

## A tax on a tax: charging SDLT on VAT

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There are dangers in specialisation, and in particular the risk that experts in one area will overlook or misunderstand the potential interaction with other areas. Take, for instance, the *Project Blue* litigation which has now reached the Supreme Court. The arguments on both sides have understandably focused on the intricacies of the relevant SDLT legislation. But according to a property law expert, Professor Julian Farrand ('Alternative finance and HMRC blinkers', EFTB 2016, 78, 1-6), the tax world (and the legislature) has overlooked the effect of a basic principle of property law: arrangements having the same substantive effect as a mortgage will be treated as a mortgage. He argues that the bank providing Islamic finance to Project Blue Ltd was acting as a mortgagee and acquired no more than an exempt 'security interest' for SDLT purposes, leaving PBL (as mortgagor) as the sole acquirer of a chargeable interest and therefore liable to SDLT.

It would be surprising if this analysis determined the case - but no more surprising than that it seems to have escaped the notice of the entire tax profession (the authors included) even though it came out more than a year ago. Indeed, it appears to have come to the attention of the parties only thanks to the timely intervention of Lady Hale, to whom Professor Farrand happens to be married. The interaction between VAT and SDLT is a more familiar topic, but can still it seems bamboozle the specialist.

### SDLT on VAT

The inclusion of VAT in the SDLT calculation (and before 2003, in the calculation of stamp duty on a sale of land) has always been somewhat controversial as a 'tax on a tax'. Certainly it is odd for a taxpayer who is entitled to recover any VAT

in full to be stuck with bearing the cost of a fraction of it via the SDLT charge. Nevertheless, it is quite clear that when land is sold for (say) £1m plus VAT, SDLT is due on the full £1.2m payable under the contract, notwithstanding that £200,000 of that is in effect being collected by the seller for the benefit of HMRC.

The starting point is FA 2003 Sch 4 para 1, which sets out the general rule that the chargeable consideration for a transaction is 'any consideration in money or money's worth given for the subject-matter of the transaction, directly or indirectly, by the purchaser or a person connected with him'. Clearly, the £1m 'real' price for the land in our example above is consideration of this kind; however, the same is not obviously true of the £200,000 'plus VAT' payment. For one thing, the seller must account for it (or, strictly speaking, an amount equal thereto) to HMRC. It is not an amount that is retained by the seller for its own benefit; and it is accordingly ignored in calculating any chargeable gain or allowable loss that may arise on the disposal. Likewise, from the purchaser's perspective, that £200,000 payment will constitute input tax for which it is in principle entitled to credit in accordance with VATA 1994 ss 25(2) and 26 (subject to the provisions of the VAT regulations). It is therefore legally a different creature from the £1m 'real' price.

Be that as it may, FA 2003 Sch 4 para 2 expressly provides that the chargeable consideration is to be 'taken to include any value added tax chargeable in respect of the transaction'. A purist may argue that para 2 is superfluous: any contract drawn up on an 'exclusive of VAT' basis will stipulate that a 'plus VAT' amount is to be paid in addition to the 'real' price and so, as a matter of English contract law, that amount naturally forms part of the

consideration for the chargeable interest being acquired. However, one can see why Parliament chose to put the matter beyond doubt, given the differing treatment of the ‘plus VAT’ amount for the purposes of different taxes; and the second half of paragraph 2 in fact contains a helpful qualification to the general principle, though one that is not relevant to our topic.

### Exchanges of land

Matters become more interesting in the context of an exchange of land, i.e. a ‘barter’ transaction, particularly where an SDLT exemption is in play. For present purposes, we focus on the case of the surrender and regrant of a lease. Suppose a landlord and tenant agree that an existing lease of commercial property is to be surrendered in consideration for a new lease being granted, with no other consideration being given by either party. FA 2003 Sch 17A para 16 makes it clear that the grant is not consideration for the surrender and the surrender is not consideration for the grant, and adds for good measure that the exchange rules (in FA 2003 Sch 4 para 5) are not to apply in such a case. But for para 16, there would be an exchange of interests in land of equal value (on the assumption that neither party is making a bad bargain) with SDLT prima facie chargeable on both parties by reference to that value.

Where both parties have exercised an option to disapply the VAT exemption in relation to the land in question, the supply by each of them will generally be a taxable one. As the supplies are of equal value, the parties can simply exchange VAT invoices of equal amounts. Each should be able to recover in full the input tax shown on the invoice it receives and thus effectively frank the obligation to account for the equivalent output tax on the invoice it issues. Accordingly, the transaction can proceed on a ‘VAT inclusive’ basis, with neither party being obliged to pay a ‘plus VAT’ amount. So, if the respective interests are worth £1m, each invoice would show a ‘real’ price of £833,333 and a VAT element of £166,667. The ‘real’ price of £833,333 can clearly be disregarded for SDLT

purposes, provided that the provisions of para 16 are met. However, is the effect of para 2 that SDLT is due on the VAT element of £166,667?

In our view, it is not. Where a surrender and regrant is documented on ‘VAT inclusive’ terms, the totality of the consideration passing between the parties falls to be disregarded by Sch 17A para 16. In other words, whilst para 2 prevents a cash element of the consideration from falling outside the SDLT net merely because it represents VAT collected on behalf of HMRC and is therefore not part of the consideration in commercial or economic terms, it does not operate so as to resurrect the VAT element as chargeable consideration where the VAT element is part of the consideration that is so disregarded.

### Some VAT law

This conclusion follows from the approach taken by VATA 1994 s 19 in identifying the relationship between the consideration given for a supply and the VAT chargeable. Section 19(2) deals with the straight cash transaction and tells us that the value of a supply for VAT purposes is such amount as, when taken together with the VAT chargeable, is equivalent to the consideration. Using our cash transaction example above, the consideration under the contract is the full amount that the purchaser is required to pay to the seller in order to acquire the property, i.e. £1.2m. In the language of FA 2003 Sch 4 para 2, that £1.2m of course ‘includes the VAT chargeable’ of £200,000. It is clearly not the case that the seller has made a supply with a value of £1.2m and needs to account for VAT on top of that (i.e. with the ‘plus VAT’ status of the £200,000 being effectively ignored); were that the case, the VAT due would be £240,000 (i.e. 20% of £1.2m). The purchaser would not expect to have to account for that amount of output tax and indeed HMRC would not expect to receive it.

Section 19(3) adopts the same basic approach where the consideration is in non-monetary form. Where interests worth £1m are exchanged on

terms that neither party is required to make an additional payment in respect of the VAT element, so that there is no ‘plus VAT’ payment, both the ‘VAT chargeable’ (in terms of para 2) and the ‘real’ price are clearly contained within the £1m of consideration given by each party. That consideration is in the form of the capital value of the land interests, being amounts that para 16 requires us to ignore in the context of a surrender and regrant.

The requirement to take the consideration as including the ‘VAT chargeable’ does not create a liability to SDLT where the consideration in question is disregarded. To view the ‘VAT chargeable’ as, in some sense, being over and above the value of the interests suffers from the same logical flaw as viewing the VAT as being due on top of the £1.2m actually paid in our example above of a straight cash transaction. Moreover, any such analysis would be inconsistent with the decision of the CJEU in *Tulică* (Case C-249/12), which confirmed that where parties have agreed a price for a supply without reference to VAT and the supplier has no domestic law right to recover any additional amount in respect of VAT from the purchaser, that price must be regarded as including any VAT chargeable on the supply, so that the ‘taxable amount’ in that instance is effectively the net-of-VAT component of the price.

It is worth noting that this result is consistent with the analysis of a barter transaction to which the exchange rules are not disappplied, such that market value is the basis for the SDLT charge, albeit for the quite different reason that HMRC accepts that market value does not include any VAT actually chargeable (see HMRC’s *Stamp Duty Land Tax Manual* at SDLT04140).

The result would seemingly be different if, instead of documenting the transaction on ‘VAT inclusive’ terms, the parties included the conventional

‘exclusive of VAT’ wording and settled the equal ‘plus VAT’ amounts by way of set-off. In that scenario, the ‘plus VAT’ element would constitute cash consideration in addition to the disregarded capital values of the land interests, thereby increasing the SDLT payable. However, there is nothing that requires the parties to document the transaction in this way, indeed it would arguably be somewhat unnatural to do so. The rationale for ‘plus VAT’ wording in a straight cash transaction is that there will be a net output tax liability that the seller needs to account for (and which the purchaser is inevitably required to fund), whereas in a barter transaction on the terms described above, no net output tax liability will arise.

### The holistic approach

We should conclude by returning to our opening theme. It appears that the Stamp Office (and perhaps others too) believes that when a tenant surrenders a lease in return for the grant of a new lease, but does so on a ‘VAT inclusive’ basis, the consideration given by the landlord - the new lease - does not include any VAT element. It therefore says that para 2 requires VAT to be added on top, attracting a charge to SDLT.

This is, in our view, to misunderstand a fundamental point about the workings of VAT. The new lease *does* include a VAT element, being the VAT fraction (one-sixth) of the value of the lease. So it cannot possibly be right to conjure up another slug of VAT that can be subjected to SDLT because it falls outside the exemption provided by Sch 17A para 16.

This would be meat and drink to VAT experts, but then they would not want to tangle with SDLT. Professor Farrand would recognise the problem - too much specialisation!

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