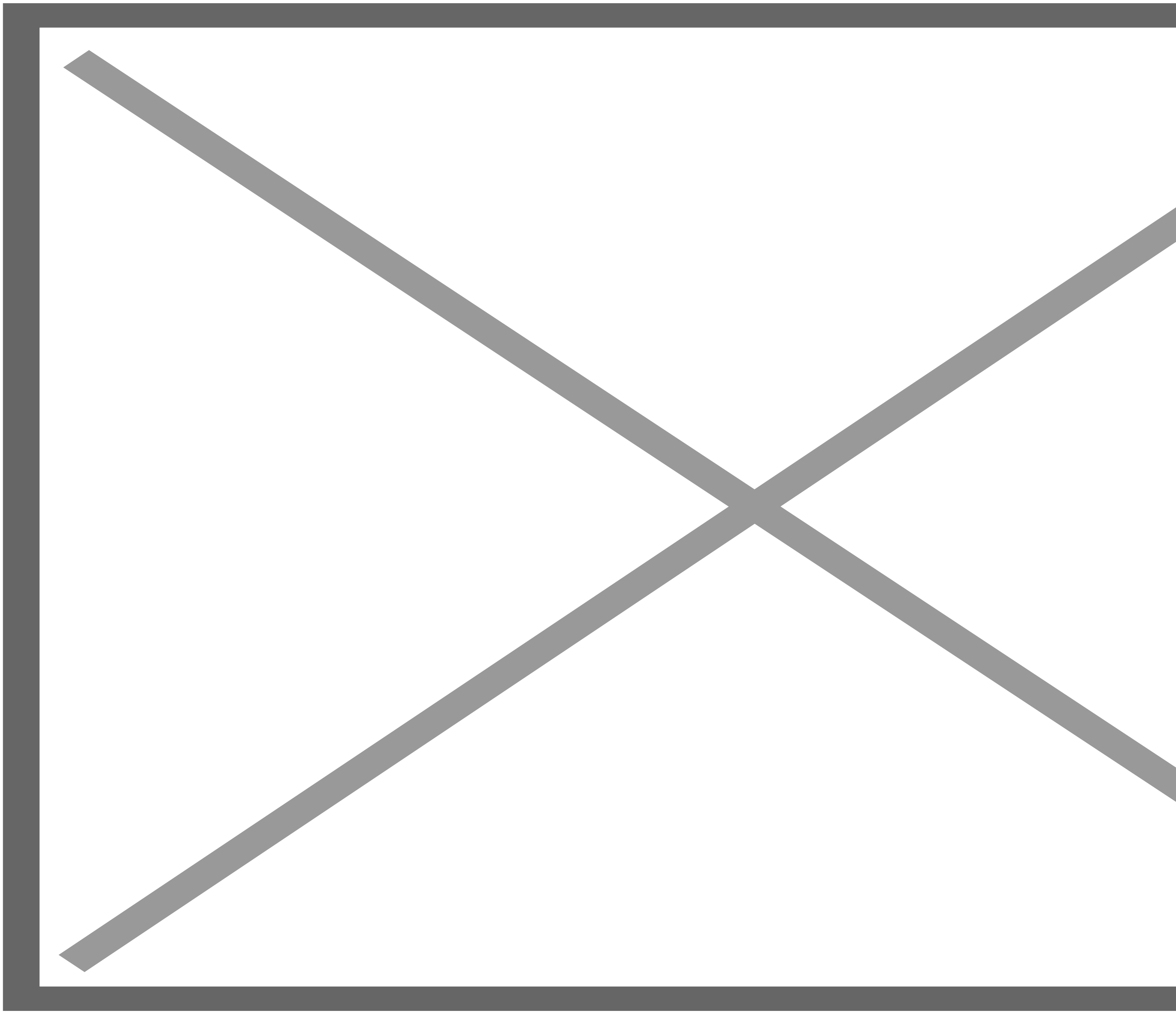
Planning gain agreements

Indirect Tax Tax voice



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Ian Harris notes an anomaly when reflecting on the ECJ decision: *Iberdrola*

In autumn 2017, the CJEU handed down Judgment in *Direktor na Direktsia Obzhalvane i Danachno-Osiguritelna Praktika – Sofia v Iberdrola Inmobiliaria Real Estate Investments EOOD* (C-132/16) ('*Iberdrola*').

The case is pertinent for so-called ‘planning gain agreements’ in the UK, under Section 106 of the Town and Country Planning Act 1990, and the Community Infrastructure Levy (CIL). The latter was established by the Community Infrastructure Levy Regulations 2010, pursuant to Section 205 of the Planning Act 2008, ostensibly to supersede ‘Section 106 Agreements’, though that has not yet been the case.

‘Iberdrola’

The facts and outcome

‘*Iberdrola*’ intended to develop a holiday village, which required upgrading the local municipal water treatment facility; ‘*Iberdrola*’, therefore, paid for the necessary upgrade and sought to recover the VAT incurred as relating to their development.

The Court held that:

> ‘Article 168(a) of [the EC Principal VAT Directive] must be interpreted as meaning that a taxable person has the right to deduct input [VAT] in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and when those services are used both by the taxable person and by the third party in the context of their economic activity, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and where their cost is included in the price of those transactions.’

In a nutshell

The CJEU thus agreed with ‘Iberdrola’ that VAT on upgrading the local municipal water treatment facility was incurred by them in connection with their overall business activity of developing a holiday village, even though the works were primarily for the benefit of the municipality and in effect ‘gifted’ thereto.

The only caveat was that the CJEU felt the VAT incurred on the upgrade would only be recoverable by ‘Iberdrola’ to the extent necessary to facilitate their development.

‘Section 106 Agreements’ and the CIL

This has raised the question whether the Judgment has any implications for ‘Section 106 Agreements’, or similar, entered into for the purposes of the CIL, where a developer is required to fund the provision of public community infrastructure ‘in return’ for planning consent.

Section 106 of the Town and Country Planning Act 1990 states:

> ‘(1) Any person interested in land in the area of a local planning authority may, by agreement or otherwise, enter into an obligation (referred to in this Section… as ‘a planning obligation’), enforceable to the extent mentioned in Sub-Section (3) -
>
> …
>
> (d) requiring a sum or sums to be paid to the authority… on a specified date or dates or periodically.’

In practice, rather than pay a cash sum to the planning authority, the developer often agrees to provide the ‘public community infrastructure’ asset themselves, effectively ‘gifting’ it to the public in the guise of the responsible local authority.

Typically this will be a new school in connection with a housing development but there is no limit to the type of asset that might be ‘gifted’ (though the equally typical requirement to undertake works to the public highway – such as constructing a roundabout to provide access to a commercial development – whilst analogous is usually governed by a similar agreement under Section 278 of the Highways Act 1980; indeed there is a raft of comparable statutory provisions).

HMRC’s view on ‘Section 106 Agreements’ is that such payment to the planning authority, be that in cash or in kind by the provision of a community asset, cannot amount to consideration for a supply by the planning authority, as it is impermissible for the latter to charge for granting planning consent (other than to the extent of the specified statutory fee). ‘Payment’ under a ‘Section 106 Agreement’ thus falls outside the scope of VAT.

VAT recovery

In order to permit the developer to secure full VAT recovery where a community asset is provided in lieu of a cash payment, HMRC then take the view that, in effect, provision of the community asset under a ‘Section 106 Agreement’ is ancillary to the overall development, with VAT recovery determined thereby. This usually results in the developer securing full VAT recovery – including on providing the community asset – on the basis of zero-rated housing development or standard-rated commercial development.

To that extent, ‘*Iberdrola*’ appears to support HMRC’s position, which is spelt out in Section 8 of Notice 742 ‘Land and Property’, para.8.4 of which, headed ‘Planning Gain Agreements’, states:

> ‘As a developer you may provide many other types of goods and services free, or for a purely nominal charge, to the local or other authority under Section 106 of the Town and Country Planning Act 1990 or other similar agreements…
>
> Such goods and services may include buildings such as community centres or schools, amenity land or civil engineering works. Alternatively, they may be in the form of services such as an agreement to construct something on land already owned by the authority or a third party. Any such provision of goods or services is not a supply for a consideration to the local or other authority, or to the third party. So, no VAT is chargeable by you on the handing over of the land or building or the completion of the works. But the input tax you incur is attributable to your supplies of land and buildings on the development for which the planning permission was given.’

The only question ‘Iberdrola’ leaves unanswered in this context, therefore, is whether a statutory requirement to fund the public community infrastructure works in order for planning permission to be granted for the development is sufficient for them to be ‘necessary’ for the development.

In practice, the answer to that question seems to be ‘yes’.

‘Business gifts’?

However, ‘Iberdrola’ did not consider whether the developer might be making a ‘business gift’ to the municipality subject to Article 16 of the EC Principal VAT Directive, viz:

> ‘The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or, more generally, their application for purposes other than those of his business, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.
>
> …’

This provision is, of course, transposed into UK law by Paragraph 5(1) of Schedule 4 to the VAT Act 1994, which states ‘…where goods forming part of the assets of a business are transferred or disposed of by or under the directions of the person carrying on the business so as no longer to form part of those assets, whether or not for a consideration, that is a supply by him of goods’ and so is subject to VAT.

Section 106

Clearly, HMRC do not see this as being the case where a developer provides a community asset under a ‘Section 106 Agreement’, possibly on the basis that the asset provided never actually forms ‘part of the assets of the [developer’s] business’ before being ‘gifted’ to the planning authority.

CIL

However, HMRC do not appear to apply the same logic to community assets provided to the planning authority in lieu of CIL.

While the CIL seeks to apply a ‘standard tariff’ for local developments, so removing the ‘horse-trading’ of individual ‘Section 106 Agreements’, and so is, ordinarily, paid in cash, it is still permissible for agreement to be reached between the planning authority and the developer for the latter to ‘pay’ the CIL due by providing an asset for the community’s use.

The Anomaly

Curiously, HMRC do see this as amounting to ‘business gift’ subject to VAT, Paragraph 8.3 of Notice 742 stating:

> ‘The Community Infrastructure Levy (CIL) is a levy that local authorities in England and Wales can choose to charge on developments in their area. The money obtained can be used to support development by funding infrastructure that the council, local communities and neighbourhoods want. It’s a levy charged upon developers.
>
> CIL is not consideration for any supplies by local authorities to developers and consequently it is outside the scope of VAT.
>
> Developers can elect not to pay money to the local authority but instead to transfer an asset such as land to the authority. Again, this is not consideration for any supplies by the local authority to the developer. But the transfer of the asset can result in a supply of it by the developer to the local authority. See Paragraph 7.6 [‘if you make free supplies of land and buildings’] for further information.’

This is an anomaly not yet explained by HMRC. Certainly, the topic has been raised at both the CIPFA VAT Committee and the Land and Property Liaison Group (LPLG) without progressing it to any clarification.

The 'answer' to the anomaly, however, might be that weasel word 'may' in HMRC's suggestion that an asset transferred in lieu of CIL 'may be' – not 'is' – a business gift. As with Section 106 agreements, the 'get out' then could be whether the asset transferred is ever an asset of the transferor's business (though this does raises its own issues regarding VAT recovery!).

It is fair to add that where a business gift is made to a VAT-registered recipient it must be accompanied by a VAT certificate in order to entitle the recipient to recover the VAT declared thereon. But there is little evidence of local authorities receiving such certificates, perhaps ‘confirming’ that the provision of an asset in lieu of CIL is relatively unusual.