31 March 2021

PRESS SUMMARY

Balhousie Holdings Ltd (Appellant) v Commissioners for Her Majesty's Revenue and Customs (Respondent) (Scotland)
[2021] UKSC 11
On appeal from [2019] CSIH 7

JUSTICES: Lord Hodge (Deputy President), Lord Briggs, Lady Arden, Lord Sales, Lord Carloway

BACKGROUND TO THE APPEAL

This appeal concerns zero-rated supplies under the Value Added Tax Act 1994 ("**VATA**") and whether HMRC was entitled to claw back the benefit of the zero-rating from the Appellant. The appeal arises from the acquisition of a care home in Scotland. On 7 March 2013, Balhousie Care Ltd ("**BCL**"), a company in the Appellant's VAT group, acquired the Huntly Care Home in Scotland from the developer (the "**Grant**"). To finance the acquisition, BCL negotiated a sale and leaseback with Target Healthcare REIT Ltd ("**Target**"): it sold the care home to Target (the "**Sale**") and Target leased the care home to BCL for 30 years (the "**Lease**"). The Sale agreement made clear that Target's right to possession of the care home was subject to BCL's rights under the Lease. BCL used the building as a care home at all material times.

The supply of land in the UK is generally exempt from VAT rather than zero-rated. This is not always helpful for the buyer as the seller cannot recover the VAT paid on its inputs so may charge the buyer a higher price. Therefore, the UK has designated certain supplies as zero-rated rather than exempt - the Principal VAT Directive (Council Directive 2006/112/EC) permits the UK to do this for clearly defined social reasons and for the benefit of the final consumer (here, the residential occupants of care homes). Schedule 8 of VATA sets out the various supplies which are zero-rated. Those relating to the construction of buildings (including care homes) are in Group 5 of Schedule 8. The relevant zero-rated supply in this case was the Grant by the developer to BCL as it was a first grant of a "*major interest*" (in Scotland, either the interest of the owner or the interest under a lease of not less than 20 years) in the care home (a building "*intended for use solely for a relevant residential purpose*").

The issue is whether BCL, as the recipient of the zero-rated supply, then disposed of its "*entire interest*" in the care home by the Sale and Lease. If it did then, pursuant to **paragraph 36(2)** of Schedule 10 Part 2 of VATA, HMRC was entitled to impose a 'self-supply charge' on the Appellant, a mechanism which effectively clawed back the benefit of the zero-rating. The Inner House of the Court of Session decided that BCL did dispose of its entire interest as the Sale disposed of exactly the interest which BCL acquired by the zero-rated Grant, regardless of the Lease which BCL received. The two transactions had to be considered separately from each other, even though (as the First-tier Tribunal had found) they were simultaneous.

JUDGMENT

The Supreme Court unanimously allows the appeal and finds that BCL did not dispose of its entire interest in the care home. Therefore, HMRC was wrong to claw back the benefit of the zero-rating. Lord Briggs gives the main judgment, with which Lord Hodge, Lord Sales and Lord Carloway agree. Lady Arden gives a concurring judgment.

REASONS FOR THE JUDGMENT

The key issue is whether under paragraph 36(2), construed purposively, the claw-back was triggered by the Sale and Lease, viewed realistically [**24**].

In order to interpret paragraph 36(2) purposively, it is necessary to read it in context with **paragraphs 35** to **37** of Schedule 10 Part 2 of VATA [**26**]. Paragraphs 35 to 37 contain a mechanism for withdrawing the benefits of zero-rating from the recipient of the zero-rated supply by imposing a tapered 'self-supply charge' to VAT if either of two stated events occurs within ten years from the completion of the building. The first is if the recipient of the supply *"has, since the beginning of the relevant period, disposed of* [its] *entire interest in the relevant premises (or part)*" (paragraph 36(2)). The second is if there is a change of use of the building from the relevant residential or charitable purpose (paragraph 36(3)) [**2**]. The purpose of paragraph 36(3) is clear: to claw back the benefit of the zero-rating because the benefit of the relief can no longer flow through to the intended beneficiaries as consumers [**33**]. Here, the immediate beneficiaries of the zero-rating were the developer and BCL, by the developer charging BCL less for the care home, but it is assumed that this benefit was passed on to the residential occupants of the care home by enabling BCL to provide services with a lower cost base [**21-22**]. With this context, to the extent that the purpose behind paragraph 36(2) can be discerned, it encourages the recipient of the zero-rated supply to maintain some level of economic interest in the premises and therefore commit to the project of creating and operating the building for the specified socially desirable residential or charitable use for ten years after its completion [**35-37**].

Construing paragraph 36(2) with this purpose in mind, first "*entire*" means exactly what it says – that the recipient of the zero-rated supply no longer has any interest in the premises [**37**]. Second, paragraph 36(2) is concerned with the existence of a state of affairs: did a time come when BCL no longer had any interest in the care home? Paragraph 36(2) is not concerned with whether this state of affairs arises from a single transaction or from a series of transactions. For this reason, the Inner House was wrong to focus on whether the Sale and Lease could be treated as a single transaction [**39-41**] and the case law from the European Court of Justice (ECJ) on whether multiple transactions need to be viewed separately or together for VAT purposes is irrelevant [**23**]. After all, the recipient of the zero-rated supply does not need to dispose of its entire interest by a taxable supply – it could dispose of it by gift [**41**]. On the facts as found by the First-tier Tribunal, there was no moment when BCL had disposed of its entire interest in the care home. This is because the Sale and Lease were simultaneous so BCL either had an ownership interest or a leasehold interest at all relevant times [**42**].

Further, HMRC was wrong to treat the "*interest*" as the specific interest that BCL acquired by the Grant (ownership), such that disposing of the ownership interest, no matter what happened at the same time, meant triggering the self-supply charge [**43-44**]. This is clear from paragraphs 35(2) and 37 [**28, 32**]. Otherwise, paragraph 36(2) would have surprising consequences (for example, if the recipient of a zero-rated first grant of a lease later acquired full ownership and then disposed of only a lease) or would fail to work (for example, if instead of a zero-rated first grant, the zero-rated supply is of specified construction services or building materials) [**9-10, 44**].

Unlike Lord Briggs, Lady Arden considers that the Inner House was right to apply the principles of EU VAT law [**51-54**]. However, it is in her judgment clear from the ECJ's decision in *Mydibel v État belge* (Case C-201/18) [2019] STC 1342 (which post-dated the Inner House's judgment) that the Sale and Lease must be treated together as a single transaction. The composite effect of the Sale and Lease was not to dispose of BCL's entire interest and so Lady Arden also allows the appeal [**55-63**].

References in square brackets are to paragraphs in the judgment