TC07706

VALUE ADDED TAX – release of an option to acquire land – whether an exempt or taxable supply – Group 1 Schedule 9 Value Added Tax Act 1994 – Articles 14 and 135 (1) VAT Directive 2006

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/07865

BETWEEN

LANDLINX ESTATES LIMITED **Appellant**

-and-

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE GUY BRANNAN
MR JULIAN STAFFORD

Sitting in public at Taylor House, London on 27 August 2019, with further written submissions on 27 and 29 November 2019 and 24 January and 11 February 2020.

Tim Brown, counsel, for the Appellant

Isabel McArdle, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This appeal raises the question whether the release (for a consideration) of an option to purchase land is a taxable supply of services or an exempt supply of an interest in land for VAT purposes.

2. Hitherto, the published practice of the Respondents ("HMRC") has for many decades been to treat the grant of an option to acquire land as an exempt supply. We were informed that HMRC has now reconsidered its position and has formed the view that the grant of an option to acquire land is a standard rated supply of services rather than an exempt supply of land. Furthermore, HMRC considers that the release of an option to acquire land is not the "mirror image" of the grant of such an option so that, even if the grant of an option were to be an exempt supply, the release of that option for a consideration would not likewise be exempt.

3. Accordingly, this appeal raises an important point of principle in relation to the correct VAT treatment of the surrender of an option to acquire land.

4. It is worth noting at the outset that no option to tax was made in respect of the land in question in this appeal.

5. HMRC decided that the appellant, Landlinx Estates Ltd ("Landlinx"), had under-declared its output tax on its 12/16 VAT return by £237,500. This decision was reached on the basis that HMRC considered that the amount of £1,425,000 received by Landlinx for the release of an option to purchase land ("the option") was a taxable supply made by it and not an exempt supply of land. Landlinx now appeals to this Tribunal against that decision.

6. HMRC informed us that they were planning to revise their published practice in relation to the tax treatment of options to purchase land.

7. In this decision we shall, for simplicity, refer to the Court of Justice of the European Union and its predecessor, the European Court of Justice, as the "CJEU" or "the Court".

THE FACTS – GENERAL

8. Although there was no agreed statement of facts, the facts in this appeal were not in dispute.

9. Mr William Wilcox, a director of Landlinx, furnished a witness statement but he was not required for cross-examination because his evidence was not disputed.

10. Landlinx was registered for VAT with effect from 1 January 2010.

11. In 20 March 2015, Landlinx signed an "Option 1 Agreement" ("the Option Agreement") as the Buyer relating to the purchase of Loxwood Nurseries in West Sussex. The agreement provided that the Seller granted Landlinx the Option subject to the conditions in the agreement; the Option being defined at page 7 as "the option during the Option Period to buy the Property or part or parts of it….."

12. The Seller did not opt to tax Loxwood Nurseries pursuant to Schedule 10 VAT Act 1994.

13. The intention of the parties was that the Option Agreement was an enforceable contract for the sale and purchase of property in accordance with section 2 Law of Property (Miscellaneous Provisions) Act 1989 (at Clause 8.2 of the Option Agreement).

14. The Option Agreement was entered into by Landlinx with a view to obtaining planning permission from the local authority to develop the site. On or about 1st July 2016, planning permission was duly obtained by Landlinx.

15. On 22 December 2016, the parties formally agreed to release the obligations between them under the Option 1 Agreement on payment of a sum of £1,425,000 by the Seller to Landlinx.

16. In early 2017, Landlinx submitted its VAT return for the 12/16 period for a repayment of £23,503.47. This amount was significantly higher than usual amount due to the amount of expenditure incurred in respect of Loxwood Nurseries. It treated the receipt of the £1,425,000 from the Seller as consideration for an exempt supply for VAT purposes and therefore did not include it on the VAT Return.

17. Shortly thereafter, HMRC began enquiring into the 12/16 Return.

18. After correspondence between Landlinx and HMRC, HMRC issued a formal decision dated 28 June 2017 to the effect that the Appellant had made a taxable supply in respect of the receipt of the £1,425,000 and issued an assessment for £237,500.

19. On 18 July 2017, Marden & Co, Landlinx's accountants, wrote to HMRC asking for HMRC's decision to be formally reviewed.

20. HMRC's decision was upheld on an internal review by letter dated 20 September 2017 on the basis that, although HMRC accepted the grant of the call option was an interest in land and was therefore an exempt supply, the surrender of that interest did not "provide the landowner with any right in the land."

21. The review letter acknowledged that Notice 742 stated that the grant of an option over land was an exempt supply but stated that it did not give guidance on whether the surrender of an option was the supply of an interest in land.

22. As already indicated, HMRC have now changed their interpretation of the law in that the granting of a call option is not an interest in land that falls within the exemption from VAT.

23. As we understood it, it was also common ground that, if Landlinx had exercised its option and purchased Loxwood Nurseries from the Seller, that transaction would have been an exempt supply by the Seller to Landlinx.

THE FACTS – THE TERMS OF THE OPTION AGREEMENT AND ITS RELEASE

24. The Option Period granted to Landlinx was two years, subject to any extensions under the terms of the Option Agreement (Clause 1 "Definitions"). The consideration for the grant of the option was £1 (Clause 1 "Definitions" and Clause 3.1). The grantors of the option were referred to as "the Sellers".

25. Clause 3.3 provided that the option could not be exercised unless Planning Permission had previously been granted.

26. Clause 7. A .1 provided a complex formula for determining the price on exercise of the option.

27. Clause 8.1 provided that the option was exercisable by notice in writing from Landlinx to the Seller at any time within six months after the agreement or determination of the price in accordance with Clause 7. A.

28. Clause 17 provided:

> "17.1 If the Seller sells or otherwise dispose [sic] of its freehold interest in the Property or any part of it the Seller will:
>
> 17.2 Give not less than twenty (20) Working Days' notice to the Buyer of the Seller's intention to dispose of the Seller's interest to the Third Party and
>
> 17.3 Ensure that immediately upon completing any such disposal and before the grant of any other interest in the Property the Third Party executes and delivers to the Buyer a deed of covenant whereby the Third Party covenants with the Buyer to observe and perform all the covenants conditions and obligations on the part of the Seller contained in this Agreement as if the Third Party were the original Seller under this Agreement."

29. Clause 21 provided that Landlinx may assign, charge or otherwise deal with or dispose of its interest in the Option Agreement.

30. By a letter dated 22 December 2016, Landlinx wrote to the Sellers as follows:

> "We refer to the Option Agreement made between you and us….
>
> In consideration of your releasing us from all current and future obligations that we have under the Option Agreement, we hereby release you from all of your current and future obligations thereunder, with the intent that the Option Agreement shall terminate immediately upon the date hereof."

31. Although not mentioned in these letters, the option was in fact surrendered to the Seller by Landlinx for a payment of £1,425,000 by the Seller to Landlinx.

THE RELEVANT STATUTORY PROVISIONS AND HMRC PRACTICE

32. Article 14(1) of the VAT Directive 2006/112/EC ("the PVD") provides:

> "'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner."

33. Article 24 of the PVD states:

> "1. 'Supply of services' shall mean any transaction which does not constitute a supply of goods."

34. Article 135(1) exempts:

> "(j) the supply of a building or parts thereof, and the land on which it stands….;
>
> (k) the supply of land which has not been built on…;
>
> (l) the leasing or letting of immovable property;"

35. Both parties accepted that the relevant provision for the purposes of this appeal was Article 135(1)(j) and that Article 135(1)(k) and (l) did not apply.

36. Article 15 of PVD provides:

> "1. Electricity, gas, heat, refrigeration and the like shall be treated as tangible property.
>
> 2. *Member States may regard the following as tangible property:*

(a) certain interests in immovable property;

(b) rights in rem giving the holder thereof a right of use over immovable property;

(c) shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof." (Emphasis added)

37. Article 135(1) is translated into UK law by Item 1 Group 1 Schedule 9 Value Added Tax Act 1994 ("VATA") which exempts:

"1. The grant of any interest in or right over land, or of any licence to occupy land …."

38. The remainder of Item 1 Group 1 Schedule 9 sets out a long list of interests in land which are excluded from the exemption.

39. The statutory Notes to Item 1 Group 1 Schedule 9 state:

"(1) "Grant" includes an assignment or surrender and the supply made by the person to whom an interest is surrendered when there is a reverse surrender."

40. A "reverse surrender" is one in which the person to whom the interest is surrendered is paid by the person by whom the interest is being surrendered to accept the surrender and is inapplicable in this case.

41. HMRC's position in this appeal was that Item 1 Group 1 Schedule 9 VATA correctly and faithfully implemented EU law.

42. Section 5 VATA provides:

"5 Meaning of supply: alteration by Treasury order

(1) Schedule 4 shall apply for determining what is, or is to be treated as, a supply of goods or a supply of services.

(2) Subject to any provision made by that Schedule and to Treasury orders under subsections (3) to (6) below—

(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;

(b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services.

(3) The Treasury may by order provide with respect to any description of transaction—

(a) that it is to be treated as a supply of goods and not as a supply of services; or

(b) that it is to be treated as a supply of services and not as a supply of goods; or

(c) that it is to be treated as neither a supply of goods nor a supply of services…."

43. Paragraph 4 of Schedule 4 to VATA provides:

"SCHEDULE 4 Matters to be Treated as Supply of Goods or Services

Section 5

> 4. The grant, assignment or surrender of a major interest in land is a supply of goods."

44. HMRC's VAT Notice 742 - Land and Property ("Notice 742") is issued as public guidance to taxpayers but does not have the force of law. Section 3.1 of Notice 742 confirms HMRC's view that the grant, assignment or surrender of an interest in, right over or licence to occupy land is normally exempt from VAT.

45. Section 7.4 of Notice 742 also confirms:

> "7.4 Options to purchase or sell an interest in land or a building
>
> If you grant someone the right to purchase an interest in your land or building within a specified time you are making a supply of an interest in land."

46. HMRC's internal guidance to Officers (VATLP20000) (7 July 2017) states:

> "A person who is granted an option to purchase property acquires the right to buy it at a future date for a specified price. That right is an interest in land. The grant of an option is an exempt supply of land if the purchase of the property would itself be exempt, if it were made at that time."

EU LAW AUTHORITIES

47. The leading authority in relation to the supply of an interest in land, and upon which HMRC based their case, is the decision of the CJEU in *Staatssecretaris van Financien v Shipping and Forwarding Enterprise Safe BV* [1990] EUECJ R-320/88 (8 February 1990) ("*Safe*"). In that case Safe, a Netherlands company, agreed to sell to another Netherlands company, Kats, the rights to a house and land. In the contract Safe undertook to transfer the legal title to the property to Kats when required by Kats and granted Kats an irrevocable power of attorney to execute the necessary transfer. The contract further provided that, in the meantime, any changes in the value of the property and all profits and outgoings were for the account of Kats. Before the sale was completed, Kats went bankrupt and its trustees in bankruptcy sold all its rights in the property to a third party. Safe subsequently transferred the legal title to the property to the third party. As the Advocate General explained at [8] leaving the sale, so to speak, "in contract" was a means of avoiding Netherlands transfer tax in circumstances where it was intended to on-sell the property to a third party. Transfer tax was only paid once i.e. on the transfer directly from the original seller to the final purchaser. Essentially, if Safe had supplied the property to Kats that transaction would be exempt from VAT. If instead Safe had supplied the property to the third party that transaction would be liable to VAT. It was in this context that the Netherlands Supreme Court referred to the CJEU for a preliminary ruling the question whether for the purposes of Article 5(1) of the Sixth Directive (now Article 14 (1) of the PVD) a supply took place only where legal ownership of the property the subject of the supply was transferred. The CJEU held:

> "6 It should be noted that Article 5(1) of the Sixth Directive provides as follows "'supply of goods' shall mean the transfer of the right to dispose of tangible property as owner ".
>
> 7 It is clear from the wording of this provision that "supply of goods" does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it as if he were the owner of the property.
>
> 8 This view is in accordance with the purpose of the directive, which is designed inter alia to base the common system of VAT on a uniform definition

of taxable transactions. This objective might be jeopardized if the preconditions for a supply of goods - which is one of the three taxable transactions - varied from one Member State to another, as do the conditions governing the transfer of ownership under civil law.

9 Consequently, the answer to the first question must be that "supply of goods" in Article 5(1) of the Sixth Directive must be interpreted as meaning the transfer of the right to dispose of tangible property as owner, even if there is no transfer of legal ownership of the property . "

48. The Court has also held that the above test is objective in nature and that it applies without regard to the purpose or results of the transactions concerned and without it being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person in question or for them to take account of the intention of a trader other than that taxable person involved in the same chain of supply: *Vega International Car Transport and Logistic* [2019] EUECJ C-235/18 at [28].

49. Furthermore, the Court has held that the test is one which must be determined in each case by national courts. In *Centralan Property* [2005] EUECJ C-63/04 ("*Centralan*") the Court said:

"63 In that context, it is for the national court to determine in each individual case, on the basis of the facts of the case, whether a given transaction in respect of property results in the transfer of the right to dispose of the property as owner within the meaning of Article 5(1) of the Sixth Directive (see, to that effect, *Shipping and Forwarding Enterprise Safe*, paragraph 13)."

50. Finally, in *Centralan* the Court held at [66]-[67] that it was possible for national legislation to result in more than one person having the right to dispose of the property as owner for the purposes of Article 14.

SUBMISSIONS IN OUTLINE

51. We summarise below the main submissions of the parties. After the hearing, we requested two sets of further written submissions from the parties and our summary includes those written submissions.

52. In short, HMRC's argument was that, although the Option Agreement created an interest in land for domestic English land law purposes, it did not confer on Landlinx the right to dispose of tangible property as owner. In other words, the interest in land created by the Option Agreement was not sufficient to constitute a supply of goods. Thus the surrender of the option was not the supply of land and buildings for the purposes of Article 135(1)(j) of the PVD.

53. Moreover, Ms McArdle argued, an option to purchase land did not transfer ownership rights in the land at any time – instead it allowed the option holder to become the owner in future on the exercise of the option. Until the option was exercised, Landlinx did not become the beneficial owner of the property and, therefore, by surrendering its rights under the Option Agreement, Landlinx was not surrendering or transferring ownership of the underlying property.

54. Ms McArdle referred to Article 14 (1) of the PVD which provided that a supply of goods "shall mean the transfer of the right to dispose of the tangible property as owner." A building, parts thereof and land (to which Article 135(1)(j) referred) were all tangible property. The provisions of domestic law in Item 1 Group 1 Schedule 9 VATA could not be interpreted more widely than the PVD allowed. Thus, only supplies of tangible property such as buildings, parts thereof and land could fall within the

exemption. Rights otherwise associated with buildings, parts thereof or land but which were not supplies of tangible property did not fall within the exemption. The judgment of the CJEU in *Safe* proceeded on the basis that a supply under the predecessor provision to Article 135(1)(j) must be a supply of goods within Article 14(1).

55. Ms McArdle referred to section 2 of the European Communities Act 1972 and Article 5 of the EEC Treaty. In *Marleasing SA v La Comercial Internacional de Alimentacion SA*. [1990] EUECJ C-106/89 ("*Marleasing*") the CJEU stated:

> "8 In order to reply to that question, it should be observed that, as the Court pointed out in its judgment in Case 14/83 *Von Colson and Kamann v Land Nordrhein-Westfalen* [1984] ECR 1891, paragraph 26, the Member States' obligation arising from a directive to achieve the result envisaged by the directive and their duty under *Article 5 of the Treaty to take all appropriate measures*, whether general or particular, to ensure the fulfilment of that obligation, is *binding on all the authorities of Member States including, for matters within their jurisdiction, the courts* . It follows that, in applying national law, whether the provisions in question were adopted before or after the directive, *the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter and thereby comply with the third paragraph of Article 189 of the Treaty*." (Emphasis added)

56. Ms McArdle also referred to the decision of the House of Lords in *Customs and Excise Commissioners v Sinclair Collis Ltd* [2001] STC 989 ("*Sinclair Collis*") where the issue was whether the placement of vending machines in pubs and leisure centres fell within the meaning of Group 1, Schedule 9 VATA 1994 which exempted "the grant of any interest in or right over land or of any licence to occupy land." Ms McArdle referred to the judgment of Lord Slynn (with whom Lord Steyn agreed) at [13] where he stated:

> "It is thus plain that the words 'licence to occupy land' in the 1994 Act cannot go wider than the words 'letting of immovable property' in the Sixth Directive."

57. In addition, Lord Scott of Foscote said at [58]:

> "The issue arising on this appeal is as to the width to be given to the words 'any licence to occupy land'. The explanation for their inclusion in the item 1 exemption is that the English law concept of a 'letting' or a 'leasing' as necessarily involving the grant of an interest in rem in land is not reflected in the legal systems of most of our European Community partners. The words were included in order to try and achieve consistency across the Community and to implement, using English law terminology, the art 13B exemption relating to 'the leasing or letting of immovable property'. It follows, in my opinion, that the words should not be construed so as to include the grant of rights that would not, for the purposes of the Sixth Directive, constitute 'the leasing or letting of immovable property'."

58. Thus, in Ms McArdle's submission, Item 1 Group 1 Schedule 9 VATA could not be construed more widely than Article 135(1)(j) of the PVD.

59. Ms McArdle maintained, however, that Item 1 Group 1 Schedule 9 VATA correctly implemented EU law as set out in the PVD.

60. Mr Brown noted that *Safe* required national courts to determine in each case whether a property transaction resulted in the transfer of the right to dispose of the property as owner within the meaning of Article 14(1). Furthermore, it was possible for

more than one person to have the right to dispose of property as owner (*Centralan* at [64]-[66]).

61. HMRC's position, Mr Brown noted, was that Item 1 Group 1 Schedule 9 VATA correctly implemented EU law. Mr Brown referred to the decision of this Tribunal in *Hanuman Commercial Ltd v Revenue and Customs* [2017] UKFTT 854 (TC) (Judge Vos). That case concerned the question whether the novation of a contract for the sale of land was an exempt supply of land within Item 1 Group 1 Schedule 9 VATA and, on the facts, Judge Vos decided that the supply in question was a supply of services rather than of goods and therefore a taxable (rather than an exempt) supply for VAT purposes. In the course of his decision, Judge Vos said:

> "53. I do not accept that the PVD must be interpreted in the strict way suggested by [counsel for HMRC] so that it cannot exempt the supply of an equitable interest in land.
>
> 54. In particular, I see no conflict between the domestic legislation in Group 1 of schedule 9 to VATA 1994 and article 135 of the PVD. There is no doubt in my mind that, for the reasons given by [counsel for the appellant taxpayer], the grant of an equitable interest in land is capable of falling within the exemption in paragraph 1(j) of group 1 in schedule 9 to VATA 1994.
>
> 55. The ECJ itself has recognised that the concept of a supply of goods must be interpreted in a way which takes account of the many different ways in which land can be transferred in different member states (see *Staatssecretarias van Financien v Shipping & Forwarding Enterprise Safe BV* case C-320/88 [1991] STC 627 [at 6-9]."

62. As a matter of English law, a call option, duly protected by a notice or a land charge, prevents the grantor of the option from selling the property unencumbered to a third party. Mr Brown referred to the judgment of Sir George Jessel MR in *L&SW Railway v Gomm* (1881) 20 ChD 562 at 581.[1] An option to buy land could properly be described, Mr Brown argued, as a contract for the sale of that land conditional upon the exercise of the option (*Spiro v Glentown Properties Limited* ([1991] CH 537 at C-F). Thus, the grant of an option meant that the grantor's interest was taken away from him and prevented him from disposing of the property unencumbered to a third party – it also gave the grantee (Landlinx, in this case) the right to dispose of it as owner.

63. Mr Brown submitted that HMRC had failed to put forward any credible argument to the effect that, if the granting of an option to purchase land created an interest in land, the surrender of such an option was not also the transfer of an interest in land. Mr Brown referred to Note 1 Group 1 Schedule 9 VATA which defined a surrender and a reverse surrender as interests in land. Moreover, where a transaction fell within the scope of an exemption provided for by the PVD, an alteration in the relationship such as a termination or release for consideration) must be regarded as falling within the scope of the same exemption (*Lubbock Fine & Co*-v *CCE* – C 63/92 [1994] STC 101 at [9] ("*Lubbock Fine*")). Thus, the release of a call option fell within the exemption in respect of the grant of a call option.

[1] "The right to call for a conveyance of the land is an equitable interest or equitable estate. In the ordinary case of a contract for purchase there is no doubt about this, and an option for repurchase is not different in its nature. A person exercising the option has to do two things, he has to give notice of his intention to purchase, and to pay the purchase money; but as far as the man who is liable to convey is concerned, his estate or interest is taken away from him without his consent, and the right to take it away being vested in another, the covenant giving the option must give that other an interest in the land." (Jessel MR) This passage was approved by the Court of Appeal in *Pritchard v Briggs.*

64. Mr Brown argued that Landlinx was entitled to rely on the domestic law provisions of Item 1 Group 1 Schedule 9 VATA noting that, in accordance with *Marleasing*, a national court was obliged to interpret domestic legislation, *so far as possible*, in the light of the wording and purpose of the PVD to achieve the result pursued by the PVD.

65. It was, however, for national law to determine how far the national court could change provisions of purely national law to fulfil this obligation. The question was how far could a national court go under the guise of interpretation; whether it can, for instance, adopt what would otherwise be regarded as a strained construction is a matter for domestic law (*HMRC v IDT Card Services Ireland Ltd* [2006] STC 1252).

66. Although the issue was not raised in Landlinx's Notice of Appeal, Mr Brown's skeleton argument or in argument at the hearing, Mr Brown in his written submissions argued that, although the supply of a call option may not be a supply of goods, it was nevertheless, by virtue of Article 15(2), a deemed supply of goods within Article 14(1) of the PVD. UK had, Mr Brown submitted, exercised the discretion afforded to it under Article 15(2)(a) of the PVD to treat certain interests in immovable property (such as the grant and surrender of a call option over land) as tangible property by enacting and not amending Item 1 Group 1 Schedule 9 VATA.

67. Mr Brown submitted that the provisions of Item 1 Group 1 Schedule 9 VATA were, essentially, originally enacted on 27 July 1972 as Item 1 Group 1 Schedule 5 to the Finance Act 1972[2]. Thus the current UK legislation was in force prior to the enactment of the European Communities Act 1972 and the subsequent adoption by the UK (and other Member States) of the Sixth VAT Directive (the predecessor to the PVD). Thus, if (as HMRC argued) a call option was not an interest in land under EU law principles (because it was not tangible property), then the UK must have exercised the discretion afforded by Article 5(3)(a) of the Sixth Directive (now Article 15(2)(a) of the PVD) to treat certain interests in immovable property as tangible property. This was because the UK did not amend its national implementing legislation when the Sixth Directive was adopted and a call option was already accepted as an interest in land as a matter of English land law.

68. Ms McArdle, in her written submissions, rejected Mr Browne's submissions in relation to Article 15(2)(a) of the PVD. Ms McArdle submitted that no part of Item 1 Group 1 Schedule 9 VATA indicated an intention of the UK to exercise a discretion in relation to the supply or surrender of a call option over land. By contrast, the UK had chosen to exercise its discretion under Article 15(2)(a) in relation to major interests in land in Schedule 4 VATA .[3] Thus, the exercise of the discretion in relation to major interests in land had taken place through legislation which created a specific category of supplies which were deemed to be supplies of goods. There was no equivalent for the type of supply in this case.

DISCUSSION

69. It was common ground that the domestic provisions of UK law relating to transactions in land contained in Group 1 Schedule 9 VATA must be interpreted, so far as possible, in accordance with wording and purpose of the PVD (see, for example,

[2] which provided an exemption for: "1. The grant, assignment or surrender of any interest in or right over land…"

[3] "Matters to be treated as supply of goods or services: 4. The grant, assignment or surrender of a major interest in land is a supply of goods." Pursuant to section 96 VATA a "major interest in land" means "the fee simple or a tenancy for a term certain exceeding 21 years…"

Customs and Excise Commissioners v Sinclair Collis Ltd [2001] STC 989 *per* Lord Slynn of Hadley at [12]-[13] and Lord Scott of Foscote at [57]-[58] and *Longridge On the Thames v Revenue And Customs* [2016] EWCA Civ 930 per Arden LJ at [84] and *St Andrew's College Bradfield v HMRC* [2016] UKUT 491 at [36] (Warren J and Judge Sinfield). We shall elaborate on the applicable principles of statutory interpretation below.

70. Secondly, it was also common ground that, while an exemption from VAT should not be construed in such a way as to deprive it of its intended effect, it is to be interpreted strictly since it constitutes an exception to the general principle that VAT is to be levied on all supplies made for consideration by a taxable person (see *HMRC v Forty Seven Park Street Ltd* [2019] EWCA Civ 849 Newey LJ at [23] citing the CJEU decision in Case C-284/03 *Belgian State v Temco Europe SA* [2005] STC 1451, [2004] ECR I-11237 at [16]).

71. In this context, we note and respectfully agree with the comments of Jonathan Parker LJ in *HMRC v Abbey National Plc* [2006] EWCA Civ 886 at [53] (made in reference to the exemption from VAT for the leasing or letting of immovable property) that the notion of interpreting strictly a loosely worded expression is something of a paradox.

72. Thirdly, the provisions of Article 135(1) providing for exemptions from VAT have their own autonomous meaning in EU law and national courts must apply the EU law meaning when interpreting national law. Thus, the CJEU said in *EC Commission v Ireland* [2000] EUECJ C-358/97

> "[51] It should be observed at the outset that according to settled case-law the exemptions provided for in Article 13 of the Sixth Directive [now Article 135 of the PVD] have their own independent meaning in Community law (see Case 348/87 *Stichting Uitvoering Financiële Acties* v *Staatssecretaris van Financiën* [1989] ECR 1737, paragraph 11, Case C-453/93 *Bulthuis-Griffioen* v *Inspecteur der Omzetbelasting* [1995] ECR I-2341, paragraph 18, and Case C-2/95 *SDC* v *Skatteministeriet* [1997] ECR I-3017, paragraph 21). They must therefore be given a Community definition."

73. It follows, therefore, that Item 1 Group 1 Schedule 9 VATA must be construed in accordance with and to give effect to Articles 14 and 135(1) of the PVD. In the context of an exemption from VAT, Item 1 Group 1 Schedule 9 VATA should not be construed more widely than is justified by the language of the PVD. The general principles of interpretation to be applied were recently summarised by the Upper Tribunal (Falk J and, Judge Herrington) in *Arron Banks v Revenue and Customs*: [2020] UKUT 101 (TCC) as follows:

> "(1) The obligation on UK courts to construe domestic legislation consistently with EU law obligations is both broad and far-reaching.
>
> (2) It is not constrained by the normal domestic rules of statutory interpretation.
>
> (3) It does not require ambiguity in the legislation being interpreted.
>
> (4) It is not an exercise in semantics or linguistics.
>
> (5) It permits departure from the strict and literal application of the words used by Parliament.
>
> (6) It permits the implication of words necessary to comply with EU law.
>
> (7) The precise form of the words to be implied does not matter.

(8) The interpretation adopted should "go with the grain of the legislation" and be "compatible with the underlying thrust" of the legislation in issue.

(9) An interpretation cannot be adopted which is inconsistent with a fundamental or cardinal feature of the legislation (as that would be amendment rather than interpretation).

(10) The interpretation adopted cannot require the court to make a decision which it is not equipped to make or which gives rise to important practical repercussions which the court cannot evaluate."

74. Item 1 Group 1 Schedule 9 VATA exempts:

"1. The grant of any interest in or right over land, or of any licence to occupy land …."

75. The Notes to Group 1 state:

"(1) "Grant" includes an assignment or surrender and the supply made by the person to whom an interest is surrendered when there is a reverse surrender."

76. It is clear, and HMRC did not seek to argue otherwise, that as a matter of English land law an option to purchase land creates an interest in land – it creates an equitable interest in land which can be protected by a notice, in the case of registered land, or by a Class C(iv) land charge, in the case of unregistered land: see *Pritchard v Briggs* [1980] Ch 338 at 419B.[4] It is a right *in rem* binding against third parties if registered as a notice at the Land Registry or on the Land Charges Register.

77. Therefore, applying the words of Item 1 Group 1 (together with the Note to Group 1), it seems to us that the release by Landlinx of the option was a "surrender" of an interest in land.

78. Although the Option Agreement created an interest in land as a matter of English land law, the real question in this appeal is whether, reading Articles 14, 24 and 135(1)(j) together, the rights which were created by the Option Agreement and which were released by Landlinx to the grantor fell within the exemption afforded by Article 135(1)(j).

79. As already noted, in *Safe* the Court interpreted Article 5 (now Article 14) as follows:

"6. It should be noted that art 5(1) of the Sixth Directive provides as follows: '"Supply of goods" shall mean the transfer of the right to dispose of tangible property as owner.'

7. It is clear from the wording of this provision that 'supply of goods' does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by

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[4] Both Goff and Stephenson LJJ in *Pritchard v Briggs* expressly adopted the following passage in the judgment of Street J, in the Supreme Court of New South Wales, in *Mackay v Wilson* (1947) 47 S.R. (NSW) 315, at page 325: "Speaking generally, the giving of an option to purchase land prima facie implies that the giver of the option is to be taken as making a continuing offer to sell the land, which may at any moment be converted into a contract by the optionee notifying his acceptance of that offer. The agreement to give the option imposes a positive obligation on the prospective vendor to keep the option open during the agreed period so that it remains available for acceptance by the optionee at any moment within that period. It has more than a mere contractual operation and confers upon the optionee an interest in the land, the subject of the agreement; see, for example, per Williams J in *Sharp v Union Trustee Co of Australia Ltd* (1944) 69 CLR 539, 558."

one party which empowers the other party actually to dispose of it as if he were the owner of the property.

8. This view is in accordance with the purpose of the Sixth Directive, which is designed, inter alia, to base the common system of value added tax on a uniform definition of taxable transactions. This objective might be jeopardised if the preconditions for a supply of goods—which is one of the three taxable transactions—varied from one member state to another, as do the conditions governing the transfer of ownership under civil law.

9. Consequently, the answer to the first question must be that 'supply of goods' in art 5(1) of the Sixth Directive must be interpreted as meaning the transfer of the right to dispose of tangible property as owner, even if there is no transfer of legal ownership of the property."

80. We do not, however, interpret *Safe* to require that in order for a transaction to fall within Article 135(1)(j) it must be a supply of goods. In *Safe* there were two potential transactions which could fall within (what is now) Article 135(1)(j). First, there was the contract between Safe and Kats which effectively, by contract, transferred the economic ownership of the property to Kats. Secondly, there was the legal transfer of the property from Safe to the third party. Both of these transactions involved, respectively, transferring the whole of the economic and legal interest which Safe owned to the other party. That there was a supply of goods from Safe to one of the other parties was clear enough, because the underlying property comprised physical land and buildings, but the real question was *which* transaction constituted the supply of goods i.e. which transaction conferred on the other party the right to dispose of the property as owner.

81. What *Safe* did not deal with, or even consider, was whether it was necessary in order to fall within Article 135(1)(j) for the supply to constitute a supply of goods or whether a lesser or derivative interest in land and buildings (such as an option), and which might constitute a supply of services, could also fall within that exemption.

82. In *Lubbock Fine*, however, Advocate General Darmon assumed that it was necessary for a transaction to constitute a supply of goods to fall within Article 135(1)(j). That case involved the surrender of a lease. The taxpayers argued that that surrender fell within Article 135(1)(l) as a transaction related to the leasing of land. The CJEU agreed with that argument and found it unnecessary to decide the second question posed to the Court viz whether the surrender of the lease would fall within the forerunner of Article 135(1)(j). The Advocate General, however, considered whether a surrender of the lease would fall within Article 135(1)(j) and concluded that it would not. He said:

"74. Is a surrender of a lease covered by the concept of 'the supply of buildings or parts thereof, and of the land on which they stand, other than as described in Article 4(3)(*a*)'?

75. It is common ground that the latter provision—which concerns the supply of a building before first occupation—has no bearing on this dispute.

76. Article 13B(*g*) [now Article 135(1)(j)] lays down an exception to the general principle laid down by art 2 of the Sixth Directive, according to which supplies of goods are subject to VAT.

77. Consequently, a transaction can fall under the exemption in art 13B(*g*) only if it constitutes a supply of goods in the generic sense of art 2.

78. Article 5 of the directive provides that the '"supply of goods" shall mean the transfer of the right to dispose of tangible property as owner'.

> 79. In its judgment in *Staatssecretaris van Financiën v Shipping and Forwarding Enterprise Safe BV* (Case C-320/88) [1991] STC 627 at 638, [1990] ECR I-285 at 303, para 7, the court held that that term was to be given a Community definition, stating that:
>
> 'It is clear from the wording of this provision that "supply of goods" does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it *as if he were the owner of the property* [emphasis added].'
>
> 80. Even by the surrender of a lease a tenant cannot transfer to the owner the power of disposal which the former never had and the latter never lost. (An owner may sell a property even when it is let.)
>
> 81. Consequently, the surrender of a lease cannot be regarded as a 'supply of goods' for the purposes of art 2. Nor, therefore, can it fall within the definition in art 13B(*g*).
>
> 82. The Community definition of the 'supply of goods' cannot vary according to the articles of the Sixth Directive.
>
> 83. I scarcely need to point out that a surrender of a lease cannot be assimilated to 'the supply of buildings or parts thereof, and of the land on which they stand'.
>
> 84. As the United Kingdom government correctly states, the terms 'land' or 'land which has not been built on' refer to the 'physical' concepts and not the rights in the land or the land which has not been built on.
>
> 85. I therefore conclude that the surrender of a lease does not fall within the scope of art 13B(*g*)."

83. It will be observed that the Advocate General simply assumed at [76]-[77] that, to fall within what is now Article 135(1)(j), the supply of land and buildings must be a supply of goods. In respectful disagreement with the Advocate General we would make the following points.

84. First, at [76]-[77] the Advocate General refers to Article 2 of the Sixth Directive. But Article 2 specifies that both supplies of goods *and services* shall be subject to VAT.

85. Secondly, the Advocate General merely assumes, without citing any authority, that a supply within what is now Article 135(1)(j) must be a supply of goods – the issue received no reasoned consideration.

86. In our view, however, Article 135(1)(j) comprehends both supplies which comprise the transferor's entire interest in the land and buildings but also the transfer of a lesser or derivative interest in the land and buildings i.e. interests *in rem* in the land and buildings, such as the Option Agreement in this appeal

87. We reach this view for the following reasons.

88. It seems to us that the purpose of Article 135(1)(j) is to exempt transactions in relation to immovable property as a general matter, subject to certain specified exceptions. This was the position of the Commission in *Lubbock Fine* itself where the Judge Rapporteur at [1994] STC 101 at 110 records the Commission's argument as follows:

> "The view of the Commission is that, if the court finds that the surrender of a lease does not fall within the concept of the 'letting of immovable property', it must be covered by the words 'supply of buildings or parts thereof and of the

> land on which they stand' appearing in art 13B(g) of the Sixth Directive. That contention is based on the general principle of the exemption of immovable property which the Sixth Directive seeks to achieve.
>
> The only exclusion from that exemption is the supply of immovable property described in art 4(3)(a) of the directive, that is to say the supply of buildings before first occupation."

89. The rationale for exempting immovable property from VAT was set out by the Advocate General himself in *Lubbock Fine* as follows:

> 23. Immovable property raises a number of specific problems for VAT purposes (such as e.g. double taxation). It is understood at two levels in the Sixth Directive:
>
> (1) as a final product supplied to a final consumer at the end of an economic production cycle;
>
> (2) as a means of production the cost of which is reflected in the price of goods or services.
>
> 24. In the first respect the production cycle of immovable property, beginning with its purchase, progressing through the construction phase and ending with its first sale, is normally assimilated to the production cycle for goods and hence is subjected to VAT.
>
> 25. More specifically, even an isolated transaction in immovable property may be taxable. Thus, art 4(3) of the Sixth Directive provides:
>
> 'Member States may also treat as a taxable person anyone who carries out, on an occasional basis, ... (a) the supply before first occupation of buildings or parts of buildings and the land on which they stand ...; (b) the supply of building land ...'
>
> 26. In that case VAT is imposed on the final price of the immovable property, whatever the components of that price. It is the concept of 'first occupation' which is used to determine the moment at which the property leaves the production process and becomes the subject of consumption (that is to say, occupied by its owner or a tenant).
>
> 27. On the second point, with respect to buildings after first occupation, a distinction must be made.
>
> 28. A building is excluded from the tax since it has already been 'consumed' by virtue of its first occupation. Transactions concerning the building are therefore, in principle, exempt.

90. That rationale, it seems to us, applies as much to a supply of a lesser or derivative interest in land and buildings as it does to the transfer of the whole interest in land and buildings.

91. In the present case, the land which was the subject of the Option Agreement, as we understand it, had already been "consumed" by virtue of its first occupation and, therefore, subsequent transactions concerning the land should be exempt because they had left the production process.[5]

[5] See, on this point, page 9 of "Proposal for a sixth Council Directive on the harmonization of Member States concerning turnover taxes Common system of value added tax: Uniform basis of assessment" (submitted to the Council by the Commission on 29 June 1973) COM(73) 950 20 June 1973

92. This reflects the purpose of the PVD in relation to the VAT status of transactions in land.

93. That the general purpose of the PVD was to exempt transactions relating to land, with certain specified exceptions, was explicitly recognised by the CJEU in *Caixa d'Estalvis i Pensions de Barcelona* [2014] EUECJ C-139/12 at [26]:

> "As a preliminary point, it must be noted that, to a large extent, the Sixth Directive exempts from VAT transactions relating to immovable property. In that regard, Article 13B(g) and (h) of that directive exempts, in particular, the transactions relating to immovable property which it lists, except those referred to in Article 4(3)(a) and (b) of that directive, namely, in particular, the supply of new buildings or of building land. In addition, those provisions are without prejudice to the possibility conferred on Member States, pursuant to Article 28(3)(b) of the Sixth Directive, read in combination with point 16 of Annex F to that directive, to continue to exempt also supplies of those buildings and land referred to in Article 4(3) thereof."

94. Furthermore, if the grant of an option, as HMRC contends, were not to be exempt from VAT this would lead to strange results – two economically equivalent transactions would be taxed in different ways. Thus, if a vendor of land sold the land to a purchaser for £1 million the transaction would be exempt from VAT. If, however, the vendor granted the purchaser a call option over the land for an option premium of £100,000 and an option exercise price of £900,000, and the option was exercised the option premium would be subject to VAT at 20% and the remaining purchase price of £900,000 would be exempt. Thus a "one-step" purchase will be taxed differently from a "two-step" purchase even though the economic effect of both transactions was the same. It is hard to believe that this was the intention of the Sixth Directive and it is even more difficult to conclude that such a result accords with the principle of fiscal neutrality. This would be a strange result, which of itself suggests that it cannot be right.

95. The exemption contained in Item 1 Group 1 Schedule 9 first appeared as Item 1 Group 1 Schedule 5 Finance Act 1972, well before the introduction of Article 13B(g) of the Sixth Directive (the forerunner of Article 135(1)(j) of the PVD). Prior to the Sixth Directive, exemptions from VAT were determined by each Member State, after consultations with the Commission (Article 10 (3) of the Second Directive 1967).[6]

96. Thus, it appears that in 1972 the UK had decided to exempt all transactions dealing with interests in land (subject to certain specified exceptions) and once Article 13B(g) of the Sixth Directive came into force, the UK simply allowed the exemptions contained in Item 1 Group 1 Schedule 5 Finance Act 1972 and the provisions of section 5(6) Finance Act 1972 to continue in force.

97. Moreover, it is clear from the legislative history of the Sixth Directive that the list of exemptions which it contained were drafted with the existing exemptions contained in the national law of Member States in mind, which supports our main conclusion that Article 13B(g) and (h) of the Sixth Directive was not intended to narrow the scope of Item 1 Group 1 Schedule 5 Finance Act 1972 (now Item 1 Group 1 Schedule 9 VATA).

98. The "Proposal for a sixth Council Directive on the harmonisation of Member States concerning turnover taxes Common system of value added tax: Uniform basis of assessment[7] stated:

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[6] See 7 below.

[7] (submitted to the Council by the Commission on 29 June 1973) COM(73) 950 20 June 1973

> "Article 10(3) of the second Directive left the Member States completely free, subject to the obligatory consultations provided for in Article 16, to provide for whatever exemptions they thought fit; whereas the purpose of the present Directive, dictated by the need to ensure equality of treatment as between the various Member States as regards collection of the Community's own resources, is that there should be uniformity as to the transactions which are taxable. This necessarily implies uniform rules as to exemptions.
>
> *The list of exemptions has been drawn up having regard (i) to the exemptions already existing in the various Member States*, and (ii) the need to keep the number of exemptions as small as possible." (Emphasis added)

99. It appears, therefore, that the provisions exempting land and buildings from VAT in the Sixth Directive (now contained in Article 135(1)(j)) were drafted with the exemptions provided for in the national law of Member States in mind.

100. Against that background, we note that Item 1 Group 1 Schedule 9 VATA (and Note 1 thereto) and the exemption from VAT in respect of land and buildings in the Sixth Directive (and now in Article 135(1)(j) of the PVD) have existed side-by-side, without challenge, for 42 years, either by HMRC (who, in their published practice, positively agreed with the approach taken) or by the EU, until the challenge before this Tribunal in 2019. This is in contrast to *Commission v United Kingdom C416/85* where the UK was taken to task for excessive latitude regarding zero-rating. This is, in our view, a strong indication that Item 1 Group 1 Schedule 9 VATA (and Note 1 thereto) was, and was regarded as, compliant with EU law.

101. We also observe in the present appeal that HMRC's published practice in Notice 742 indicated that the grant of a call option over land was an exempt transaction. We also note that Note 1 to Group 1 Schedule 9 VATA provides that a surrender of an interest in land is treated in the same way as the grant of an interest in land i.e. it is an exempt supply.

102. We consider that the release of a call option to acquire land for a consideration should be taxed in the same way as the grant of the option i.e. it is an exempt supply. Not only does Note 1 to Group 1 Schedule 9 VATA so provide, but the decision of the CJEU in *Lubbock Fine*, where a surrender of a lease was treated in the same way and entitled to the same exemption as its grant, clearly indicates that the release of an option over land should be treated in the same manner as its grant.

103. Landlinx, therefore, had every reason to believe that the grant and surrender of an option to purchase land would be an exempt supply when it entered into the Option Agreement. Indeed, we would have thought that that view would have been regarded as axiomatic for most VAT practitioners. Landlinx, encouraged in that belief by the provisions of UK domestic law and HMRC's published practice, had no reason to require in the contractual documentation that the consideration paid to it should be VAT exclusive. Had our decision on the main point of this appeal been otherwise, a very real unfairness would have been visited on Landlinx – a matter upon which we would have been unable to adjudicate because we have no judicial review jurisdiction– and one which would have caused us to view this outcome with considerable concern. In the light of our decision, that unfairness does not now arise.

104. In the light of our conclusion that a supply of land and buildings within Article 135(1)(j) is not confined to supplies of goods and can include an option (and its surrender), it is unnecessary for us to express a concluded view on Mr Brown's supplementary submission concerning Article 15(2)(a) of the PVD. Nonetheless, we shall consider it briefly.

105. Mr Brown submitted that the UK must be taken to have exercised its discretion under Article 15(2)(a) even though there is no explicit indication in the legislation that the UK has exercised its discretion in relation to Item 1 Group 1 Schedule 9 VATA. Ms McArdle, however, submitted that the UK had not exercised its discretion under Article 15(2)(a) in relation to Item 1 Group 1 Schedule 9 VATA. No part of the legislation demonstrates any intention of the UK state to exercise a discretion in relation to such rights (i.e. options), or a category of rights into which those rights would fall. Instead, the UK had exercised its discretion under Article 15(2)(a) by enacting paragraph 4 of Schedule 4 relating to major interests in land (as defined in section 96 (1) VATA). In that latter case, the UK has clearly exercised its discretion under Article 15(2)(a) by primary legislation. Had the UK additionally exercised its discretion under Article 15(2)(a) in relation to Item 1 Group 1 Schedule 9 VATA in respect of supplies which did not constitute supplies of goods we would have expected the legislation expressly to acknowledge this fact.

106. The difficulty with Ms McArdle's argument is that the wording in paragraph 4 Schedule 4 VATA relating to major interests in land first appeared in the Finance Act 1972, section 5(6). The first equivalent of Article 15(2)(a) of the PVD first appeared, as far as we can ascertain, in 1977 in the Sixth Directive (Article 5(3)(a)). It therefore seems that the UK had already decided to treat major interests in land as supplies of goods in 1972 rather than exercising a discretion afforded by the Sixth Directive.

107. Finally, we should acknowledge that our decision involves an important point of EU law. Neither party, however, indicated any desire for us to refer this issue to the CJEU. Bearing in mind the guidance concerning references to the CJEU given by Lord Denning MR in *HP Bulmer Ltd & Anor v. J. Bollinger SA & Ors* [1974] EWCA Civ 14 and the proportionality of costs involved in a reference when measured against the amount of tax involved, we have decided not to refer this matter as a preliminary issue to the CJEU.

108. For the reasons we have given, we allow this appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

109. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 13 MAY 2020