happened in *Robert Gordon's College*. The College opted to tax the lease of the playing fields to the subsidiary thereby creating a taxable supply generating output tax against which it could credit the VAT paid on the building costs. But the subsidiary also granted a licence of the playing fields back to the College so the pupils could use the playing fields. The subsidiary as well as the College opted to tax the land so the subsidiary had to add VAT to the licence fees that it charged to the College. As the College was using the licenced land for its exempt business of providing educational services, the College could not recover the input VAT it paid to the subsidiary on the licence fees. As Lord Hoffmann noted at p 205, the advantage was to the College's cashflow rather than its ultimate liability to tax. The Commissioners' challenge to the College's arrangements relied on different, earlier anti-avoidance provisions from the ones raised by this appeal and the House of Lords ultimately found in favour of the College. But the case is a useful illustration of the kinds of avoidance mechanisms with which Schedule 10 is concerned.

17. Para 12 of Schedule 10 is a key provision for the purposes of this appeal. It sets out circumstances in which, even though the option to tax has been exercised, the grant of land is not a taxable supply on which VAT should be charged but reverts to being an exempt supply which is not subject to VAT. It provides:

“**12.— Developers of exempt land**

(1) A supply is not, as a result of an option to tax, a taxable supply if—

(a) the grant giving rise to the supply was made by a person (‘the grantor’) who was a developer of the land, and

(b) the exempt land test is met.

(2) The exempt land test is met if, at the time when the grant was made (or treated for the purposes of this paragraph as made), the relevant person intended or expected that the land—

(a) would become exempt land (whether immediately or eventually and whether or not as a result of the grant), or

(b) would continue, for a period at least, to be exempt land.

(3) ‘The relevant person’ means—

(a) the grantor, or

(b) a development financier.

(4) For the meaning of a development financier, see paragraph 14.

(5) For the meaning of ‘exempt land’, see paragraphs 15 and 16.

(6) If a supply is made by a person other than the person who made the grant giving rise to it—

(a) the person making the supply is treated for the purposes of this paragraph as the person who made the grant giving rise to it, and

(b) the grant is treated for the purposes of this paragraph as made at the time when that person made the first supply arising from the grant."

18. One can see that para 12 contains many different elements which need to be in place before the paragraph switches off the option to tax so that the grant is actually an exempt transaction on which VAT cannot be charged. Some of those elements are expanded upon within para 12 itself, some in the subsequent paragraphs and some in regulations. Fortunately, not all these elements required for para 12 to apply are contentious so far as this appeal is concerned. It is common ground that:

(i) We are not concerned with the "development financier" provisions or with the deeming provision in sub-para (6).

(ii) Mr Moulsdale is the "grantor" for the purposes of para 12.

(iii) The sale of the property from Mr Moulsdale to Cumbernauld SPV was a "grant giving rise" to the supply of the property.

19. Several of the key elements used in para 12, in particular whether a grantor is a "developer of the land" and what is "exempt land", have numerous sub-elements.

20. Looking first at the term "developer of the land" used in para 12, this is defined in para 13 of Schedule 10:

"**13.— Meaning of grants made by a developer**

(1) This paragraph applies for the purposes of paragraph 12.

(2) A grant made by any person ('the grantor') in relation to any land is made by a developer of the land if—

(a) the land is, or was intended or expected to be, a relevant capital item (see sub-paragraphs (3) to (5)), and

(b) the grant is made at an eligible time as respects that capital item (see sub-paragraph (6)).

(3) The land is a relevant capital item if—

(a) the land, or

(b) the building or part of a building on the land,

is a capital item in relation to the grantor.

(4) The land was intended or expected to be a relevant capital item if the grantor, or a development financier, intended or expected that—

(a) the land, or

(b) a building or part of a building on, or to be constructed on, the land,

would become a capital item in relation to the grantor or any relevant transferee.

(5) A person is a relevant transferee if the person is someone to whom the land, building or part of a building was to be transferred—

(a) in the course of a supply, or

(b) in the course of a transfer of a business or part of a business as a going concern.

(6) A grant is made at an eligible time as respects a capital item if it is made before the end of the period provided in the relevant regulations for the making of adjustments relating to the deduction of input tax as respects the capital item.

…

(8) In this paragraph a ‘capital item’, in relation to any person, means an asset falling, in relation to the person, to be treated as a capital item for the purposes of the relevant regulations.

(9) In this paragraph ‘the relevant regulations’, as respects any item, means regulations under section 26(3) and (4) providing for adjustments relating to the deduction of input tax to be made as respects that item.”

21. Again, some parts of para 13 of Schedule 10 are not contentious in this appeal because it is common ground that:

(i) The “relevant regulations” referred to in para 13(6), (8) and (9) as being made under section 26 VATA are the Value Added Tax Regulations 1995 (SI 1995/2518), particularly regulations 112 and 113.

(ii) The “period provided” in those Regulations for the purposes of para 13(6) of Schedule 10 is ten years.

(iii) Applying para 13(2) to the facts of this case, the question whether Mr Moulsdale was a developer when selling the property to Cumbernauld SPV turns on whether the land “**was intended or expected to be**” a relevant capital item, rather than on whether the land “**is**” a relevant capital item.

(iv) Applying para 13(4), the question whether the land “was intended or expected to be” a relevant capital item turns on whether the grantor (Mr Moulsdale) intended or expected that the land would become a capital item in relation to Cumbernauld SPV **as a “relevant transferee”** rather than on whether it would become a relevant item in relation to Mr Moulsdale **as the grantor**.

(v) If we focus on whether the land was intended or expected to be a relevant capital item in relation to Cumbernauld SPV, then it is accepted by both parties that the sale of the land was made at "**an eligible time**" for the purposes of para 13(6) because the 10 year adjustment period has not yet started to run at the time of the sale.

22. Turning next to the term "exempt land" used in para 12, this is defined by para 15 of Schedule 10.

"**15.— Meaning of "exempt land": basic definition**

(1) This paragraph explains for the purposes of paragraphs 12 to 17 what is meant by exempt land.

(2) Land is exempt land if, at any time before the end of the relevant adjustment period as respects that land—

(a) a relevant person is in occupation of the land, and

(b) that occupation is not wholly, or substantially wholly, for eligible purposes.

(3) Each of the following is a relevant person—

(a) the grantor,

(b) a person connected with the grantor,

(c) a development financier, and

(d) a person connected with a development financier.

…

(4) The relevant adjustment period as respects any land is the period provided in the relevant regulations (within the meaning of paragraph 13) for the making of adjustments relating to the deduction of input tax as respects the land.

(5) For the purposes of this paragraph any question whether a person's occupation of any land is 'wholly, or substantially wholly,' for eligible purposes is to be decided by reference to criteria specified in a public notice."

23. It is common ground that the "exempt land test" referred to in para 12(1)(b) as defined in para 12(2) is met here. The property is "exempt land" within the meaning of para 15 because a person (that is Optical Express) connected with the grantor (that is Mr Moulsdale) is in occupation of the land and that occupation "is not wholly, or substantially wholly, for eligible purposes" within the meaning of para 15(5) (because Optical Express is occupying the property to carry on an optician business which is exempt from VAT).

24. Focussing then on the parts of paras 12 and 13 of Schedule 10 which are at issue in this case, the issue starts to emerge:

(i) the sale of the property from Mr Moulsdale to Cumbernauld SPV is an exempt supply if the sale was made by Mr Moulsdale as a "developer of the land" and if the "exempt land test" is met.

(ii) It is common ground that the "exempt land test" is met because Optical Express was in occupation of the land and running a VAT exempt opticians' business and Optical Express is connected with Mr Moulsdale.

(iii) Whether Mr Moulsdale was "a developer of the land" or not depends on if he intended or expected the land to be a relevant capital item in relation to Cumbernauld SPV and if the sale to Cumbernauld SPV was made at an eligible time.

(iv) It is common ground that the sale to Cumbernauld SPV was made at an eligible time.

(v) whether the land would be a “relevant capital item” in relation to Cumbernauld SPV depends on whether it would be treated as a capital item for the purposes of regulations 112 and 113 of the VAT Regulations 1995.

(b) Regulations 112 and 113 of the VAT Regulations 1995

25. That brings me to regulations 112 and 113 of the VAT Regulations 1995. Those Regulations are made under section 26 VATA for the purpose of calculating how much input tax a trader can deduct when it buys a capital item for use in its business and that trader’s business combines both sales which are subject to VAT and sales which are not subject to VAT, for example because they are exempt. Generally speaking, if a trader’s business is entirely making taxable supplies then, if it buys in a capital item such as a large piece of machinery, it can immediately claim a credit for all the VAT it has paid on the price of that piece of machinery. But if a trader buys a capital item for use in its business, and half of that business is taxable supplies and half is non-taxable supplies, then the trader can immediately claim back half the VAT that it paid on the capital item as a VAT credit.

26. What happens if after a few years, the trader changes the balance of its business so that now, say, 80 per cent of its sales are taxable? It is still using that piece of machinery to support that business so should be able to adjust the amount of credit that it can claim for the VAT it paid when it bought the machinery to reflect the fact that now the capital item of machinery is being used in a business which is 80 per cent taxable supplies. Regulations 112 and 113 provide for when and how that adjustment can happen. This adjustment mechanism is generally referred to as the Capital Goods Scheme.

27. Regulation 113 is the important regulation for our purposes. It defines (a) the kinds of capital items in respect of which an adjustment to the recoverable VAT can be made and (b) the kinds of expenditure in respect of which the adjustment can be made both as to what the expenditure paid for and how much it was. If the taxable person incurs “VAT bearing capital expenditure” of the specified kind and in the specified amount, then the Capital Goods Scheme applies to the input VAT so incurred.

28. Regulation 113 provides (I have highlighted the parts that are relevant for this appeal):

“**113.—**

(1) **The capital items to which this Part applies are any of the items specified in paragraph (2) on or in relation to which the owner incurs VAT bearing capital expenditure of a type specified in paragraph (3), the value of which is not less than that specified in paragraph (4)**.

(2) The items are—

(a) land;

(b) **a building** or part of a building;

(c) a civil engineering work or part of a civil engineering work;

(d) a computer or an item of computer equipment;

(e) an aircraft;

(f) a ship, boat or other vessel.

(3) The expenditure—

(a) in the case of an item falling within paragraph (2)(a) or (d), is the expenditure relating to its acquisition;

(b) **in the case of an item falling within paragraph (2)(b),** (c), (e) or (f), **is the expenditure relating to its—**

(i) **acquisition**,

(ii) construction (including where appropriate manufacture),

(iii) refurbishment,

(iv) fitting out,

(v) alteration, or

(vi) extension (including the construction of an annex).

(4) The value for the purposes of paragraph (3) is—

(a) **not less than £250,000 where the item falls within paragraph (2)(a), (b)** or (c);

(b) not less than £50,000 where the item falls within paragraph (2)(d), (e) or (f).”

29. Regulation 114 then sets the period following the purchase of the capital item during which an adjustment can be made. For our purposes, as I have said, that period is ten years, which means that if the trader changes the split of its business as between taxable and exempt supplies more than 10 years after incurring the capital expenditure falling within regulation 113, it is too late either for it to claim a retrospective credit for input VAT or for HMRC to unwind the credit that was given at the time it was purchased. It is because of that 10 year limit that Mr Moulsdale cannot rely on para 13(3) of Schedule 10 and on the fact that the land “is” a relevant capital item in relation to him as grantor. The requirement set by para 13(2)(b) that the grant is made at an eligible time as respects the land would not be met because the sale of the land to Cumbernauld SPV took place more than 10 years after Mr Moulsdale himself bought the land and paid VAT on the purchase price of it.

30. “VAT bearing capital expenditure” is defined in regulation 115(5) as being capital expenditure at the standard or reduced rate.

31. The class of capital items and expenditure specified in regulation 113 for the purpose of the Capital Goods Scheme is imported into paras 12 and 13 of Schedule 10 for the purpose of determining whether a particular supply of land is covered by the option to tax or whether that option to tax is disapplied so that the supply reverts to being exempt. The relevant elements of regulation 113 for the purposes of this appeal are those which relate to buildings and acquisition costs. The acquisition cost of the building in this case was well in excess of the minimum set in regulation 113(4). The

FTT found that there were no other kinds of costs which Mr Moulsdale intended or expected Cumbernauld SPV to incur in relation to the building sold: see para 43

32. Putting the relevant provisions of paras 12 and 13 of Schedule 10 together with regulation 113 of the VAT Regulations 1995, one sees that:

(i) Mr Moulsdale will be a “developer of the land” for the purposes of paras 12 and 13 if he intended or expected that the building he was selling to Cumbernauld SPV would become a relevant capital item in relation to Cumbernauld SPV; and

(ii) The building would become a relevant capital item in relation to Cumbernauld SPV if Cumbernauld SPV was intended or expected to pay VAT on the acquisition costs of more than £250,000 on the building.

33. If Mr Moulsdale did intend or expect Cumbernauld SPV to pay VAT on the sale price for the building then, because the land is exempt land and the sale took place within the eligible time, he is a “developer of the land” and all the elements are in place for para 12(1) to disapply the option to tax so that the sale of the land reverts to being an exempt transaction on which Mr Moulsdale should not charge VAT. Conversely, if Mr Moulsdale did not intend or expect that Cumbernauld SPV would pay VAT on the price of the building, then the building would not become a relevant capital item in relation to Cumbernauld SPV so the sale would not be made by Mr Moulsdale as a developer of the land and the option to tax would apply, making the sale subject to VAT.

34. The problem with this is that the circumstance on which the application of the provision depends – whether Mr Moulsdale intends or expects Cumbernauld SPV to pay VAT on the price of the building – is entirely within Mr Moulsdale’s control as he is the person who decides whether to charge VAT on the sale or not. As I said at the outset, the conundrum is that if he charges VAT then he is a developer of the land and VAT is not in fact payable because the option to tax is disapplied but if he does not charge VAT then he is not a developer of the land and the option to tax still applies to the sale so that he should charge VAT.

35. The operation of these provisions was considered by Judge Falk in *PGPH Ltd v Revenue and Customs Comrs* [2017] UKFTT 782 (TC), [2018] SFTD 546 (“*PGPH*”). In that case the dispute was over, amongst other things, whether the taxpayer, PGPH, had intended or expected to carry out refurbishment work at a cost of more than £250,000 on its property after a right to use the property had been granted to another company

for a fee. There was no doubt that after the grant, the taxpayer did not carry out refurbishment to more than that value. Judge Falk recorded that she heard oral evidence from two witnesses for the taxpayer and considered a number of documents including correspondence in relation to the grant: para 13. She set out her findings of fact on the dealings and on the taxpayer's funding arrangements. PGPH argued that it had not had the intention or expectation that the refurbishment would be carried out following the grant of the property. That would mean that it was not a developer of land, so that the option to tax was not disapplied. That would mean that the fees charged by PGPH to the occupier were subject to VAT from which PGPH could then deduct the input VAT it paid on the supplies used in the refurbishment before accounting for it to HMRC. If PGPH was a developer of land, the option to tax would be switched off by para 12 of Schedule 10, the fees charged would not be taxable so PGPH would have no output VAT from which to deduct the input VAT it incurred in refurbishing the premises.

36. Judge Falk found that taking account of all the evidence it was more likely than not that Mr Parker, a director of the taxpayer, did intend or expect that PGPH would spend more than £250,000 on building works: para 86. She discussed the test to be applied at para 116:

> "116. It is clear that the references to intention or expectation in paras 13(2) and (4) of Sch 10 impose a subjective test. For the test to be satisfied the relevant person, in this case PGPH through its sole shareholder and director Mr Parker, must have had an intention or expectation at the date of grant. The question is exactly what that intention or expectation must be. In my view it must be an intention or expectation to incur expenditure on something which, if it is incurred, will result in there being a capital item within [reg] 113 of the VAT Regulations. …"

37. She held further that there was no requirement in Schedule 10 that the capital expenditure was actually incurred, only that it had been intended or expected: para 118. Para 12 of Schedule 10 therefore had the effect that PGPH's option to tax the land did not apply to the fees charged for grant of the land to the occupier. It followed that those fees were not taxable and that HMRC had been right to deny PGPH the input tax credits incurred on the expenditure for the refurbishment.

The decisions below

38. Both Mr Moulsdale and HMRC acknowledge the difficulty created by the provisions of Schedule 10 but have proposed different ways round it.

39. Mr Simpson KC, appearing on behalf of Mr Moulsdale, argues that because Mr Moulsdale has exercised the option to tax in relation to the land, he would ordinarily intend or expect that Cumbernauld SPV would pay VAT on the purchase price of the land. The inquiry should stop there and conclude that because of that expectation, Mr Moulsdale is to be treated as a developer of the land (assuming that, as here, all the other conditions for para 12 to apply are met). The grant is therefore exempt. One should not go on to reconsider the disapplication of the option to tax after concluding that the grant is exempt but one should rather disregard the question of whether VAT is chargeable as a result of the application of the paragraph itself.

40. HMRC argue that one avoids the circularity by recognising that when incorporating the class of assets which are to be treated as a capital item for the purposes of regulation 113 into the definition of “capital item” for the purposes of paras 12 and 13 of Schedule 10, one must disregard the acquisition costs of the building in so far as those acquisition costs are the consideration for the “supply” referred to in para 12(1) of Schedule 10. Put another way, HMRC argue that the way to avoid circularity is by treating the reference to the creation of a capital item as a reference to a capital item other than the one which would arise on the grant.

41. The First-tier Tribunal (Judge Anne Scott and Peter Sheppard) issued its decision on 15 June 2018: [2018] UKFTT 309 (TC). The FTT noted at the outset that the parties were agreed that the sole issue for determination by the Tribunal was the interpretation of the relevant provisions of Schedule 10 because of the admitted circularity of the provisions: para 3. The FTT also stated that there was no doubt that the sale from Mr Moulsdale to Cumbernauld SPV was a genuine transaction but that the relevant provisions apply mechanistically. There does not need to be any intention to avoid tax before the disapplication of the option to tax is triggered.

42. They recorded Mr Simpson’s argument that in order to avoid circularity, having decided that the transaction was “caught” by Schedule 10 (because the option to tax had been exercised) one must ignore for this purpose the grantor’s intention or expectation arising from the application of para 12 itself. The FTT rejected this argument because it would exempt many sales of land in respect of which the option to tax had been exercised:

> "42. We have some difficulty with his proposition that the process comes to a halt once it is established that the transaction is exempt in that that would mean that in cases where the sale price of the land and buildings was over £250,000 and the relevant person occupying it met the 'exempt land test' there would be no charge to tax. Although the purpose of the legislation is to limit the circumstances in which the option to tax can be deployed it is also aimed at anti-avoidance and to implement that approach would be to encourage the avoidance of tax."

43. Such a broad disapplication of the option to tax would, the FTT held, achieve the opposite of the result indicated by the general tenor of EU VAT law because it would render a normal commercial transaction exempt even where there had been an option to tax. However, that was not entirely the reason for the FTT's rejection of Mr Moulsdale's appeal. They went on to say:

> 43. As a matter of fact, we find that at the date of the grant the appellant knew that the supply would not be, and could not be, taxable. Accordingly, given the terms of regulation 113(1) of the VAT Regulations (see paragraph 27 above), and knowing that no other relevant expenditure was likely, the appellant could not have intended or expected that the property would become a capital item in the hands of the purchaser."

44. Mr Moulsdale appealed to the Upper Tribunal which issued its decision on 12 March 2020: [2019] UKUT 72 (TCC), [2020] STC 796. The Upper Tribunal (Lord Ericht and Judge Dean) refused the appeal.

45. Mr Simpson argued before the Upper Tribunal that the FTT had erred in its finding of fact recorded at para 43 of the FTT's decision that Mr Moulsdale must have known about the effect of paras 12 to 17 of Schedule 10 and about regulation 113 and so he must have known that the effect of the law was that the building would not become a capital item in Cumbernauld SPV's hands. Mr Simpson acknowledged that no evidence had been called before the FTT, but argued that the bundle before them had included a letter from Mr Moulsdale's financial controller, Mr Graeme Murdoch. He had written to HMRC on behalf of Mr Moulsdale on 22 December 2016 during the exchange of correspondence about the correct tax treatment of the sale. Mr Simpson said that this letter showed that Mr Moulsdale had, as a matter of fact, intended or expected that the building would become a relevant capital item for Cumbernauld SPV.

46. The Upper Tribunal rejected Mr Moulsdale's reliance on the letter from Mr Murdoch. They held that it was not a letter contemporaneous with the event but was an assertion by a member of Mr Moulsdale's staff made in a letter written more than two years after the sale: para 26.

47. The Upper Tribunal then referred to *PGPH* as holding that references to intention or expectation in para 13(2) and (4) of Schedule 10 impose a subjective test; "the intention to be ascertained is that of the Appellant at the date of the grant": para 29. The Upper Tribunal held as follows:

> "39. The requirements of the legislation must be satisfied at the date of the grant; if there is no intention or expectation of expenditure or that works would be carried out resulting in a capital item under regulation 113(1) then the rules are not engaged. On the facts of this appeal, the only expenditure that could make the property a capital item is on the acquisition but no VAT was charged and there was no evidence before the F-tT that the Appellant had any intention or expectation that the property would become a capital item in the hands of the purchaser. It is clear that the provision is only intended to apply where, at the point of entering into the transaction, the transferor intends or expects that a capital item will be created in the purchaser. That requirement cannot be met when the grantor knows that the invoice issued will treat the grant as exempt."

48. The Upper Tribunal held that the FTT had approached the test by reference to Mr Moulsdale's knowledge as to the facts of the transaction and not by reference to his knowledge of the statutory provisions. They said that their conclusion was fortified by a consideration of the potential for tax avoidance if they were to decide otherwise.

49. Mr Moulsdale appealed further. The Court of Session (Inner House) refused the appeal by a majority (Lord Carloway (Lord President) and Lord Menzies) with Lord Doherty dissenting: [2021] CSIH 29, [2021] STC 1077. Lord Carloway focused first on the factual position, prompted by the statement in *PGPH* that the intention or expectation on the part of the grantor (as referred to in para 13(4) of Schedule 10) was a subjective rather than an objective intention. The Court said that for the anti-avoidance provisions to apply, the appellant had to demonstrate that the option to tax had been disapplied because, as a matter of fact, he intended or expected the land to be a capital item in the hands of the purchaser. The problem for the appellant was that he had not led any evidence of his subjective expectation or intention in relation to the

status of the land as a capital item in the hands of the purchasers. Lord Carloway also rejected Mr Moulsdale's reliance on Mr Murdoch's letter and held that the absence of any form of evidence on the critical point of Mr Moulsdale's subjective intention at the time of the sale remained: para 16:

> "This is what the UT identified and why the appeal was refused as not raising a point of law. There is no ground upon which this court would be justified in reversing the decisions of the two specialist tribunals on what was ultimately a matter of fact. On this basis, the appeals must be refused."

50. Lord Carloway then said that although the matter was not argued, he thought that the "eligible time" requirement in para 13(2)(b) of Schedule 10 was also not met. HMRC accept before this court that that was not right; they accept in this appeal that the eligible time requirement is met here because the 10 year period of adjustment of the capital item in the hands of Cumbernauld SPV had not started to run at the time of the grant.

51. Lord Menzies also decided the case on the basis that in order to succeed, Mr Moulsdale had to satisfy the FTT in terms of Schedule 10 para 13(4) that he had intended or expected that the land would become a capital item to be used in the business operated by Cumbernauld SPV: para 21. This involved a subjective test; it was a matter of fact and Mr Moulsdale did not lead any evidence about it. The FTT had been entitled to make the finding it did at para 43 of its judgment and that was enough to justify refusing the appeal.

52. Lord Doherty dissented. He recorded the competing arguments put forward by the parties. Mr Moulsdale argued that his intention or expectation should be assessed ignoring any disapplication which paras 12 to 17 of Schedule 10 might effect. HMRC argued that the capital item (that is to say the acquisition costs) under the grant must be ignored for the purpose of deciding whether the grantor's option is disapplied. He rejected HMRC's construction as untenable because it was not the ordinary and natural reading of para 13(4) and regulation 113 and was indeed at odds with such a reading: para 50. The language of the provision was apt to encompass capital items created at the date of the grant or at a later date. Mr Moulsdale's construction was a sensible construction which avoided circularity: para 51.

The proper construction of paras 12 and 13 of Schedule 10

53. With respect to the tribunals below and the majority of the Inner House, I do not agree that evidence - or the absence of evidence - from a taxpayer about how he or she thought that the statutory provisions would apply to the grant is the key to deciding this case. The taxpayer may have a good understanding of the law and may be well advised or may be unaware of the existence of Schedule 10. That does not affect how the provisions do apply or whether the grant is subject to VAT. I agree with Judge Falk's comments at para 123 of *PGPH* that such a factual inquiry leads to capricious results. In her judgment, she addressed an argument as to whether the intention or expectation referred to in para 13(4) of Schedule 10 imported a requirement that the grantor knew about the Capital Goods Scheme in regs 112 and 113 of the VAT Regulations 1995:

> "122 Mr Lall [counsel for PGPH] submits that this imports a requirement for some knowledge of the Capital Goods Scheme. Whilst I can see that that is a conceivable literal interpretation of the words, I do not think that it is the correct interpretation on any form of purposive construction, or indeed that it is necessary to strain the language of the words to conclude that the interpretation [PGPH] suggests is wrong. A perfectly legitimate literal interpretation is that the words 'falling … to be treated as a capital item' simply describe a set of facts that would fall within the relevant regulations. The reference to 'would become' relates to the nature of the intention or expectation: did the grantor in fact intend or expect that works would be undertaken of a type which would in fact fall within the regulations.
>
> 123 If it were correct that the grantor needs to have some knowledge of the Capital Goods Scheme then that would lead to capricious results. A grant by a grantor who was completely unaware of the regulations would not be caught. The rules would however apply to a grantor who was aware of the regulations to the extent suggested by [PGPH], but did not have a detailed knowledge. [PGPH] also accepted, …, that the rules would apply to a grantor who was fully aware of the regulations but was under the mistaken impression that they or the disapplication rules did not apply on the facts. As [HMRC] submitted, if it was necessary to draw distinctions between categories in this way then that would open up an

> entire line of enquiry for which there is no justification in the rules, and which cannot have been intended from a policy perspective. The purpose of the rules must be better served by applying the provisions in the same way to each category, irrespective of the grantor's extent of knowledge of the law. I can see no conceivable policy reason to draw a distinction between different categories."

54. There may be other cases in which the application of the provisions turns on factual issues which it falls to the FTT to resolve. That was the position in *PGPH* where the VAT bearing capital expenditure which Mr Parker may or may not have intended or expected would be incurred was not the payment for the supply of the property itself but the subsequent refurbishment costs. It is in that context that the statement of Judge Falk in *PGPH* that the Tribunal should apply a subjective test based on information available to the grantor and on the grantor's evidence about what was happening at the time of the grant is relevant.

55. Here there was no such factual dispute. No one intended or expected that either Mr Moulsdale or Cumbernauld SPV would incur any VAT bearing capital expenditure on the building other than the acquisition cost that would be paid by Cumbernauld SPV to Mr Moulsdale. They both subjectively intended and expected that Cumbernauld SPV would pay Mr Moulsdale for the building.

56. I agree therefore with Lord Doherty that one or other of the rival constructions of these provisions should be adopted. However, I prefer the construction put forward by HMRC rather than that put forward by the Appellant. In my judgment, for the purposes of these provisions, the grantor's intention or expectation as to the incurring of VAT bearing expenditure on a capital item must be an intention or expectation about incurring some other cost, different from the very expenditure to which the test in paras 12 and 13 is being applied in order to decide whether it should bear VAT or not. Adopting that construction of the provisions, the question of whether the taxpayer had adduced sufficient evidence about his intentions or expectations in respect of the grant itself falls away.

57. Paragraph 13(8) of Schedule 10 provides that a "capital item" means an asset falling to be treated as a capital item for the purposes of the VAT Regulations 1995. So far as the operation of the Capital Goods Scheme on its own terms is concerned, it is entirely appropriate to include the acquisition costs where that cost was subject to VAT, when land or a building is the capital good in question. The items covered by regulation 113 such as ships, aircraft and computers, as well as land and buildings, are likely to involve very substantial capital outlay for a business and must be at least the

minimum of £250,000 or £50,000 in order to qualify. If the price of that item bears VAT, that is precisely the circumstance in which the Capital Goods Scheme is intended to allow a subsequent adjustment to the recoverability of that VAT by a taxable person, if and when the balance of that taxable person's business between taxable and exempt supplies changes in the 10 years after the purchase.

58. But it is important to bear in mind that the court's task in this appeal is to construe para 13 of Schedule 10 in its context so as to give effect to the purpose for which para 13, as part of paras 12 to 17 of Schedule 10, was enacted. I therefore agree that one must start, as HMRC submit, with the principle that Schedule 10 is aimed at ensuring that exempt businesses cannot recover input tax.

59. Mr Simpson fairly accepted that it does not make sense for the subjective intention or expectation of the grantor to relate to whether tax is chargeable on the acquisition cost itself because that leads one into the circularity problem. He argues that in these circumstances, therefore, one must treat this as an objective test. All that the grantor must intend or expect is that (a) there is a supply of land; (b) an option to tax has been exercised in relation to the land so that the price will include VAT; and (c) the price of the land or the building on it is more than £250,000. If those objectively ascertainable factors are in place then one regards the grantor as intending or expecting that VAT will be charged so that the land will become a VAT bearing capital expense in the hands of Cumbernauld SPV. The supply will therefore be exempt from tax because of the operation of para 12 and VAT will not, in fact, need to be added to the sale price.

60. The problem with that construction is that it allows the taxpayer who has taken advantage of exercising the option to tax its land so as to claim input tax credits or to spread payments of irrecoverable input tax then to switch off the option to tax and make a cheaper, VAT exempt sale to a non-taxable purchaser simply by intending or expecting to sell the land or building for more than £250,000. I therefore agree with the reasoning of the FTT (at para 44) that although the drafting of this legislation is unfortunate, the obvious purpose of the provisions would be defeated if they had the effect of rendering a normal commercial transaction such as this one exempt in circumstances where the owner of the land had, presumably for its own advantage, previously opted to waive the exemption and tax transactions relating to the land. An additional pointer towards HMRC's construction is that paras 12 to 17 are intended to limit the right conferred on taxpayers to opt to treat their land as generating taxable rather than exempt supplies, when it is to their advantage to do so. These anti-avoidance provisions erode that entitlement and so should be narrowly rather than broadly construed. It is true that a curiosity of this case is that it is Mr Moulsdale rather than HMRC who is arguing that the anti-avoidance provisions should be broadly

construed so as to disentitle Mr Moulsdale's reliance on the option to tax which he has exercised. But that should not stand in the way of the narrow construction.

61. Mr Moulsdale's construction is also inconsistent with the wording of para 12 which directs the focus on the intention and expectation of the grantor (or development financier) which would be irrelevant if the provision applied as he contended it did. The test in para 13(4) does not turn on the transaction itself but on what the grantor intended or expected would happen in respect of the land in the hands of the relevant transferee and whether the relevant transferee would incur VAT bearing capital expenditure on it.

62. The main argument against HMRC's construction was that it appears to render some parts of the definition of a relevant "capital item" in para 13 redundant. At its most stark, it is clear from para 13(4)(a) of Schedule 10 that it is intended that land can be a capital item in relation to the relevant transferee and that the circumstances in which it is to be a capital item are when it would be treated as a capital item by regulation 113 of the VAT Regulations. But regulation 113(3)(a) provides that, when the item is land, the only expenditure that one looks at to see if it bore VAT is the expenditure incurred on acquisition. The additional categories of expenditure, such as refurbishment, fitting out or extension costs, only apply to other types of items such as buildings, aircraft and ships. That appears to be true at present, but para 13 in Schedule 10 is enacted in primary legislation and the purpose of incorporating a definition of capital items that is contained in regulations may in part be that it is automatically updated as the Capital Goods Scheme changes over time. As HMRC submitted, the general provision in para 13(4) cannot *ex ante* envisage all products of the intellectual effort which may be directed to tax avoidance. Para 13(4) has potential future application if and when the types of expenditure specified in regulation 113(3) in relation to land include something other than acquisition costs.

63. Further, as HMRC point out, there is a redundancy in para 13(4) even adopting Mr Simpson's construction. The land could never be a capital item in relation to the grantor once the eligible time has expired for him, since the grantor will not incur acquisition costs; he is selling rather than buying the land.

64. A point was raised at the hearing as to whether there was any significance to be attached to the term "developer of land". Here there was no intention or expectation that either Mr Moulsdale or Cumbernauld SPV would "develop" the land in any ordinary sense of that word. As Lord Hoffmann said in *MacDonald v Dextra Accessories Ltd* [2005] UKHL 47; [2005] 4 All ER 107, para 18:

> "a definition may give the words a meaning different from their ordinary meaning. But that does not mean that the choice of words adopted by Parliament must be wholly ignored. If the terms of the definition are ambiguous, the choice of the term to be defined may throw some light on what they mean."

65. However, both counsel recognised that there could be circumstances in which Mr Moulsdale would have satisfied the "relevant capital item" test in para 13(2)(a) because he incurred more than £250,000 VAT bearing expenditure on the building when he bought it in 2001. If he had satisfied the "eligible time" test, he would have been a "developer of the land" for the purposes of para 13 even though he had no plans to build further on the land or refurbish the offices already on the land.

66. HMRC made further submissions as to the application of the general objectives and principles of the Principal VAT Directive, in particular the principle of fiscal neutrality. For my part, I did not find that those principles added anything to the arguments more directly focused on the wording of the provisions.

Conclusion

67. For reasons different from those given by the Inner House, I would refuse the appeal on the basis that, as HMRC submit, the construction for which they contend is the correct way for the court to make as much sense as it can of the text of the statutory provisions read in its appropriate context.