# ADDRESSING BORDERLINE ANOMALIES

Consultation response from:

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# 1. Introduction

## 1.1 Overview

1.1.1 We do not believe that the consultation fairly describes the various headings as anomalies. For example:

- The relief applied to works of approved alterations to certain listed buildings was designed for the purpose of protecting heritage buildings.

- The fact that some charges for "self-storage" attract VAT and others do not does no more than reflect the nature of the supply and the underlying facts.

1.1.2 It is perfectly reasonable that the nature and operation of reliefs and rules of taxation be subject to periodic review. However, our general impression is that the main drivers for change for some of these measures is not a desire to correct anomalies but operational objectives of HMRC, such as reducing the use of resources dealing with enquiries from taxpayers or "correcting" an adverse Tribunal or Court decision.

1.1.3 Our impression is that the full impact of these changes is not fully understood in some cases. This view has been reinforced by the lack of clarity in HMRC's responses to questions regarding how the new rules would apply to some very basic and common situations.

1.1.4 We think it unlikely that the potential adverse revenue collection consequences arising from some measures has been fully understood and costed.

1.1.5 The changes to achieve greater clarity of law in some areas do not in our view take sufficient account of the fact that any change to statute will at a stroke render much case law worthless and lead to further legal disputes (a new body of case law will need to be established).

1.1.6 Some of these changes seem to run contrary to the Government's stated policy aim of reducing unnecessary regulations and tax rules. For example, the changes to rules regarding hairdressers' chair rental introduces new and complex legislation, which almost inevitably will have unintended consequences but will not change the VAT liability of the targeted transactions, which are in our view (and HMRC's view) already subject to VAT.

1.1.7 At least one measure (the new definition of standard-rated hot food) seems to be based on an expectation by HMRC that the impossibility of applying statute will not cause difficulty because of "reasonable HMRC policies regarding application". If HMRC knows even before a law is introduced that it will be impossible to apply then that cannot be good law. It also flies in the face of HMRC's oft taken stance on other matters, which amounts to *"Sorry but we have no discretion and must apply the law no matter how unfair the outcome."*

## 2. Catering: "hot takeaway food" and "premises"

### 2.1 Hot takeaway food

2.1.1 We are sympathetic to the difficulty HMRC has experienced in establishing a clear dividing line between zero-rated food and standard-rated food. However, the proposed measures seem fundamentally unfair to taxpayers that are forced to grapple with this issue.

2.1.2 The effect of this measure will simply be to replace one form of uncertainty with another and the operational rules that will be applied rely on the law not being applied strictly.

2.1.3 Looking at the proposed legislation and indicative guidance we would highlight the following:

#### *The point at which a liability judgement is made*

2.1.4 The reference point for deciding when food is hot is, based on HMRC clarification, the point at which it is handed over to the customer. This is almost certainly going to be challenged since the effect will be that if a customer purchases a hot item at a food counter (for example in a supermarket) and spends 40 minutes shopping then, by the time they reach the checkout, they may be charged 20% VAT on an item that is already cold.

2.1.5 This also introduces a significant compliance difficulty since a system needs to be adopted that allows the VAT liability to be recognised at the point of payment if the item has cooled since being handed over at a counter. This may require complex and expensive systems changes for many retailers.

#### *HMRC proposes to apply rules which are not in line with statute*

2.1.6 HMRC has indicated that it will be trying to operate common sense working rules that allow the law to be operated in a straightforward way. For example "if the food is not hot to the touch it may be zero-rated" and "a sampling exercise may form the basis for calculations of liabilities for those using a retail scheme".

2.1.7 This leaves a number of concerns in particular:

- Food hygiene rules preclude check-out staff touching the product,
- The proposed legislation references temperature above "ambient temperature" not "body temperature",
- The law makes reference to any part of the food item exceeding ambient temperature. Given that the external temperature of cooling food will exceed core temperature, the "touch test" is unlikely to be reliable even if ambient temperature is taken to be synonymous with body temperature.

2.1.8 Fundamentally, HMRC has suggested legislation that is unworkable and is supporting this with assurances that it will then adopt policies that paper over this deficiency. Bearing in mind that HMRC routinely puts forward the view that it has no power to agree a tax treatment that is not in accordance with statute, it seems to us unacceptable that this approach should be taken to new legislation. It appears to contravene established principles of tax administration to introduce laws that cannot be applied without the prior intention of taxing by administrative concession.

### *Rules will add 20% VAT to certain food that cannot be eaten hot*

2.1.9 There may not be many obvious examples under this heading but no doubt cases will arise as the rules are applied in practice. The example we have been given is that of pork pies. These contain a food jelly which is liquid at the time of cooking and only solidifies when the product is cooled. The product will often be sold when hot (straight from the oven) with the customer understanding that not only can the pie not be eaten until cooled but that it might be dangerous to do so – for example there is a risk of scalding from hot liquid. Yet under the new rules this product will be taxed as hot food.

### *Rules will introduce new uncertainties and further litigation*

2.1.10 A simple example is the question "What is bread?" which will remain zero-rated if sold hot. It may lead to the flow of questions such as:

*Bread is a baked product made of flour and water (yeast presumably not always present). What type of flour determines bread – or can this be any milled product. What are the characteristics of bread – is toast bread or does it still need to be a soft product?*

*If toast is bread then presumably a crisp product meets the test – does this cover other products that are essentially flour and water and baked?*

*Does the test exclude the introduction of other food content – for example "olive bread" "onion bread", "flavoured naan"?*

*If it does not exclude the introduction of other products, is there a point at which the additional food content stops the product being bread? If there is an "additional content" threshold, what is it?*

*Pizza is essentially bread with a topping, can pizza be zero-rated? Perhaps pizza can be excluded because it has a topping, but then what about a Calzone pizza?*

*If a topping precludes the zero-rating of a hot pizza, does this remove all bread with a topping from the zero-rated – what is the effect of a dusting of sesame seeds (or are only certain toppings to be viewed as problematic).*

2.1.11 It is not clear to us that a definition can be found that will not simply create new uncertainties and disputes.

### *The practical implication for all businesses*

2.1.12 Our biggest concern is that even with appropriate changes to the legislation taxpayers will still be left with a situation in which they cannot make clear liability judgements and apply them in a straightforward manner.

2.1.13 Products straight from the oven will be standard-rated. As it sits on a shelf and cools it will at some stage become a zero-rated product. As the next batch arrives the cycle will start again. Identifying the point of change will be extremely difficult (if not impossible) and the product price will, if tax is factored in, fluctuate as the day proceeds. This may be countered by adopting an "average price" but this will not alter the simple fact that it will be exceedingly difficult to account for VAT correctly under any point of sale system, and these sales systems seem to predominate.

2.1.14 Errors and inconsistencies are inevitable and HMRC inspectors are faced with an impossible challenge if they wish to audit transactions (short of standing outside the shop with a thermometer and conducting random checks how would an inspector ever know whether the correct rate is applied?)

2.1.15 We believe that it is fundamentally flawed to introduce a law that is likely to result in product liabilities changing as the day progresses (zero-rated pasties after 10am, standard-rated before 9am and "who knows what liability" between 9 and 10 – it comes down to the external temperature, rate of cooling, whether the law is applied or an HMRC "work around" is applied.

### *Potential reduction of disputes?*

2.1.16 We believe that it is naive of HMRC to believe that the proposed new rules will not lead to the same number of disputes, the same number of anomalies and an equally patchy application of the standard and zero rates of VAT.

2.1.17 The fact that product liabilities will vary in the manner described suggests that there will be an increase to the number of disputes regarding the application of the rules, as opposed to the fundamental concepts. Initially there will be an increase in disputes on concepts as the new law beds down.

### *Specific questions posed*

***Q1. Does the legislation meet its objective?***

In our view it does not. HMRC argues that the change is intended to remove the incidence of similar products attracting different VAT treatments. This new law would achieve no change in this respect and can only be operated with significant difficulty and on the basis that the letter of the law will not apply, which seems to be HMRC's intention from the outset.

We see absolutely no advantage in changing the current law unless it forms part of a coherent attempt to remove complexity for all food retailers. For example other EU territories take the view that all food should be taxed at a single reduced rate.

***Q2. What types of bread are most likely to be baked on premises?***

This question is best answered by bakers responding to the consultation. We would simply reiterate that it is to us inconceivable that there will be no disputes. Where a tax treatment changes based on a product description there will always be a debate about where the boundary lies. It is a matter of great concern that HMRC seems to place insufficient weight to the reality that, if it changes the law on a liability boundary, it will merely change the dispute and cause additional work for businesses and HMRC as we throw away a valuable body of case law and start again.

## 3. Sports Nutrition Drinks

3.1.1 We have no issues with the objective of this change although we envisage some disputes around the meaning of the word "marketed". Does this preclude a statement of nutritional benefit on packaging or does it suggest a need to review the marketing strategy of the manufacturer or the retailer or both?

### *Specific questions posed*

***Q5. Does the proposed legislation meet its objective?***

Possibly, but case law will determine the precise meaning of the words "marketed as products designed to enhance physical performance".

***Q6. Impact on business***

We have no comment.

## 4. Self storage

4.1.1 The current rules present no more of an anomaly than many similar transactions. The fundamental point is that the application of VAT will depend on an objective assessment of the facts. (Different treatments of self storage charges are no more an anomaly than the fact that some lettings of office accommodation will be exempt whilst other lettings attract VAT, depending on whether the landlord has opted to tax).

4.1.2 The proposed rules seem to introduce a huge amount of complexity for commercial letting activities. For example, it catches commercial warehouses and introduces uncertainty as to the extent of the mandatory tax charge. For example, if a warehouse building has offices attached is it necessary to apportion rent or does the predominant use dictate the VAT liability?

4.1.3 As regards the consideration of "tax avoidance", it is clear that this measure will introduce a host of tax planning opportunities and the assumption that only supplies between connected parties needs to be considered a concern is possibly naive. HMRC only needs to

remember its original attempt to deal with "lease and leaseback" schemes to conclude that a simplistic connected persons test will only spawn unconnected party transactions.

4.1.4 HMRC also needs to consider that this proposal presents a significant temporary use opportunity (for example a developer may be able to make supplies of standard-rated storage prior to an eventually intended development to obtain an input VAT recovery on initial acquisition costs) or make a small area of a property available for third party self-storage to make VAT costs associated with an entire development partly recoverable (in a case in which they would otherwise be treated as wholly attributable to exempt supplies).

4.1.5 This measure stands above all other Budget proposals as the measure most likely to lead to unintended consequences. We would not be surprised if the additional revenue HMRC anticipates collecting is dwarfed by unforeseen tax loses arising from the introduction of a new opportunity to charge VAT without the need for an option to tax. This adverse impact could perhaps by limited be making supplies of self storage taxable without an option to tax only when it is supplied to a non-taxable person.

### *Specific questions posed*

***Q7. Do the rules tax all self storage?***

Yes

***Q8. Does the connected party test create problems for fully taxable businesses?***

We are relaxed about this element of the legislation since the ability to make an option to tax remains open.

## 5. Hairdressers' chair rental

5.1.1 We have no strong views on this measure beyond observing that it seems to conflict with the Government's aim of simplifying tax law to introduce further legislation to make taxable supplies that HMRC and most observers seem to believe are already taxable under existing law.

### *Specific questions posed*

***Q10. (a) Does the law achieve its aim?***

Yes

***Q10. (b) Does the law capture other supplies?***

Probably. For example, in a building with a shared reception it seems a landlord may need to charge VAT on rent to a salon if the receptionist deals with bookings and appointments.

This may also raise technical questions about whether "services" as defined in proposed Note 18 requires an identifiable "supply" - for example if it is part of a service charge it would ordinarily be viewed as part of the consideration for rent.

In summary, we see this change as unnecessary and its full impact difficult to predict.

## 6. Holiday caravans

6.1.1 We have no strong views on this measure.

## 7. Approved Alterations to listed buildings

7.1.1 The relief can be presented as an anomaly insofar as it provides no VAT reduction for repair and maintenance and only reduces costs in relation to alterations. However, it is quite clear that this relief intentionally was designed to help protect heritage buildings, and to a great extent achieves this aim.

7.1.2 HMRC should note that these changes will fundamentally alter the commercial evaluation of using heritage buildings for a new purpose. We are often asked by charities, nursing homes and private individuals to quantify and compare the VAT cost of:

- putting a rundown listed building to a new use and
- a greenfield development.

For example, the issue might be: "Should a charity convert an existing listed building or simply build a new facility (which will be zero-rated)".

7.1.3 We believe that following this change comparisons of this type will cease and conversions/ changes of use of historic buildings will cease to be a viable consideration.

7.1.4 It may be that since the relief was introduced the UK's stock of heritage buildings capable of conversion to a new use has diminished to the point that the relief no longer has sufficient purpose to justify continuing with it. However, HMRC should be under no illusions that withdrawing this relief will lead to a reduction in the number of heritage buildings whose use is changed.

7.1.5 We accept that all reliefs need to be reviewed and there is a legitimate view that this relief should be removed. The issue that concerns us most about the proposals is that HMRC's approach seems no different to the approach it would take to closing a tax avoidance loophole (without allowing taxpayers sufficient time to prepare for the change).

7.1.6 Transitional rules have been introduced but these do not begin to meet the legitimate expectations of taxpayers that have committed to projects on the basis of existing rules. We have spoken to taxpayers who quite literally do not know what to do in the circumstances

they now face. We have spoken with a number of taxpayers who are in despair about how to complete projects that have been started but will not be completed within the transitional period envisaged by HMRC. This reflects a combination of inadequate budgets (they were not expecting to pay 20% VAT) and a lack of available builders/craftsmen (we have spoken to builders who indicate that they are swamped with enquiries from taxpayers rushing to meet the deadline).

7.1.7 The question that must be asked is "Why is such rapid change necessary?" If this is not a revenue collecting measure what possible harm would arise from having an extended transitional period? HMRC fails to recognise that work to listed buildings involves a significantly longer timeframe than other building projects in terms of both planning, obtaining listed building consents and procuring craftsmen with the requisite skills

7.1.8 In our opinion the fairest basis of implementation would be to say that the relief should continue to apply to any person who owned a listed building on 21 March 2012 and has obtained listed building consent for work by 21 March 2013 and completed work by 21 March 2015.

7.1.9 An alternative approach might be to say that the relief should apply to any taxpayer who has applied for listed building consent by 1 October 2012 where the works are completed by 21 March 2015.

7.1.10 HMRC should reflect on what it wants to achieve. If it is additional revenue collection in the shortest period then the measures as drafted have merit - although a very heavy burden will fall on a small number of taxpayers who are caught by an unfortunate accident of timing. If HMRC simply wishes to phase out a relief that has ceased to serve a purpose there is absolutely no reason why it should not be phased out in a way that allows taxpayers who have already made a significant financial commitment to a project to be protected from a potentially catastrophic impact of sudden rule change.

7.1.11 We would also highlight the potential economic benefit of a longer lead in to removal. At a time of stagnation within the building sector this may encourage taxpayers to proceed with projects whilst allowing sufficient time for the work to be done to the right standard (rushed works to heritage buildings is not desirable).

### *Specific questions posed*

**Q17 Features of historic interest**

We see no reason to distinguish between internal and external features of historic or architectural interest. It should be possible to retain either features without losing the zero-rate relief.

**Q18 Transitional rules**

For the reasons stated above we view the Transitional Rules as too restrictive and wholly unfair to the many taxpayers who have committed large sums to buying heritage buildings in anticipation of the relief applying.

**Q19 10% transitional relief**

We cannot judge how many people will benefit and are more concerned with the large number of taxpayers who will not, which based on anecdotal evidence is the majority of people affected by these changes.

**Q20 Impact on businesses and consumers**

The impact will be significant. Our greatest concern is for taxpayers who have already made a significant financial investment prior to the rule changes but we also consider that there will be a long term disincentive to charities and care homes to take on and adapt heritage buildings (it will now be cheaper to take the new build/Greenfield option in all cases).

We are also extremely sceptical that the Listed Places of Worship Scheme will provide adequate recompense (the scheme is already underfunded and grant applications are widely scaled back), although we accept that without a funding announcement it is not something that can be properly judged.

On a final note, the current rules encourage prospective developers/ heritage home owners to seek listed building consent for alterations as this is a necessity that brings with it a benefit in that the VAT zero-rate can only apply to approved alterations. Once this benefit is removed it may be more likely that cost conscious property's owners will carry out unauthorised works, particularly where they are to internal areas of properties not visible to the conservation officer.

If the desire to achieve simplification of the rules is the true objective this may be achieved without placing heritage buildings at greater risk.

The most straightforward approach would be to apply the reduced rate of 5% VAT to all work to listed buildings, whether that work is of alteration or repair and maintenance. The liability judgement would then be straight forward, the impact of change would be reduced and the perceived anomaly (whereby alterations qualify for relief but repair costs do not) would be removed. Such a change should reduce the number of enquiries HMRC face on this point.

## *Recommendations*

- Fair transitional rules should be adopted as suggested above
- 5% VAT should be introduced to **all** work to qualifying listed buildings