Compulsory purchase orders: taxable supplies?

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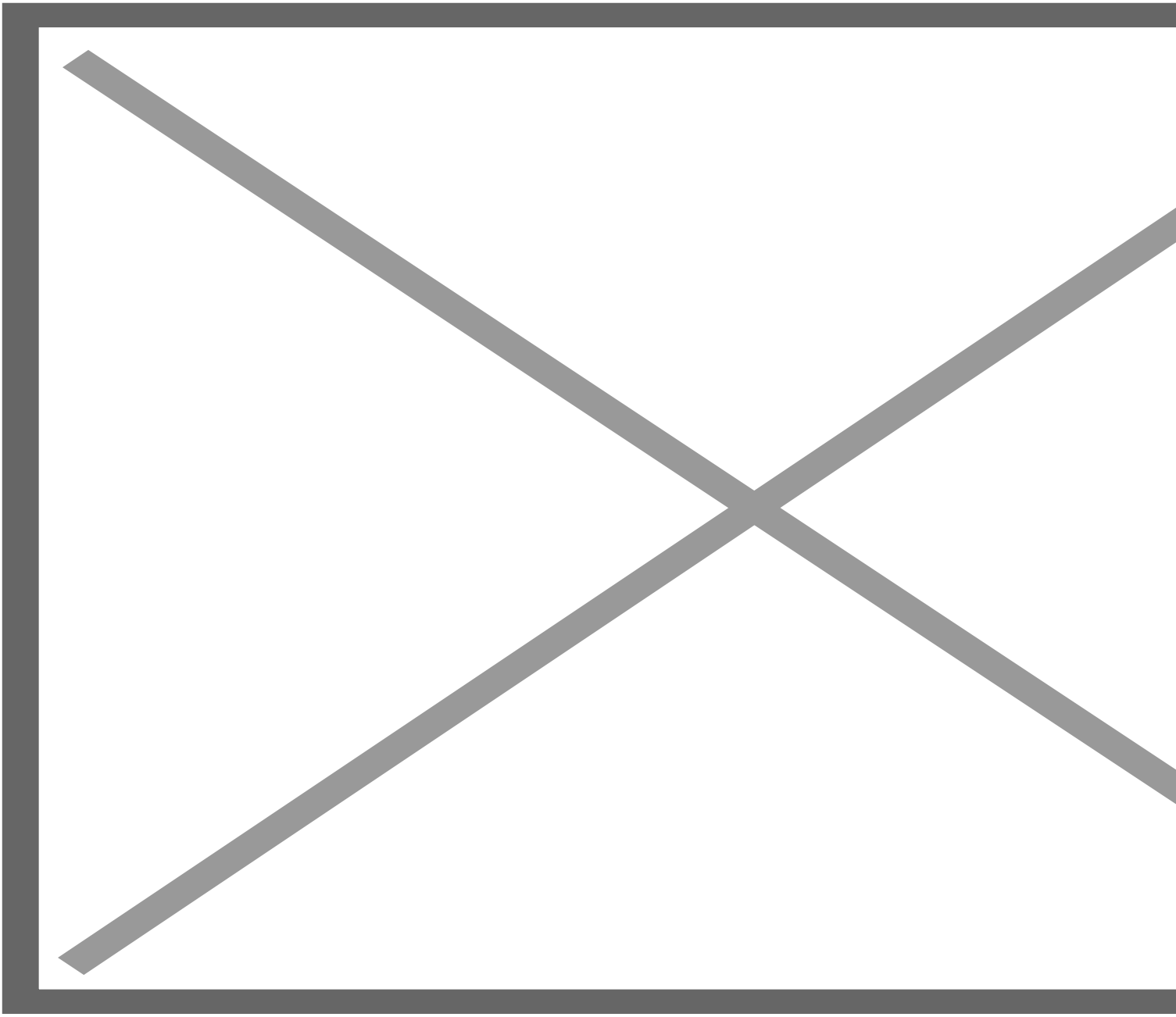

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Ian Harris looks at some fundamentals of the scope of VAT and public bodies

Aficionados of the minutiae of EU VAT law will be familiar with Article 13(1) of the EC Principal VAT Directive, which the ECJ has held means that a public body acting as such when engaged in economic activities is nevertheless not within the scope of VAT where the activity is subject to a special legal regime applicable

only to the public sector and not charging VAT would not cause a significant distortion of competition (see *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d'Arda and others v Comune di Carpaneto Piacentino and others ('Carpaneto')* [*joined cases C?231/87 and C?129/88*] and more recently *Isle of Wight Council & others [C?288/07]*).

There has, for some time, been a view among local government VAT practitioners that applying these criteria to compulsory purchase orders (CPOs) suggests the conveyance of real estate under such powers ought to fall outside the scope of VAT; 'CPO' clearly being a special legal regime only available to public bodies.

Indeed, if one sees a fundamental principle of VAT as being consensuality – the making of a supply of something wanted or needed by the customer who undertakes to pay therefor – then CPOs seem even less likely to be within the scope of VAT.

Gmina Wroclaw

However, the CJEU has recently handed down Judgment in *Minister Finansów v Gmina Wroc?aw [C-665/16]* which highlights another of the lesser known provisions of the EC Principal VAT Directive: Article 14(2)(a).

Article 14(2)(a) states that:

> '… each of the following shall be regarded as a supply of goods:
>
> (a) the transfer, by order made by or in the name of a public authority or in pursuance of the law, of the ownership of property against payment of compensation; …'.

The CJEU in '*Gmina Wroc?aw*' thus had little difficulty in ruling that the compulsory transfer of immovable property from one public body to another constitutes a VATable transaction, even given the unusual circumstances of the case (in effect the Mayor of Wroc?aw, being both the chief executive authority of the Municipality and the local representative of the State Treasury, was both 'seller' and 'buyer').

Background

The background to the dispute is interesting in that land owned by the Municipality of Wroclaw was transferred to the State Treasury in order to build a road, for which the latter was responsible in the guise of its local representative, the Mayor of Wroclaw. The Regional Government of Lower Silesia determined the level of compensation due for the compulsory transfer and this was effected by an internal transfer within the Municipality's accounts.

The Municipality sought a ruling from the Minister of Finance as to whether the transaction constituted a supply for VAT purposes and, if so, which body should appear on the VAT invoice as the purchaser of the goods.

The Minister of Finance decided that

1. the transaction was a VATable supply of goods,
2. the compensation constituted consideration for that supply,
3. the Municipality, not the Mayor, was the taxable person in question, and
4. for VAT purposes the supplier and the purchaser were the same taxable person.

The Municipality disagreed and appealed to the Regional Administrative Court, which held that, because the supplier and the purchaser were the same person, economic control over the property had not been transferred

and so no supply had taken place for VAT purposes.

Questions for the CJEU

The Minister for Finance appealed that decision to the Supreme Administrative Court, which eventually decided to refer the following questions to the CJEU:

> '1. Does the transfer, pursuant to the law, of the ownership of immovable property owned by a municipality to the State Treasury in return for payment of compensation, in the case where, under the rules of national law, that immovable property continues to be managed by the mayor of the municipality, who is simultaneously the representative of the State Treasury and the executive body of the municipality, constitute a taxable transaction within the meaning of Article 14(2)(a) of [the EC Principal VAT Directive]?
>
> 2. In answering that question, is it significant whether the compensation paid to the municipality consists of an actual payment or is a mere internal accounting transfer within the municipal budget?'

CJEU observation

The CJEU observed that, to be a supply under Article 14(2)(a), three cumulative conditions must be satisfied:

1. there must be the transfer of a right of ownership,
2. that transfer must be effected by order made by or in the name of a public authority or in pursuance of the law,
3. there must be payment of compensation.

Addressing the first condition, the transfer of the right of ownership, the CJEU stressed that a transfer in the economic sense is unnecessary in the context of Article 14(2)(a). While a compulsory transfer might be deprived of its ordinary economic nature, Article 14(2)(a) only requires there be a transfer of ownership. Consequently, the transfer of legal title alone is sufficient, even if pursuant to compulsory powers.

Clearly the transfer of ownership was effected pursuant to the law in the name of a public authority, the second condition, which left the question of compensation and whether an internal accounting transfer is sufficient.

Rehearsing familiar tenets on the meaning of consideration – a direct link between what is supplied and the consideration received, in turn requiring a legal relationship between the supplier and purchaser entailing reciprocal performance with the price received by the supplier constituting the value given in return – the CJEU held that the compensation calculated by the Regional Government is directly linked to the transfer of ownership, hence, so long as that payment is made, it is irrelevant that it is effected by means of an internal accounting transfer.

Judgment

The CJEU therefore ruled, as follows

> 'Article 2(1)(a) and Article 14(2)(a) [of the EC Principal VAT Directive] must be interpreted as meaning that a transfer of ownership of immovable property belonging to a taxable person for [VAT] purposes to the Public Treasury of a Member State, carried out in accordance with the law and in return for a payment of compensation, constitutes a transaction subject to VAT in a situation, such as that at issue in the main

proceedings, where the same person simultaneously represents the expropriating authority and the municipality that is the subject of the expropriation and where the latter continues the practical management of the relevant property, even if the payment of compensation has been made only by means of an internal accounting transfer within the budget of the municipality.'

Stirling Council

So far as the author is aware, the only instance of the VAT treatment of CPOs being judicially considered in the UK was as long ago as 2002 when the VAT Tribunal heard *Stirling Council* ([2002] 17,480). This, however, did not consider what is now Article 14(2)(a) but rather became bogged down in the question of a barter.

Background facts

In order to construct a new road in Stirling, the Council embarked on the compulsory purchase of land the major owner of which was the Ministry of Defence. In fact the acquisition was completed by agreement as a CPO cannot be invoked against the Government, the Secretary of State for Defence accepting a net payment £450,000 together with an undertaking by the Council to construct Territorial Army Hall to replace that on the land acquired.

It was this latter undertaking that led to the appeal.

The arguments

The Council contended that construction of the new TA hall was an act it engaged in as a public authority; further that the construction of the replacement TA hall represented compensation under the principle of equitable reinstatement, the construction, the Council arguing, being simply a matter of paying the price necessary as an integral part of the acquisition procedure in the course of the execution of the Council's statutory functions.

In a nutshell, the Council argued that the construction of the new TA hall and its transfer to the MoD fell within what is now Article 13(1) so as to be treated as falling outside the scope of VAT.

The Council submitted that the special legal regime applicable was contained in the Local Government (Scotland) Act 1973 and the Roads (Scotland) Act 1984. In the Council's view, it was a public body utilising its public powers and was entitled under the 1973 Act to make equivalent compensation payments when unable to exercise compulsory powers against an emanation of the Crown. The Council could not go about constructing buildings but could do so only under statutory authority.

HMCE(sic) argued that two supplies took place: one of land to the Council and one of construction services by the Council – the Council agreed to construct a new TA hall valued at £1.3m and that was a VATable supply, HMCE's view being that construction of the replacement TA hall was a matter of private law, subject to a contractual agreement between the Council and the MoD, and had nothing to do with the Council acting under a special legal regime.

The outcome

The VAT Tribunal dismissed the Council's appeal, holding in essence that:

1. HMCE's analysis of the transactions was correct; there were two distinct supplies, a VAT-exempt supply of land by the MoD to the Council and a standard-rated supply of a building, or construction thereof, by the Council to the MoD; and
2. the Council acted as a local authority but under private law not under a special legal regime applicable only to public bodies.

Implications

Gmina Wroc?aw clearly confirms that the purchase of real estate under a CPO – a compulsory purchase order – is a supply within the scope of VAT (though of course exempt from VAT unless subject to an option to tax); this is indisputable give the very clear wording of Article 14(2)(a).

Of wider interest, the CJEU held that internal accounting transfers do not preclude effecting payment of compensation within the meaning of Article 14(2)(a). By implication, therefore, perhaps similar internal accounting transfers – as for example where inter-company debtor and creditor balances are adjusted, such as to deal with management charges – also constitute consideration for VAT purposes.