

FOR REFERENCE ONLY

24 JUL 1998

The Nottingham Trent University
Libraries & Learning Resources
SHORT LOAN COLLECTION

| Time | Date | Time | Date | |
|-----------------------|----------|---------|------|--|
| 27 | APR 2004 | 10:00 | | |
| XXXXXXXXXX | | | | |
| 1 | NOV 2004 | 10:00 | | |
| XXXXXX | | | | |
| 15 | MAY 2004 | 4:00 PM | | |

Please return this item to the issuing library.
Fines are payable for late return.

THIS ITEM MAY NOT BE RENEWED

ProQuest Number: 10183526

All rights reserved

INFORMATION TO ALL USERS

The quality of this reproduction is dependent upon the quality of the copy submitted.

In the unlikely event that the author did not send a complete manuscript and there are missing pages, these will be noted. Also, if material had to be removed, a note will indicate the deletion.



ProQuest 10183526

Published by ProQuest LLC (2017). Copyright of the Dissertation is held by the Author.

All rights reserved.

This work is protected against unauthorized copying under Title 17, United States Code
Microform Edition © ProQuest LLC.

ProQuest LLC.
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106 – 1346

**VALUE ADDED TAX -
THE IMPACT OF WAIVER OF EXEMPTION ON THE
ENGLISH COMMERCIAL PROPERTY MARKET**

DAVID N BOOTH

**A thesis submitted in partial fulfilment of the requirements of Nottingham
Trent University for the degree of Master of Philosophy.**

January 1998

**Department of Surveying
Nottingham Trent University**

Volume 1

40 0671183 6



ABSTRACT

The European Court judgement (case 416/85) would probably have added more than £1,000 million in Value Added Tax to the commercial property sector of the United Kingdom economy. The Government's response was to implement but mitigate the impact of this judgement by allowing taxpayers the opportunity to recover input tax (tax paid).

Early research based on investors' reactions to this option to tax indicated a low take-up rate, with investors opting only where there was a clear financial advantage to do so. This was a significant outcome because the Government relied on this mechanism to mitigate the impact of the European Court judgement (case 416/85). This suggested an opportunity to examine the effectiveness of the Governments chosen method of mitigation.

The Government was unable to prevent the European Court's requirement to extend value added tax affecting those individuals and companies who could recover only part or none of the tax. Commentators around the time of the judgement predicted a significant impact on rents associated with this sector of the commercial property market. This suggested an opportunity to examine the perceived effects on rents in this sector of the market.

The principal outcomes of the thesis are the results of a series of mail questionnaires developed from the key issues which examine the impact of waiver of exemption on the English commercial property market.

These show a variable but essentially low take-up rate of waiver of exemption and confirm the importance of the recovery of input tax as a key determinant in the decision to opt to tax. They also demonstrate that some exempt/part exempt tenants are willing to pay a premium or more rent to secure an unelected building.

ACKNOWLEDGEMENTS

I am pleased to have the opportunity as part of the thesis to be able to thank all those who have helped and supported me during its production.

Firstly I would like to thank Professor John Moohan who has supervised the project throughout with enormous care and skill. His knowledge, support and encouragement has been a vital part of the thesis. My own knowledge and understanding has been enormously enriched as a result of having had the opportunity to work with John.

I am also grateful to my other supervisors, Miss Di Butler for her contributions throughout the research and Professor Ian Storey particularly for his invaluable assistance during the development of the questionnaires.

I would also like to thank Charlie Hardwick at Nottingham Trent University's Dryden Street library for his assistance with the literature review and Tim Salter of the computer department for his assistance with the computer analysis of the results. Finally, I would like to thank Stephanie Lubynskyj and Claire Hutchinson, secretaries to the Surveying Department for their help in typesetting this thesis.

ABBREVIATIONS

| | |
|-------------|--|
| AG | Advocate General |
| EC | European Court |
| ECSC | European Coal and Steel Community |
| ERM | Exchange Rate Mechanism |
| HMCE | Her Majesty's Customs and Excise |
| KFR | Knight Frank Rutley Research |
| RICS | Royal Institution of Chartered Surveyors |
| STD | Standard Trunk Dialling |
| UK | United Kingdom |
| VAT | Value Added Tax |

**VALUE ADDED TAX -
THE IMPACT OF WAIVER OF EXEMPTION ON THE
ENGLISH COMMERCIAL PROPERTY MARKET**

| <u>TABLE OF CONTENTS</u> | <u>PAGE</u> |
|---|--------------------|
| Abstract | i |
| Acknowledgements | ii |
| Abbreviations | iii |
| Contents | iv-x |
| List of Appendices | xi-xiv |
| <u>1.0 CHAPTER ONE AN INTRODUCTION TO A STUDY OF THE IMPACT OF WAIVER OF EXEMPTION ON THE ENGLISH COMMERCIAL PROPERTY MARKET - AIMS AND OBJECTIVES</u> | |
| 1.1 Introduction | 1 |
| 1.2 Background to the Research Project | 3 |
| 1.2.1 A Source of Conflict | 4 |
| 1.2.2 The Need for Empirical Studies | 5 |
| 1.3 Research Methods and Chapter Summary | 7 |
| <u>2.0 CHAPTER TWO WAIVER OF EXEMPTION AND THE ENFORCEMENT OF EUROPEAN ECONOMIC COMMUNITY DIRECTIVES RELATING TO INDIRECT TAXATION</u> | |
| 2.1 Introduction | 16 |
| 2.2 Co-operation in Europe | 16 |
| 2.3 Value Added Tax (VAT) | 21 |
| 2.4 VAT Zero-rating Provision in the UK and the Commission | 26 |
| 2.5 The Response of the UK Government | 31 |
| 2.6 Summary and Conclusions | 34 |

| | | | |
|-----|--|--|----|
| 3.0 | <u>CHAPTER THREE</u> | <u>THE FINANCE ACT 1989 - DEVELOPMENT, APPLICATION, AMENDMENTS AND POST- LEGISLATIVE COMMENTARY</u> | |
| 3.1 | Introduction | | 38 |
| 3.2 | The Finance Bill Debate | | 39 |
| | 3.2.1 The Election to Waive Exemption | | 40 |
| | 3.2.1.1 The Extent of Waiver of Exemption | | 42 |
| | 3.2.1.2 The Making of an Election to Waiver Exemption | | 44 |
| | 3.2.1.3 The Consequences of Making an Election to Waive Exemption | | 45 |
| | 3.2.2 The Government's Proposals to Charge VAT on Building Land | | 48 |
| | 3.2.2.1 The Self Supply of Building Land Proposal (not enacted) | | 50 |
| | 3.2.2.2 The Self Supply of Finished Buildings Proposal (not enacted) | | 51 |
| | 3.2.2.3 Self Supply on Developers (enacted) | | 55 |
| 3.3 | The Finance Act 1989 | | 60 |
| 3.4 | Post Legislative Commentary | | 70 |
| | 3.4.1 The Meaning of VAT Changes for Commercial Property Development | | 70 |
| | 3.4.1.1 Land with Development Potential | | 70 |
| | 3.4.1.2 Funding Developments | | 72 |
| | 3.4.1.3 Planning Gain | | 72 |
| | 3.4.1.4 VAT Liability on Disposal of the Development | | 73 |
| | 3.4.2 The Meaning of the VAT Changes for those Trading in Commercial Property | | 74 |
| | 3.4.2.1 Surrenders, Assignments and Re-grants | | 75 |
| | 3.4.2.2 Stamp Duty | | 77 |
| | 3.4.2.3 Fixtures, Fittings and Reverse Premiums | | 78 |
| | 3.4.3 The Meaning of the VAT Changes for those who Let Commercial Property | | 78 |
| | 3.4.3.1 Drafting Considerations | | 79 |
| | 3.4.3.2 Managing Agents and Service Charges | | 81 |
| | 3.4.3.3 Dilapidations | | 83 |
| 3.5 | Transitional Provisions | | 84 |

| | | |
|---------|---|-----|
| 3.6 | Subsequent Amendments to the Finance Act 1989 | 90 |
| 3.6.1 | The VAT (Buildings and Land) Order 1991 | 90 |
| 3.7 | Summary and conclusions | 96 |
| 4.0 | <u>CHAPTER FOUR RESEARCH HYPOTHESES. METHODOLOGY AND ALTERNATIVE RESEARCH METHODS</u> | |
| 4.1 | Introduction | 105 |
| 4.2 | Aim One - To examine the Effectiveness of Waiver of Exemption in Mitigating the Effects of the EC Judgement (case 416/85) on the English Commercial Property Market | 106 |
| 4.2.1 | Commissioner of the European Communities versus UK (case 416/85) | 106 |
| 4.2.2 | Early Research | 109 |
| 4.2.3 | The Advantages and Disadvantages of an Election to Waive Exemption | 111 |
| 4.2.4 | The Effectiveness of Waiver of Exemption in Mitigating the Effects of the EC Judgement (case 416/85) on the English Commercial Property Market in the UK | 117 |
| 4.3 | Aim Two - To assess the Perceived Effects of Waiver of Exemption on Rents in the English Commercial Property Market | 119 |
| 4.3.1 | The Tax Burden | 120 |
| 4.3.2 | Economic Price Theory | 121 |
| 4.3.2.1 | The Theory | 122 |
| 4.3.2.2 | The Application of Economic Price Theory to Property Taxes | 123 |
| 4.3.2.3 | The Effect of Elasticity | 125 |
| 4.3.2.4 | A Possible Explanation of the Concept of Two Tier Markets using Economic Price Theory | 127 |
| 4.3.3 | The Perceived Effects of Waiver of Exemption on Rents in the English Commercial Property Market | 131 |
| 4.4 | Data Collection Methods | 132 |
| 4.4.1 | Observation | 132 |
| 4.4.2 | Personal Interview | 136 |
| 4.4.3 | Telephone Interview | 138 |
| 4.4.4 | Mail Questionnaire | 139 |
| 4.5 | Summary and Conclusions | 141 |

5.0 **CHAPTER FIVE** **THE EFFECTIVENESS OF WAIVER OF EXEMPTION
IN MITIGATING THE EFFECTS OF THE EC
JUDGEMENT (CASE 416/85) ON THE ENGLISH
COMMERCIAL PROPERTY MARKET**

| | | |
|---------|---|-----|
| 5.1 | Introduction | 147 |
| 5.2 | Purpose | 148 |
| 5.3 | The Pilot Questionnaires | 148 |
| 5.3.1 | Chosen Method | 148 |
| 5.3.2 | Sample Frame and Data Sources | 150 |
| 5.3.3 | Developing the Questionnaires | 152 |
| 5.3.3.1 | Pilot Property Owners Questionnaire | 153 |
| 5.3.3.2 | Pilot In-house Surveyors Questionnaire | 156 |
| 5.3.3.3 | Pilot Professional Advisors Questionnaire | 157 |
| 5.3.4 | Analysis of Responses | 158 |
| 5.3.4.1 | Response Rate | 158 |
| 5.3.4.2 | Methodology | 159 |
| 5.3.4.3 | Method | 160 |
| 5.3.5 | Alterations and Amendments to the Pilot Questionnaires | 161 |
| 5.3.5.1 | Response Rate | 161 |
| 5.3.5.2 | Sample | 162 |
| 5.3.5.3 | Questionnaires | 163 |
| 5.4 | Method | 168 |
| 5.4.1 | Chosen Method | 168 |
| 5.4.2 | Sample | 169 |
| 5.5 | Results of Main Circulation | 171 |
| 5.5.1 | Response rate | 171 |
| 5.5.2 | Analysis of Responses to Questionnaires | 173 |
| 5.5.2.1 | Property Owners Questionnaire, Question 1 | 173 |
| 5.5.2.2 | Property Owners Questionnaire, Question 2, In-house Surveyors and Professional Advisors Questionnaire, Question 1 | 174 |
| 5.5.2.3 | Property Owners Questionnaire, Question 3 | 177 |
| 5.5.2.4 | Property Owners Questionnaire, Question 4 | 178 |
| 5.5.2.5 | Property Owners and In-house Surveyors Questionnaire, Question 5, Professional Advisors Questionnaire, Question 3 | 179 |

| | | |
|----------|--|-----|
| 5.5.2.6 | Property Owners Questionnaire, Question 6, In-house Surveyors Questionnaire, Question 4 and Professional Advisors Questionnaire, Question 2 | 181 |
| 5.5.2.7 | In-house Surveyors Questionnaire, Question 2 | 183 |
| 5.5.2.8 | In-house Surveyors Questionnaire, Question 3 | 184 |
| 5.5.2.9 | Professional Advisors Questionnaire, Question 4 | 185 |
| 5.5.2.10 | Property Owners Questionnaire, Question 7, In-house Surveyors Questionnaire, Question 6 and Professional Advisors Questionnaire, Question 5 | 185 |
| 5.6 | Critique | 193 |
| 5.6.1 | Methodology | 193 |
| 5.6.2 | Response Rate | 195 |
| 5.6.3 | Data | 196 |
| 5.6.4 | Quality of Response | 199 |
| 5.7 | Conclusions | 200 |
| 6.0 | <u>CHAPTER SIX</u> <u>THE PERCEIVED EFFECTS OF WAIVER OF EXEMPTION ON RENTS IN THE ENGLISH COMMERCIAL PROPERTY MARKET</u> | |
| 6.1 | Introduction | 205 |
| 6.2 | Purpose | 206 |
| 6.3 | The Pilot Questionnaires | 207 |
| 6.3.1 | Chosen Method | 207 |
| 6.3.2 | Sampling Frame | 209 |
| 6.3.3 | Developing the Questionnaires | 211 |
| 6.3.3.1 | Occupiers Pilot Questionnaire | 212 |
| 6.3.3.2 | Investors Pilot Questionnaire | 219 |
| 6.3.3.3 | Developers Pilot Questionnaire | 221 |
| 6.3.3.4 | Surveyors Pilot Questionnaire | 222 |
| 6.3.4 | Analysis of Responses to Pilot Questionnaires | 223 |
| 6.3.4.1 | Response Rate | 223 |
| 6.3.4.2 | Methodology | 224 |
| 6.3.4.3 | Method | 225 |
| 6.3.5 | Alterations and Amendments to the Pilot Questionnaires | 226 |
| 6.3.5.1 | Response Rate | 226 |
| 6.3.5.2 | Sample | 227 |
| 6.3.5.3 | Questionnaires | 228 |

| | | |
|----------|--|-----|
| 6.4 | Method | 234 |
| 6.4.1 | Chosen Method | 234 |
| 6.4.2 | Sample | 236 |
| 6.5 | Results of Main Circulation | 237 |
| 6.5.1 | Response Rate | 238 |
| 6.5.2 | Analysis of Responses to Questionnaires | 239 |
| 6.5.2.1 | Occupiers, Investors and Developers Questionnaires, Question 1 | 239 |
| 6.5.2.2 | Occupiers, Investors and Developers Questionnaire, Question 2 | 241 |
| 6.5.2.3 | Occupiers Questionnaire, Question 3 | 242 |
| 6.5.2.4 | Occupiers Questionnaire, Section A, Question A1 | 243 |
| 6.5.2.5 | Occupiers Questionnaire, Section A, Question A2 | 243 |
| 6.5.2.6 | Occupiers Questionnaire, Section A, Question A3/4 | 244 |
| 6.5.2.7 | Occupiers Questionnaire, Section A, Question A5 | 247 |
| 6.5.2.8 | Occupiers Questionnaire, Section B, Question B1 | 249 |
| 6.5.2.9 | Occupiers Questionnaire, Section B, Question B2 | 249 |
| 6.5.2.10 | Occupiers Questionnaire, Section B, Question B3 | 250 |
| 6.5.2.11 | Occupiers Questionnaire, Section B, Question B4 | 250 |
| 6.5.2.12 | Occupiers Questionnaire, Section B, Questions B5-B6 and Developers Questionnaires, Questions 7-8 | 251 |
| 6.5.2.13 | Occupiers Questionnaire, Section B, Questions B7-8 and Developers Questionnaire, Questions 9-10 | 253 |
| 6.5.2.14 | Investors and Developers Questionnaires, Question 3 and Surveyors Questionnaire, Question 1 | 253 |
| 6.5.2.15 | Investors and Developers Questionnaires, Question 4 and Surveyors Questionnaire, Question 2 | 255 |
| 6.5.2.16 | Surveyors Questionnaire, Question 3 | 256 |
| 6.5.2.17 | Investors and Developers Questionnaires, Question 5 and Surveyors Questionnaire, Question 4 | 256 |
| 6.5.2.18 | Investors and Developers Questionnaires, Question 6 | 270 |

| | | |
|-------|---|-----|
| 6.6 | Critique | 272 |
| 6.6.1 | Methodology | 273 |
| 6.6.2 | Response Rate | 275 |
| 6.6.3 | Data | 276 |
| 6.6.4 | Quality of Response | 278 |
| 6.7 | Conclusions | 281 |
| 7.0 | <u>CHAPTER SEVEN</u> <u>CONCLUSIONS</u> | |
| 7.1 | Summary of Aims | 291 |
| 7.2 | Summary of Discoveries | 292 |
| | 7.2.1 The Decision to Elect to Waive Exemption | 292 |
| | 7.2.2 The Impact on Rents and the Quantity of Commercial Property Offered to Let | 293 |
| 7.3 | Further Research | 295 |
| | Bibliography | 298 |
| | Appendices | |

APPENDICES

- 1 An Economic Overview of the UK Commercial Property Market 1987-1992
 - The Boom Years 1987-1989
 - The Downturn 1990
 - The Bottom of the Trough 1991
 - The Economic Recession 1992
- 2 Extract from The Finance Bill 1989, Schedule 6A
- 3 Extract from the Value Added Tax (Buildings and Land) Order 1991
- 4 Early Research
- 5
 - 5.1 Pilot Questionnaire Property Owners
 - 5.2 Covering Letter
 - 5.3 Pilot Questionnaire In-house Surveyors
 - 5.4 Pilot Questionnaire Professional Advisors
 - 5.5 Responses to Pilot Questionnaires
 - Property Owners Questionnaire, Question 1.
 - Property Owners Questionnaire, Question 2, In-house Surveyors and Professional Advisors Questionnaire, Question 1.
 - Property Owners Questionnaire, Question 3.
 - Property Owners Questionnaire, Question 4.
 - Property Owners Questionnaire, Question 5, In-house Surveyors Questionnaire, Question 4 and Professional Advisors Questionnaire, Question 2.
 - In-house Surveyors Questionnaire, Question 2.
 - In-house Surveyors Questionnaire, Question 3.
 - Property Owners Questionnaire, Question 6, In-house Surveyors Questionnaire, Question 5 and Professional Advisors Questionnaire, Question 3.
 - 5.6 Questionnaire Main Circulation Property Owners.
 - 5.7 Questionnaire Main Circulation In-house Surveyors.
 - 5.8 Questionnaire Main Circulation Professional Advisors.
 - 5.9 Results of Main Circulation.
 - Property Owners Questionnaire, Question 1.
 - Property Owners Questionnaire, Question 2, In-house Surveyors and Professional Advisors Questionnaires, Question 1.
 - Property Owners Questionnaire, Question 3.
 - Property Owners Questionnaire, Question 4.
 - Property Owners and In-house Surveyors Questionnaires, Question 5.
 - Professional Advisors Questionnaire, Question 3.
 - Property Owners Questionnaire, Question 6, In-house Surveyors Questionnaire, Question 4 and Professional Advisors Questionnaire,

Question 2

In-house Surveyors Questionnaire, Question 2.

In-house Surveyors Questionnaire, Question 3.

Professional Advisors Questionnaire, Question 4.

Property Owners Questionnaire, Question 7, In-house Surveyors Questionnaire, Question 6, and Professional Advisors Questionnaire, Question 5.

6.

6.1 Occupiers Pilot Questionnaire

6.2 Covering Letter

6.3 Investors Pilot Questionnaire

6.4 Developers Pilot Questionnaire

6.5 Surveyors Pilot Questionnaire

6.6 Results of Pilot Circulation

Occupiers Pilot Questionnaire, Question 1.

Occupiers Pilot Questionnaire, Question 2.

Occupiers Pilot Questionnaire, Section A, Question A1.

Occupiers Pilot Questionnaire, Section A, Question A2.

Occupiers Pilot Questionnaire, Section A, Question A3.

Occupiers Pilot Questionnaire, Section A, Question A4.

Occupiers Pilot Questionnaire, Section A, Question A5.

Occupiers Pilot Questionnaire, Section B, Question B1.

Occupiers Pilot Questionnaire, Section B, Question B2.

Occupiers Pilot Questionnaire, Section B, Question B3.

Occupiers Pilot Questionnaire, Section B, Question B4.

Occupiers Pilot Questionnaire, Section B, Question B5.

Occupiers Pilot Questionnaire, Section B, Question B6.

Occupiers Pilot Questionnaire, Section B, Question B7.

Occupiers Pilot Questionnaire, Section B, Question B8.

Investors and Developers Pilot Questionnaires, Question 1.

Investors and Developers Pilot Questionnaires, Question 2 and Surveyors Pilot Questionnaire, Question 1.

Investors and Developers Pilot Questionnaires, Question 3, and Surveyors Pilot Questionnaire, Question 2.

Surveyors Pilot Questionnaire, Question 3.

Investors, Developers and Surveyors Pilot Questionnaires, Question 4.

Investors Pilot Questionnaire, Question 4 and Developers Pilot Questionnaire, Question 5.

Developers Pilot Questionnaire, Question 6.

Developers Pilot Questionnaire, Question 7.

Developers Pilot Questionnaire, Question 8.

Developers Pilot Questionnaire, Question 9.

6.7 Questionnaire Main Circulation Occupiers.

6.8 Questionnaire Main Circulation Investors.

6.9 Questionnaire Main Circulation Developers.

6.10 Questionnaire Main Circulation Surveyors.

- 6.11 Data Sources Main Questionnaire Circulation.
- 6.12 Results Main Questionnaire Circulation.
 - Occupiers, Investors and Developers Questionnaires, Question 1.
 - Occupiers, Investors and Developers Questionnaires, Question 2.
 - Occupiers, Investors and Developers Questionnaires, Question 2 (Analysed by Category).
 - Occupiers Questionnaire, Question 3.
 - Occupiers Questionnaire, Section A, Question A1.
 - Occupiers Questionnaire, Section A, Question A2.
 - Occupiers Questionnaire, Section A, Question A3/A4.
 - Occupiers Questionnaire, Section A, Question A5.
 - Occupiers Questionnaire, Section B, Question B1.
 - Occupiers Questionnaire, Section B, Question B2.
 - Occupiers Questionnaire, Section B, Question B3.
 - Occupiers Questionnaire, Section B, Question B4.
 - Occupiers Questionnaire, Section B, Question B5. and Developers Questionnaire, Question 7.
 - Occupiers Questionnaire, Section A, Question B6. and Developers Questionnaire, Question 8.
 - Occupiers Questionnaire, Section A. Question B7. and Developers Questionnaire, Question 9.
 - Occupiers Questionnaire, Section A, Question B8. and Developers Questionnaire, Question 10.
 - Investors and Developers Questionnaires, Question 3 and Surveyors Questionnaire, Question 1.
 - Investors and Developers Questionnaires, Question 4 and Surveyors Questionnaire, Question 2.
 - Surveyors Questionnaire, Question 3.
 - Investors and Developers Questionnaires, Question 5 and Surveyors Questionnaire, Question 4.
 - Investors and Developers Questionnaires, Question 6.

- 7 Towards a Conceptual Framework for a Model of the Commercial Property Market
 - Characteristics of the Commercial Property Market
 - MacLennan's Alternative Approach
 - A Possible Framework for the Economic Analysis of the Commercial Property Market
 - The Concept of Equilibrium
 - Housing Choice and Demand
 - The Process of Evaluation
 - The Search Process
 - The Bid-formation Process
 - Supply
 - The Supply of Existing Commercial Stock
 - The Supply of New Commercial Property

The Demand Assessment Phase
The Project Planning Phase
The Construction Phase
The Active Search Phase

Conclusions

Data Requirements, Collaboration and Resource Requirements

Critique of the Conceptual Framework for a Model of the Commercial
Property Market

How Further Research Might be Approached

CHAPTER ONE

AN INTRODUCTION TO A STUDY OF THE IMPACT OF WAIVER OF EXEMPTION ON THE ENGLISH COMMERCIAL PROPERTY MARKET -

AIMS AND OBJECTIVES

1.1.0 INTRODUCTION

This thesis is the outcome of a research project to study the impact of waiver of exemption on the English commercial property market. Towards this objective the research project has incorporated two inter-related areas of study:

- * To examine the effectiveness of waiver of exemption in mitigating the effects of the European Court (EC) judgement (case 416/85) (1) on the English commercial property market.

- * To assess the perceived effects of waiver of exemption on rents in the English commercial property market.

Waiver of exemption, more commonly known as the option to tax, was introduced into the UK tax structure as part of the Finance Act 1989. The UK Government were obliged (EC judgement case 416/85) to extend Value Added Tax (VAT) to commercial construction and the purchase of the freehold interest in new commercial property. The Government chose waiver of exemption to mitigate the

impact of this judgement on the commercial property market by enabling some taxpayers to recover what would otherwise have been irrecoverable VAT.

Only Moore and Lawrence (2) had conducted empirical work in this area prior to the commencement of this project. Thus the research project was original, action based and was intended to contribute to the furtherance of knowledge in this field.

This introductory chapter is intended to familiarise the reader with the research project and has the following objectives:

- * To introduce the subject matter.

- * To define the parameters of the research, its aims, relationships to current and previous studies, the methods employed and the nature of the discoveries made.

- * To describe the construction of the thesis with a brief chapter summary.

The chapter begins by considering the reasoning behind the decision to undertake a study of this subject.

1.2.0 BACKGROUND TO THE RESEARCH PROJECT

In 1990 with the exception of a survey of 151 property investors carried out by Moore and Lawrence (3) there had been no previous empirical study of waiver of exemption.

The observations of commentators at the time of its introduction were conflicting. Some questioned whether the option would be taken up:

“But we question whether this will be the case (invariably opt to tax), at least in the early years of the new regime while VAT on development land is not biting”. (4)

Others were certain that the option would be taken up by the majority:

“In the majority of cases, the best course will be to make the election”. (5)

But all were of the opinion that waiver of exemption would have an impact on the commercial property market:

“Quite simply values must fall because a substantial amount of tax is to be charged where none was paid before”. (6)

“In markets which are dominated by exempt tenants, it is conceivable that there would be a 13% (VAT @ 15%) drop in rental and capital value, if the option is exercised”. (7)

It was apparent that an opportunity existed to establish what had actually happened to the commercial property market as a result of the changes in VAT introduced in the Finance Act 1989, which included waiver of exemption.

The next section briefly explains the background to the introduction of waiver of exemption.

1.2.1 A SOURCE OF CONFLICT

It is the policy of the European Community that all Member States adopt a common VAT system, which is justified on the grounds of a need to harmonise tax bases to establish a common market.

At the time of the introduction of VAT into the United Kingdom (UK) in the Finance Act 1972 most UK property transactions were outside the scope of VAT. In 1981 the EC began to investigate the UK's zero rating provisions leading to infraction proceedings, EC judgement (case 416/85), alleging that the UK had failed to fulfil its obligations under the Treaty of Rome (Sixth Directive 17 May 1977).

Judgement was given (21 June 1988) which obliged the UK to limit the sub-category of zero rated supplies by removing it from business transactions, which are the sale of freehold interests in new commercial property or services of construction related to commercial property.

Her Majesty's Customs and Excise (HMCE) issued a consultation document (8) on 21 June 1988 with a view to amending legislation which was issued in draft on 6 February 1989 and enacted in Section 18, Schedule 3. Finance Act 1989 which became law following Royal Assent on 27 July 1989. The EC judgement (case 416/85) obliged the UK Government to impose VAT on commercial construction and the purchase of the freehold interest in new commercial property.

The UK Government saw this judgement as a challenge to national sovereignty in that European law was being extended into domestic taxation. The Government proposed to mitigate the effects of the judgement by minimising the extra burden of the tax. The method chosen was the introduction of a new schedule 6A into the Value Added Tax Act 1983 permitting the option to tax certain exempt supplies, referred to as 'waiver of exemption' from 1 August 1989.

1.2.2 THE NEED FOR EMPIRICAL STUDIES

The UK Government was bound to implement the terms of the EC judgement (case 416/85). Had that judgement been implemented in full, large amounts of extra tax would have been incurred on commercial construction and on the purchase of the freehold interest in new commercial property. This would have had a significant impact on commercial property investment and development.

The Government's answer was to introduce a mechanism which allowed taxpayers the option to recover that VAT. This mechanism was waiver of exemption.

“The estimated yield from the proposals that I have announced will be some £65 million for the initial year 1989-90, rising to a full year level of £160 million in 1991-92. This compares with a full year yield of £425 million that would accrue from the tax if the measures of mitigation which I have just announced were not introduced”. (9)

The Government's first problem was that some tax payers might not take up the option to tax which would reduce the effectiveness of their chosen method of mitigation. Their second problem was that certain categories of occupier would bear the full burden of the extra VAT. These occupiers referred to as part exempt/exempt could only recover part or no VAT.

These then were the main opportunities:

- * To analyse and assess the impact of waiver of exemption on the English commercial property market.
- * To analyse and evaluate original data concerning the state of the English commercial property market.
- * To make a contribution to knowledge.

1.3.0 RESEARCH METHOD AND CHAPTER SUMMARY

This research was designed to study the impact of waiver of exemption on the English commercial property market. The foundations for this work are:-

- * A critical review of existing literature in relevant areas.

- * An exploration of the impact of the Finance Act 1989 on the English commercial property market.

At the beginning of Chapter One it is acknowledged that there had been only one previous study of the option to tax carried out shortly after its introduction. There had been no subsequent assessment of market reactions. The analysis of empirical data was therefore essential to lay a firm foundation of knowledge.

Chapters Two and Three provide the historical background to the thesis. They trace with reference to existing literature, the development of VAT from post World War II co-operation in Europe, through its introduction into the UK and end by examining the implications of waiver of exemption for those involved with the English commercial property market.

Chapter Two examines the development of the European Community and Value Added Tax (VAT), its major system of indirect taxation for Member States. It considers the UK Government's reluctance to become involved in post-war

European co-operation and hence its ability to influence the development of the European Community's legislation, before gaining entry to the Community in 1973, a source of subsequent conflict.

The UK adopted VAT in 1972 and initially extended zero-rating (chargeable to VAT at zero per cent) to the construction of and grants of major interests in commercial buildings. But, as a result of the limits on the European Community's revenues which this caused, the European Commission began to investigate the UK's zero-rating policy which led to infraction proceedings (case 416/85). The subsequent judgement required the UK to remove from zero-rating the construction of buildings for non-domestic use.

The UK Government recognised the need to act quickly to avoid the damaging effects of the uncertainty and the extra tax which this judgement produced. The method chosen to mitigate its effects was the use of the 'landlords option' subsequently known as the option to tax.

After a period of consultation the Government brought forward its proposals to implement the EC judgement (case 416/85) as part of the Finance Bill 1989. The debate which followed, which is examined in Chapter Three, concentrates on the Government's economic record rather than the VAT changes proposed. The legislation this produced was characterised by numerous and late amendments, partly as a result of the Government's dilemma of having to implement the

Judgement whilst at the same time mitigating its effects. It required further amendment even after the Act became law on 1 April 1989.

The option to tax, which became effective from 1 August 1989, was introduced to allow taxpayers to recover input tax. Commentators around the time of the introduction of the Finance Act 1989 were under no misapprehension about the extensive impact which the changes in VAT treatment of non-domestic buildings would have on the English commercial property market not least in terms of the impact on rents. An appreciation of the English commercial property market can be obtained by reference to:

Enever, N., and Isaac, D., 1994. *The Valuation of Property Investments*, 5th Edition, *Estates Gazette*.

Millington, A.F., 1988, *An Introduction to Property Valuations*, 3rd Edition, *Estates Gazette*.

In Chapter Four research hypotheses are developed for the two parallel and inter-related areas of study. The literature search identified only one empirical study based on investors' intentions regarding the option to tax. This established:-

- no sign of a general rush to opt to tax; and,

- investors only intended to opt to tax where there was a clear financial advantage to do so.

This was a significant outcome because the Government relied on this mechanism to mitigate the effects of the EC judgement (case 416/85).

It is suggested in Chapter Four that the decision whether or not to elect to waive exemption might be linked to a cost benefit evaluation of the advantages and disadvantages associated with that decision. By establishing the factors which determine whether or not to opt to tax it might be possible to assess the effectiveness of waiver of exemption.

Fully taxable tenants can recover in full the VAT charged. Exempt tenants are unable to recover the VAT charged on rents and will bear the full burden of the tax. It is suggested in Chapter Four that economic price theory might provide an explanation of the impact of waiver of exemption, there will be a reduction in the disequilibrium rent paid by exempt/part exempt tenants to the equilibrium rent, post tax. There will also be a reduction in the quantity of commercial property offered to let.

Chapter Five examines the take-up of waiver of exemption and the absolute and relative importance of the factors which determine whether or no to opt to tax.

Following a pilot survey to test the methodology and method, data was collected by mail questionnaire from property owners, in-house surveyors and professional advisors.

The results are analysed based on descriptive statistics produced from aggregate data and comparisons made between group and area responses. The conclusions drawn from this analysis are that there has been a variable take-up of waiver of exemption with most respondents opting to tax between 1-20% of their properties. The recovery of input tax was identified as the key factor in the decision to opt to tax.

Chapter Six assesses the perceived effects of waiver of exemption on rents in the English commercial property market. Rather than develop a methodology which would allow a quantitative analysis of changes in rents, market opinions were tested directly.

Following a pilot survey to test methodology and method data was collected by mail questionnaire from occupiers, developers, investors and surveyors and this was used to examine the key issues where were:-

- (i) tax status
- (ii) how occupiers were dealing with any increase in occupational costs results from being charged VAT on rents; and.

(iii) changes in the amount of accommodation offered to let.

The results are examined based on descriptive statistics from aggregate data and comparison made between group/area responses. The following results were obtained:-

- * some part exempt/exempt tenants have sought to pay a lower rent on review when VAT has been charged on their rents.
- * some part exempt/exempt tenants are willing to pay a premium or more rent to secure an unelected building.
- * two tier markets have developed in some commercial centres.
- * part exempt/exempt tenants are adopting a variety of approaches to deal with the extra VAT including taking less floor space.
- * some exempt investors/developers have been discouraged from the development of new schemes.
- * some exempt investors/developers have moved from new development to refurbishment.

The substantive conclusions are considered in Chapter Seven. These results indicate that the introduction of waiver of exemption has had a significant impact on the English commercial property market. There has been a variable but predominantly low take-up of the option to tax. The recovery of input tax is the key factor in determining whether or not to elect to waive exemption. The effectiveness of waiver of exemption has been affected by lack of knowledge and attempts by some individuals/companies to develop leases which avoid the VAT legislation.

Rents have in some instances been adversely affected as a result of landlords opting to tax, with some exempt/part exempt tenants seeking to pay a lower rent on review. Two tier markets have developed in some commercial centers, with some part exempt/exempt tenants prepared to pay a premium or more rent to secure an unelected building.

The extension of VAT in the Finance Act 1989 has had other effects with some part exempt/exempt tenants accepting reduced profits, raising product prices and taking less space to offset irrecoverable VAT. Some exempt/part exempt investors and developers have reduced site bids, been discouraged from new development and moved to refurbishment as a result of the extension of VAT to non-domestic construction.

VAT is a significant and in some instances crucial factor in the development of new premises.

1. Court of Justice of the European Communities, Reports of Cases before the Court, 1988, part 3. Case 416/85 Commission of the European Community v United Kingdom of Great Britain & Northern Ireland. Office for official publications of the European Communities. p.3153.
2. Moore, J., and Lawrence, A., 14 October 1989. To elect or not to elect, Estates Gazette, pp 78 & 81.
3. Moore, J., and Lawrence, A., 14 October 1989. To elect or not to elect, Estates Gazette, pp 78 & 81.
4. Hedley, C., 2 July 1988. The effects of the European Court judgement, Estates Gazette, p.26.
5. Moore, J., and Lawrence, A., 14 October 1989. To elect or not to elect, Estates Gazette, p.81.
6. Coopers & Lybrand and Savills. European Harmonisation. VAT: property and construction.
7. Hedley, C., 18 February 1989. VAT on construction, Estates Gazette, p.24.

8. Soares, P.C., 1988. VAT Property planning after the EEC decision.
Appendix 3, Longman, 2nd Edn, p.101.

9. Parliamentary Debates (Hansard) 21 June 1988 Sixth Series Vol. 135
HMSO, p.969.

CHAPTER TWO

WAIVER OF EXEMPTION AND THE ENFORCEMENT OF EUROPEAN ECONOMIC COMMUNITY DIRECTIVES RELATING TO INDIRECT TAXATION

2.1.0 INTRODUCTION

This chapter considers the origins of waiver of exemption. It begins with a study of post-war co-operation in Europe, tracing the development of the European Economic Community and its major system of indirect taxation - Value Added Tax (VAT).

The second part of this chapter considers the UK Government's failure to comply with its obligations under the Treaty of Rome and its response to the requirement that VAT should be extended to non-domestic construction.

2.2.0 CO-OPERATION IN EUROPE

Forms of co-operation have existed throughout Europe for centuries. For example the Anglo-French Commercial Treaty of 1786, which was possibly the most important trade agreement of the eighteenth century, was an attempt to end the traditional rivalry between France and Britain. It was the pursuit of national self-interest which was seen by many as the cause of wars. But it was only the

devastation and waste of the two World Wars which led some people to believe that there was a better way to organise European affairs. Winston Churchill called for,

“...a kind of United States of Europe” (1)

The United States of America, in providing post-war Marshall Aid, strongly advised European States to remove the barriers that restricted trade between them and in 1947 the Organisation for European Economic Co-operation was established to help with co-ordination of post-war aid to Europe. Pressure to create a European Assembly from those who favoured a Federal Europe (an attempt to create a political union among separate states by dividing powers between a central authority and the members states) to provide political and economic co-operation led to the setting up of the Council of Europe in 1949 with an Assembly of European Parliaments and a Committee of Ministers. However the Council was only an advisory body.

This post-war co-operation in Europe was followed by a proposal from Robert Schuman (Prime Minister of France 1947-8 and Foreign Minister 1948 and 1952) which had been elaborated by Jean Monnet (former Assistant General of the League of Nations). The proposal was not initially aimed at integration of Europe but was to end the rivalry between France and Germany. The proposal had two objectives:

“...to place the entire French and German coal and steel industry under a common High Authority in an organisation open to other countries of Europe”, and, “to abolish tariffs which restricted the free exchange of coal and steel products”. (2)

On the whole Schuman's plan was attractive to France and West Germany and was well received by Italy and the Benelux countries (Holland, Belgium and Luxembourg). However the plan was rejected by the British, with the Prime Minister, Mr Attlee commenting that the Government could not accept:

“...the principle that the most vital economic forces of this country should be handed over to an authority that is utterly undemocratic and is responsible to nobody”.(3)

Negotiations were completed in 1951 and Italy, Holland, Belgium, Luxembourg, France and West Germany signed the Treaty of Paris, establishing the European Coal and Steel Community (ECSC) in July 1952. The ECSC set up five institutions to operate a common market in steel and coal products abolishing tariffs, quotas, subsidies, restrictive practices and price discrimination. These were, a High Authority established in Luxembourg on 10th February 1953, the Council of Ministers, the Consultative Committee, the Common Assembly and the Court of Justice.

Further attempts at co-operation were made in the early 1950's to set up a European Defence Community and a European Political Community but these failed.

To renew momentum towards closer unity the six countries which met in 1951 met again in Messina in June 1955 and declared their aim:

“...the development of a united Europe must be pursued by the development of common institutions, the progressive fusion of national economies, the creation of a common market and the progressive harmonisation of other social policies”. (4)

They set up an intergovernmental committee to examine and propose further strategies for greater integration. Paul Henri Spaak (the Belgian Foreign Minister) was appointed Committee Chairman and the Committee's report, in 1956 provided the basic framework for the Treaty of Rome. The Treaty created the European Economic Community, the European Atomic Energy Council and set up a permanent economic community.

It soon became clear that the UK's decision to remain outside the Community was questionable. The UK's attempts to play an independent world-wide role were becoming increasingly costly and of little benefit. In addition, between 1957-60 gross national product increased by 15% in the Community and only 10.8% in the UK. For the UK the dangers of staying outside the Community might outweigh the possible disadvantages of joining. However General de Gaule resisted the UK's applications to join in 1961 and again in 1967.

It was only with the retirement of de Gaule that European integration appeared to regain momentum. The UK finally gained entry to the European Community in 1973 following the signing of the Treaty of Accession on 22nd January 1972 albeit on disadvantageous terms since much of the existing European Community law and practice had been designed with the original Six in mind.

This has caused permanent friction between the European Communities and the UK which has become a feature of decision-making.

As the European Community moves towards an overall economic union one of the areas which needs harmonisation is taxation. The Treaty of Rome, whose aim is:

“...ever closer union of the European peoples”. (5)

contains specific provisions dealing with the harmonisation of legislation in certain areas. Article 99 of the Treaty deals with taxation in particular. It reads as follows:

“The Commission shall consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Members States, can be harmonised in the interest of the common market”.

(6)

Article 100 of the Treaty authorises the Council of Ministers (a body retained from the ECSC, which is the principal decision-making institution) to issue Directives, based on proposals of the European Commission, (a hybrid organisation with political and administrative tasks whose main functions include, upholding the European ideal, proposing new policy initiatives and ensuring existing policies are implemented) aimed at further harmonisation of domestic legal and administrative provision which have a direct impact on the formation and functioning of the Common Market. It states:

“The Council shall, acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the Common Market”. (7)

2.3.0 VALUE ADDED TAX (VAT)

VAT has existed in Europe since its introduction into France in 1954 as part of a major reform of tax legislation replacing the existing form of a turnover tax. The European Community adopted VAT as its major system of indirect taxation with the First and Second Directives dated 11 April 1967. The First Directive committed Member States to replace existing cumulative tax systems with a non-cumulative VAT system by 1 January 1972 (new Member States were required to introduce the new system on entry). The second Directive introduced some basic concepts, including, ‘taxable person’ (a person who is registered or is required to be registered for VAT purposes and makes or intends to make taxable supplies).

The next significant move towards harmonisation was the European Community’s Sixth Directive issued on 17 May 1977 which set out in considerable detail the way in which VAT was to be applied in member countries. Article 1 of the Sixth Directive states that:

“Member States shall modify their present value added tax systems in accordance with the following Articles”;

and,

“They shall adopt the necessary laws, regulations and administrative provisions so that the systems as modified enter into force at the earliest opportunity and by 1 January 1978 at the latest”. (8)

The Sixth Directive has been supplemented by further directives but the main objective of harmonisation has still not been achieved. The authority of the Sixth Directive is, however, being increasingly recognised by the courts and tribunals.

Sales taxes (i.e. a tax on sales) have been used for centuries by almost all countries world-wide. VAT was created as a refinement of the old sales tax system. Problems with the old system included: difficulties in quantification, easy evasion and an inflexible tax base. In contrast VAT is easily quantifiable, places little extra burden on the trader, has a wide coverage with few exceptions and allows the government to estimate its yield for economic planning purposes.

VAT is a general single stage tax on consumption which is collected fractionally along the whole chain of distribution from the point of first production or importation to the supply to the final consumer or to the point of exportation from the territory concerned.

Under the legislation the trader, known as ‘the taxable person’ has to account for the tax at specified rates on all outputs, effectively those sales which are liable to tax. However although the tax collected must be paid over to the authorities, a credit mechanism is available for the taxable person to recover tax which has been charged on the inputs (supplies) coming into the business (any economic activity

carried out on a sufficiently regular or continuous basis). These inputs are normally the purchases made by the business for operating.

Although VAT is charged only on the supplies made in the course or furtherance of a business, supplies of certain goods or services are exempt which means that although they are made in the course or furtherance of business they are outside the scope of VAT. Supplies are either taxable or exempt and taxable supplies are either standard-rated (carries VAT at 17.5%) or zero-rated (chargeable to VAT at zero percent). A common feature of a VAT system is for outputs to be taxed through commodity lists included in the legislation of the country concerned.

VAT in its basic form is a very simple tax. The costs which would be incurred in trying to avoid VAT more than outweigh any benefits which might be gained from avoidance. Since only the person engaged in business activities is allowed to reclaim the VAT on his expenses and to charge the tax it follows in theory that the tax is neutral so far as the business is concerned, its burden being borne by the consumer who cannot make any claim for the recovery of the tax. VAT is essentially therefore a tax on final consumption by the retail customer collected at each stage of purchase and sale.

VAT was adopted into the UK with the passing of the Finance Act 1972 which became law on the 27 July 1972. The tax came into operation on 1 April 1973 replacing the former purchase tax and selective employment tax. The legislation was subsequently consolidated in the Value Added Tax Act 1983.

The scheme of treatment of land transactions which was established survived with modifications until 1989. The modifications have for the most part been minor. The most important was undoubtedly the removal of zero-rating treatment for construction services on alterations with effect from 1 June 1984, together with further restrictions of zero-rating provision.

The broad VAT picture in relation to property transactions before 1989 was that most of them were either outside the scope of VAT, were not carried out by taxable persons in the course or furtherance of a business or were exempt if they were so carried out. Zero-rating extended to the construction of new buildings and to fitting them with fitted kitchens and space and water heating appliances and to grants of major interests in buildings and their supplies such as hotel accommodation, exhibition space, car parking and some letting of facilities for sport and physical recreation and reverse premiums but these were, generally speaking, of relatively marginal importance.

In enacting the provisions of the Sixth Directive into UK law the Government took the view that Article 28 ('Transitional Provisions'), would allow the UK to resist any erosion of the right to continue zero-rating supplies in subsequent years. In fact the UK's zero-rating extended to some 17 different categories of supply, including certain foodstuffs, books, fuel and power. The UK's zero-rating provisions as stated by the Judge-Rapporteur, Mr G.Bosco, in the European Court (case 416/85) which ensued quoting Commission studies:

“..covered some 35% of private consumption in the UK,.... Consequently, VAT coverage in the UK is limited to 44% of private consumption as compared with 90% in most other Member States”. (9)

It is because zero-rating has the effect of limiting the tax base for VAT and by inference Community revenues, that the European Council has been anxious to confine the ambit within which it can be imposed. However it should be stated that the UK's contribution to the European Community's central funding was not adversely affected by such extensive zero-rating as a result of the special formula agreed with the European Commission.

Article 28(2) of the Sixth Directive states:

“Reduced rates and exemptions with refund of the tax paid at the preceding stage which are in force on 31 December 1975, and which satisfy the conditions stated in the last indent of Article 17 of the Second Council Directive of 11 April 1967, may be maintained until a date which shall be fixed by the Council, acting unanimously on a proposal from the Commission, but which shall not be later than that on which the charging of tax on imports and the remission of tax on exports in trade between the Member States are abolished.

On the basis of a report from the Commission the Council shall review the above mentioned reduced rates and exemptions every five years and acting, unanimously on a proposal from the Commission shall where appropriate adopt the measures required to ensure the progressive abolition thereof.” (10)

Article 17 of the Second Directive states that Member States may:

“...provide for reduced rates or even exemptions with refund, if appropriate, of the tax paid at the preceding stage, where the total incidence of such measures does not exceed that of the reliefs applied under the present system. Such measures may only be taken for **clearly defined social reasons** and for the **benefit of the final consumer**, and may not remain in force after the abolition of the imposition of tax on importation and the remission of tax on exportation in trade between Member States”. (11)

The Directives of the Council of Ministers become the 'supreme' legislation to the extent that once a directive has been issued the legislation of each member country must be immediately amended or new laws created to bring in the minimum requirements.

Whereas VAT Regulations are binding in their entirety and directly applicable in the legal system of all Member States, the Directives are binding only as to their result. The form and method of compliance is left to individual Member States. The European Court of Justice is empowered to ensure that in the interpretation and application of the Treaty, the law is observed in each Member State. In this connection it is the ultimate court of appeal and its decisions are binding in their entirety with specific reference to a Member State, commercial enterprise or private individual.

2.4.0 VAT ZERO-RATING PROVISION IN THE UK AND THE COMMISSION

In 1981 the Commission began investigating the UK's zero-rating provisions. There was an exchange of correspondence between the European Commission and HMCE in which the Commission suggested that the UK's use of zero-rating was too extensive. HMCE maintained that all the UK zero-rated items were covered by Article 28 of the Sixth Directive. Not satisfied with such a response, the Commission then issued a 'reasoned opinion' against the UK Government and requested the latter to respond formally. The specific items challenged were:

- (a) the construction and sale of private housing (but not local authority housing);
- (b) animal feed stuffs, seeds and live animals yielding food for human consumption;
- (c) construction of buildings for industrial and commercial use and in the community and in civil engineering sectors;
- (d) fuel and power other than to final consumers;
- (e) sewerage services and water supplied to industry;
- (f) news services other than to final consumers; and,
- (g) protective boots and helmets supplied to employers for the use of their employees.

The UK Government responded with a vigorous defence for the continued zero-rating of the above items in an attempt to satisfy the European Commission. However, the Commission then took the step of commencing formal infraction proceedings in the European Court of Justice, case 416/85, under Article 169 of the first Treaty of Rome, alleging that the UK failed to fulfil its obligations under the Treaty particularly under the Sixth Directive.

Formal hearing of the case took place in Luxembourg before the judges of the European Court of Justice on 15 September 1987. Following the formal hearing in accordance with normal procedure, the Advocate General (AG) gave a written opinion on the case on 2 December 1987. The AG's opinion is important in that it provides a written form of advice to the full Court of Judges and is normally upheld. Thus although the formal judgement was not given until 21 June 1988 it was possible to anticipate the outcome following the AG's opinion. Both the AG, and the Court looked closely at the phrases 'for clearly defined social reasons' and 'for the benefit of the final consumer'. In the AG's opinion both had to be read together and therefore in considering each item both had to be satisfied for the zero-rating to be lawful.

In considering 'clearly defined social reasons' the AG suggested that the Court should declare zero-rating contrary to Community Law only where its objective was clearly unrelated to the satisfaction of fundamental needs. This is clearly a controversial area since whilst the application of zero-rating could result in a reduction of the tax burden on the least well-off in society, it could also be used by Member States to satisfy the needs of a great majority of the population e.g. zero-rating of animal food in the UK. The European Court held that the Commission has a role in keeping social policies under review to ensure that the consequent zero-rating is restricted to what is justified by the social policies concerned.

The Commission regarded a 'final consumer' as:

“...those persons who stand at the final stage in the manufacturing and commercial chain and have no right to deduct VAT, that is to say non-taxable persons.” (12)

In this way a distinction is drawn between the case of a retailer who buys stock for his shop and the customer who buys an article from the retailer for his personal use.

The retailer is not the final consumer since he can recover the input tax. However, the consumer is the final customer since he cannot.

In considering the phrase, ‘for the benefit of the final consumer’ it was held that a supply would be for the benefit of the final consumer if it is made to him or if it is made,

“...at a stage higher in the production or distribution chain which is nevertheless sufficiently close to the (final) consumer to be of advantage to him.....” (13)

The AG thought that a degree of caution was necessary in considering the notion of ‘benefit’ to the final consumer in view of the complexity which certain circumstances could produce. However if this was likely to be of benefit for the final consumer the Court should not reject the application of zero-rating to inputs which are directly and exclusively used in the product which is itself zero-rated, (this led to the eventual acceptance by the Court of the UK’s application of zero-rating to animal feedstuffs).

Using this analysis the AG and then the Court considered each item in turn explaining their reasons for accepting or dismissing zero-rating in each case.

The AG recognised that construction, extending to the housing sector, industrial and commercial buildings, community and civil engineering sectors was the most significant area under question. The UK argued that it was difficult to distinguish between local authority housing, which clearly justified zero-rating from other housing, since housing now occupied by the most underprivileged in society was in many cases provided by the private sector as a result of recent social measures taken to encourage home ownership. The AG contended that such a wide view was unacceptable. The Court could not uphold the UK's contention that the zero-rating of these sectors encouraged renewal of infrastructure and buildings. The contention was unacceptable because if these were to benefit the final consumer then to treat the whole population as the final consumer was not compatible with the distinctions made above.

The European Court in giving its decision also accepted the UK's argument that zero-rating was lawful in respect of animal feed stuffs, seeds and live animals yielding food for human consumption. However it ruled that the zero-rating of the remaining items under challenge did not comply with Article 28 of the Sixth Directive and that the UK had failed to fulfil its obligations under the Treaty of Rome.

2.5.0 THE RESPONSE OF THE UK GOVERNMENT

The Government appreciated the need to react quickly to the decision and on the afternoon of the Court's judgement, the Economic Secretary to the Treasury, Mr Peter Lilley made the following comments to Parliament:

“The Government will study carefully the detailed terms of the court's judgement, against which there is no right of appeal and with which it is obliged to comply. The Government will consult interested parties, including trade and professional bodies and also charities, on how the judgement can best be applied in practice. Legislation to implement the judgement will then be brought before the House for approval as part of next year's Budget. I can give the House an assurance that no changes will take effect before 1 April 1989.” (14)

He went on to say:

“In the meantime, I am concerned to avoid the damaging effects of a period of uncertainty for the construction industry and its customers, and to mitigate the effects of the extension of Value Added Tax to non-domestic construction. (15)

On the same day (21 June 88) a HMCE consultation document was released in which comments and representations on certain aspects of the proposed changes were invited. This contained certain 'key decisions':

- (a) Non-domestic construction services and the freehold sale of new non-domestic buildings and of land for non-domestic developments were to be taxed at the standard rate.

(b) The change from zero-rating to standard-rating was to apply from 1 April 1989. The normal transitional rules for bringing in a VAT change were to apply. But in addition, because of the long-term nature of many building contracts, there was exceptionally to be a relief for contracts entered into before 21 June 1988. Zero-rating was thus to continue for these qualifying contracts even if the supplier concerned would normally have tax points on or after 1 April 1989.

(c) In order to mitigate the effect on the construction and property industries, a provision permitted by Article 13C of the Sixth Directive, known as the 'landlords' option', was to be introduced. There follows an extract from the HMCE Consultation Paper issued on 21 June 1988 relating to the option to tax:

"With effect from 1 August 1989 any person making a supply in respect of any non-domestic building, or of any developed land (other than building land) used for a non-domestic purpose, which would be an exempt supply under item 1 of Group 1, Schedule 6, will be able to opt to convert that supply, and all his future supplies in respect of that particular building or land, into a taxable supply. The main features of the scheme will be:

- (i) The option is entirely at the discretion of the supplier: he will not be obliged to consult the recipient before deciding whether to opt although he may choose to do so in practice.
- (ii) The option applies to both new and existing buildings and must be exercised on a building by building basis. Once exercised, it cannot be varied for future supplies (letting or sale).

- (iii) Landlords will have to send Customs and Excise a list of the buildings for which they are opting except where the only supplies eligible for option treatment in respect of a particular building are licences to occupy as opposed to leases/tenancies.
- (iv) A landlord will not be able to opt to tax a lease/tenancy/licence to occupy any part of a building which is to be used as a dwelling; any supply related to a dwelling must remain an exempt supply (or in appropriate cases, under Group 8/8A, a zero-rated supply).
- (v) In respect of existing buildings, landlords will have to charge value added tax as if the consideration for each supply under the option was one half of the rent due for the period 1 August 1989 to 31 July 1990. Tax will become chargeable on the basis of the full rent due for periods from 1 August 1990 onwards. For charities the phasing-in will be over a five year period, starting on 1 August 1989, with the appropriate adjustments being made to the proportions of rent chargeable with value added tax. For new buildings unoccupied by tenants or licensees at 1 August 1989, tax will become chargeable on the basis of the full rent due from the commencement of the lease or licence.
- (vi) A landlord who opts for taxation from 1 August 1989 will be able, in respect of lettings which up until 31 March 1989 were zero-rated under item 1 of Group 8/8A, to disregard for partial exemption purposes the four months from April to July 1989 in which the rents become exempt. In addition a landlord who has opted for any building or land and who has to apply the transitional relief described in (v) will be able to treat the input tax incurred in respect of that building or land for the years concerned as fully deductible subject to the normal rules." (16)

2.6.0 SUMMARY AND CONCLUSIONS

The purpose of this chapter has been to trace the origin of waiver of exemption. This began with a study of the need for closer post-war co-operation in Europe. The UK Government's initial reluctance to become involved in post-war co-operation in Europe led to the United Kingdom's exclusion from it until 1973 with the disadvantageous result that European law and practice was designed for the original Six.

This source of conflict led to infraction proceedings - case 416/85 which held that the UK Government had failed to fulfil its obligations under the Treaty of Rome.

The UK Government which was obliged to comply with this EC judgement (case 416/85) was determined to mitigate the effects of its extension of VAT into non-domestic construction. The chosen method was a provision permitted by Article 13C of the Sixth Directive known as the 'landlord's option'. The development of this option, referred to in subsequent legislation as an election to waive exemption, will be considered in the next chapter.

1. Arbuthnott, H., and Edwards, G. 1979. A Common Man's Guide to the Common Market, Macmillan, 2nd edn. p. 1.
2. Henderson, W., 1962. The Genesis of the Common Market, Frank Case & Co. Ltd. p. 139
3. Henderson, W., 1962. The Genesis of the Common Market, Frank Case & Co. Ltd. p. 141.
4. Henderson, W., 1962. The Genesis of the Common Market, Frank Case & Co. Ltd. p. 158.
5. Arbuthnott, H., & Edwards, G. 1979. A Common Man's Guide to the Common Market, Macmillan, 2nd Edn. p. 6.
6. Treaties Establishing the European Communities. 1973. Office for official publications of the European Communities p. 254.
7. Treaties Establishing the European Communities. 1973. Office for official publications of the European Communities. p. 255.
8. Official Journal of the European Communities Vol. 20 No. L 145. 13 June 1977. Office for official publications of the European Communities. p. 2.

9. Court of Justice of European Communities Report of Cases before the Court 1988 Part 3 Case 416/85 Commission of the European Community v United Kingdom of Great Britain and Northern Ireland. Office for official publications of the European Communities. p.3129.
10. Official Journal of the European Communities Vol. 20 No. L 145. 13 June 1977. Office for official publications of the European Communities. p. 20.
11. Official Journal of the European Communities Special Edition 1967. Article 28(2) Council Directive 77/388/EEC. 17 May 1977. Office for official publications of the European Communities. p. 20
12. Court of Justice of the European Communities Reports of Cases before the Court 1988 part 3 Case 416/85 Commission of the European Community v United Kingdom of Great Britain & Northern Ireland. Office for official publications of the European Communities. p. 3153.
13. Court of Justice of the European Communities Reports of Cases before the Court 1988 part 3 Case 416/85 Commission of the European Community v United Kingdom of Great Britain & Northern Ireland. Office for official publications of the European Communities. p. 3153.
14. Parliamentary Debates (Hansard) 21 June 1988 Sixth Series Vol. 135. HMSO. p.969.

15. Parliamentary Debates (Hansard) 21 June 1988 Sixth series Vol. 135.
HMSO. p.969.

16. Soares, P. C. 1988 VAT Property planning after the EEC decision.
Appendix 3. Longman 2nd Edn. p. 101.

CHAPTER THREE

THE FINANCE ACT 1989 - DEVELOPMENT.

APPLICATION, AMENDMENTS AND POST

LEGISLATIVE COMMENTARY

3.1.0 INTRODUCTION

A study of the development of the VAT changes in the treatment of land and buildings in the UK following EC judgement (case 416/85) is fundamental to an understanding of the impact which these changes have had on the commercial property market.

The purpose of this chapter will be to consider that development, to provide a rigorous explanation of the enacted legislation and to examine the potential effect of these changes on the English commercial property market.

An explanation of the transitional provisions introduced by the Government to mitigate the impact of and subsequent amendments to the Finance Act 1989 is also included in this chapter because of their potential impact on this research.

3.2.0 THE FINANCE BILL DEBATE

Chapter Two concluded with the Government's decision to consult widely before introducing legislation to implement the EC judgement (case 416/85). The Government's proposals for reform were brought before the House of Commons on 20 March 1989 as part of the Finance Bill 1989 (the relevant extracts are reproduced in Appendix 2). This Bill was an extensive document with some 250 pages and the debate which followed at Second Reading on 25 April 1989 centred on those clauses which reflected the Government's economic record rather than those relating to the proposed changes in VAT. Some MP's expressed concern:

“This is a mammoth Finance Bill with 250 pages..... We must consider carefully whether it will be possible for any Standing Committee to give the Bill the attention it needs if our financial legislation is to be properly scrutinised.” (1)

After Second Reading, the Bill then passed to Select Committee - Standing Committee G. Here Schedule 3 of the Bill, which contained the proposed changes in VAT, finally received some reasoned debate. Maas summarises the standard of the debate thus:

“Readers can draw their own conclusions as to how thorough the scrutiny has been from the fact that the committee devoted 5½ hours to consideration of these provisions (relating to VAT), 1 hr 40 mins to the three pages on residential development and non-business charitable development, 50 mins to the nine lines on caravan pitches, and 3 hrs to the remaining 11⁴/₅ pages on land and commercial buildings - an average of about 15 mins per page.” (2)

Commentators who provided an explanation of the proposed legislation focused on two areas which were considered to be the most controversial and likely to have the most impact. These were, the option to tax and the attempts to charge VAT on non-domestic building land.

This section begins with an explanation of the proposed legislation introducing waiver of exemption and highlighting some of its more controversial features.

The second part of this section considers the Government's attempts to charge VAT on non-domestic building land including the numerous amendments made to this part of the draft legislation as it passed through the House of Commons and ends with a discussion of the legislation as finally enacted.

3.2.1 THE ELECTION TO WAIVE EXEMPTION

The election to waive exemption has its origins in Article 13C of the Sixth Directive (3). This article enables Member States to allow their taxpayers a right of option to tax the letting and leasing of immovable property and certain other specific transactions where they would otherwise be exempt. It also allows the Member State to restrict the scope of the option and to fix details of its use.

The option to tax has been used by other Member States for a number of years, each adopting a different set of rules. The UK Government when introducing the option chose its own rules based on the experiences of other Member States and the

results of the process of consultation set up immediately following the EC judgement (case 416/85).

The proposed legislation is contained in paragraphs 2,3 & 4 of the Finance Bill 1989 reproduced in Appendix 2.

The effect of waiver of exemption is to allow taxpayers the ability to make taxable what would otherwise be exempt supplies of interests in land. For example under the proposed legislation if an institution bought the freehold interest in a new commercial property VAT would be payable on the purchase price. If the purchaser were to let the building the VAT paid would be irrecoverable because such a letting involves the making of a supply which doesn't incur VAT. If this institution chose to elect to waive exemption it would be able to recover the VAT paid on the purchase price because it would be able to attribute its input tax to the making by it of a taxable supply. The effect of waiver of exemption is to pass the VAT burden down the line to the ultimate occupier of the premises.

So long as the building is occupied for the purpose of a fully taxable business the occupier will be able to recover the VAT charged on rents and most taxpayers will be unaffected by waiver of exemption. It is only where an occupier does not use the premises only for taxable purposes that a detrimental effect may occur. Such exempt/part exempt occupiers include banks, building societies and insurance companies whose businesses are involved in the making of exempt supplies.

Exempt occupiers are unable to recover VAT charged on rent and will bear the full burden of the tax.

Waiver of exemption was introduced by the Government to enable VAT incurred in respect of the property concerned to be recovered. For example a person who constructs a commercial building may elect to waive exemption and in doing so, provided all the requirements of the proposed legislation are satisfied, will be able to recover the VAT incurred on the construction costs of that building.

3.2.1.1 The Extent of Waiver of Exemption

Sub-paragraphs 2(2) and 3(2) Finance Bill 1989 define those buildings which may be subject to an election to waive exemption.

Paragraph 3(2) of Finance Bill 1989 provided that an election to waive exemption could be made in relation to any building or land:

“3.-(2)An election under paragraph 2 above may be made in relation to -

- (a) any building (or planned building) specified, or of a description specified, in the election, other than one on agricultural land;
- (b) all agricultural land (including the buildings on such land) in which the person making the election has (or after the election obtains) an interest, over which he has (or obtains) a right or which he has (or obtains) a licence to occupy, or
- (c) any land (not being land on which a building has been or is being constructed or agricultural land) specified, or of a description specified in the election.”

But the grant of an interest in land cannot be made taxable if it is in relation to:

- “2.-(2) (a) a building or part of a building intended for use as a dwelling or number of dwellings or solely for a relevant residential purpose; or
- (b) a building or part of a building intended for use solely for a relevant charitable purpose, other than as an office.”

The taxpayer’s apparent freedom to chose any non-domestic/charitable building or land on which to elect to waive exemption is further limited by the Bill:

“3.-(2)..... and for the purposes of paragraph (a) of this sub-paragraph buildings linked internally or by a covered walkway, and parades, precincts and complexes divided into separate units, shall be taken to be a single building (if they otherwise would not be).”

HMCE’s attempt to minimise the number of separate properties in respect of which an election was deliberate. For example there would be difficulties in apportioning the costs of services such as car parking and landscaping between the tenants of a multi-tenanted office block if the landlord elected to waive exemption for some but not all tenants. But commentators suggested that there would be problems with this provision,

“This is a provision of enormous breadth and therefore uncertainty.” (4)

Parades, precincts and complexes are not defined by the legislation and as such are open to differing interpretations. The impact of this sub-paragraph is to ensure that large complexes such as the Barbican would be treated as a single building for the purposes of making an election. The difficulty which this sub-paragraph introduces

is that in exercising the option on a small kiosk forming part of a much larger complex the whole complex becomes subject to the election.

The Royal Institution of Chartered Surveyors (RICS) in their briefing note to Standing Committee G found:

“..the attempt to define shopping parades, buildings linked by walkways and other groups of buildings as single buildings both illogical and contrary to market practice.” (5)

Paragraph 3(2) was the subject of limited debate in Standing Committee where the opposition put forward an amendment that the linkage should be at the discretion of the owner. This amendment was not accepted. The Secretary of State, Mr Peter Lilley, commented that this was necessary to avoid issues of complexity (6).

3.2.1.2 The Making of an Election to Waive Exemption

The proposed legislation contained no rules as to the form of making an election to waive exemption. But, sub-paragraph 3(1) of the Finance Bill 1989 provided that:

“3.-(1) An election under paragraph 2 shall have effect -

- (a) from the beginning of the day on which the election is made or of any later day specified in the election; or
- (b) where the election is made before 1 November 1989, from the beginning of 1 August 1989 or any later day so specified.”

Sub-paragraph 3(4) of the Finance Bill 1989 provided for the period of notice which HMCE require:

“3.-(4)Except where the Commissioners otherwise allow, a notification required under sub-paragraph (3) above shall be given not later than the period of thirty days beginning with the day on which the election is made.”

The notice will not be effective unless it is given in a written form which HMCE prescribe (sub-para.3(3) Finance Bill 1989). This is set out in VAT Notice 742 paragraph 51:

“51. You must give written notice of your option to tax to your local VAT office not later than 10 (subsequently amended to 30) days after you exercise it. If you are not already registered for VAT, but will become registerable by exercising the option to tax, you must include your written notice with your application for registration. You need not, however, give written notice where you opt to tax and the total consideration for which you have opted is expected to be less than £20,000 in the next 12 months.” (7)

3.2.1.3 The Consequences of Making an Election to Waive Exemption

This section considers some of the more controversial aspects of waiver of exemption specifically highlighted by commentators.

Paragraph 3(3) of the Finance Bill 1989 provides that once made an election to waive exemption is irrevocable:

“3.-(3)An election under paragraph 2 above shall be irrevocable

This has the effect that once made any subsequent supply by the person making the election as regards the land and buildings concerned will be a taxable supply. For example if a building is let, VAT will be charged on rents and any subsequent sale of the landlord's interest.

The issue of irrevocability was discussed in Standing Committee G (8), but only in the context of buildings of architectural merit. The opposition were concerned that this might lead to an increase in the total demolition of buildings of architectural merit. Their amendment was subsequently withdrawn. The debate failed to consider such important issues as the impact of irrevocability on future exempt/part exempt purchasers or tenants who would have to bear the burden of the tax.

An election to waive exemption can be made at any time but in making an election, landlords do not need to obtain their tenant's consent. Soares considered the ability given to one taxpayer to impose a tax on another,

“...hardly to the credit of the Government....” (9)

Those debating the proposed legislation in Standing Committee G shared Soare's concern. But Mr Peter Lilley responding for the Government rejected the opposition's claims for a tenant's veto. He indicated that this:

“...could create great complexities, the opportunity for fraud and greater problems of enforcing compliance.” (10)

An election to waive exemption is personal to the individual or company (within the same VAT group) making the election. It has no effect on the position of any other person, e.g. a multi-occupied building with freeholder, headlessee and tenants. An election by the freehold owner will not mean that the headlessee will be regarded as having made an election. In practice such an action by the freeholder may necessitate their headlessee making an election to waive exemption to recover the VAT charged on rent.

Once made all subsequent supplies by the person who elected to waive exemption in respect of the land and building concerned will be taxable at the standard rate. For example, the freehold sale of a building over three years old will be taxable if the owner has elected to waive exemption. Such an election is exercisable on a building by building basis. It would be impractical for one option to include every property in the landlord's portfolio.

The option to tax may apply to both new and existing leases. Whilst it would have been entirely possible for the Government to allow the option on leases post 1 April 1989 this would have reduced the mitigating effects of the proposed legislation.

Having completed a consideration of the consequences of making an election to waive exemption the following section looks at the controversial proposals for building land introduced in the Finance Bill 1989.

3.2.2 THE GOVERNMENT'S PROPOSALS TO CHARGE VAT ON BUILDING LAND

The HMCE consultation document released on 21 June 88 (11) proposed that the freehold sale of building land other than land sold with planning permission wholly for residential development would be removed from exemption and be made liable to VAT at the standard rate.

Articles 4.3(b) (12) and 13B(h) (13) of the Sixth Directive require that a supply of building land is taxed. The UK had taken advantage of Article 28.3(b) (14) and Annexe F, item 16 (15) of the Sixth Directive, a transitional derogation whereby building land could be exempted.

Mr P Lilley, Economic Secretary to the Treasury, explained the Government's reasoning behind charging VAT on building land thus:

“Exemption made sense when new buildings were zero rated, but once we had been required by the European Court to tax new, non-domestic buildings it would not have been sensible to continue with the building land exemption for this category of building. This is because retaining an exemption for the largest cost element - or second largest after labour - in the overall cost of a new building would have introduced a gross distortion in the market place. It would have introduced a massive fiscal incentive in favour of self-developments and against buying from a developer or renting from a landlord. When a building is bought or leased, the price or rent paid reflects the open market value of the building including the land on which it stands. People buying or renting accommodation would be paying VAT on the full price or rent charged. By contrast, if they could go out and acquire the land for their new accommodation before a brick had been laid upon it, they would pay no VAT on the land and thus bear VAT only on the cost of construction.” (16)

The Government hoped that it would be possible to arrive at a satisfactory definition of building land and HMCE invited comments on the most appropriate definition in their consultation document (17). The RICS in a briefing note for Standing Committee G of the House of Commons who were considering the Finance Bill 1989 considered the proposed definition of building land to be:

“..a matter of particular concern.” (18)

The RICS criticised the proposal both in terms of principle and practice. They considered that the proposed tax was effectively a tax on betterment and they found the concept of charging VAT where no money might be passing:

“..very unsatisfactory.” (19)

The RICS also felt that there would be valuation and workload problems if the new tax were to be administered by the Valuation Office.

The comments of the RICS and others led the Government to realise that their initial proposals would prove unworkable. Peter Lilley alluded to some of the other problems during the Standing Committee debate:

“Originally at the time of the European Court judgement last June when the consultation paper was issued, we hoped it would be possible to arrive at a satisfactory definition of building land, bearing in mind in particular that we did not want to apply VAT to what became land for housing. However, the longer the consultation exercise progressed, the more we became convinced that taxing the actual sales of building land, however defined was not the answer. On the one hand, if land assumed the status of building land only after planning permission was obtained, land acquired before planning

permission would escape VAT. We would, indeed, be introducing a fiscal incentive to get land for development before obtaining planning permission. Thus the distortion in favour of self-development would still be there. The same thing would happen when buildings were obtained with a view to demolition or redevelopment. At the time the buildings were acquired, the vendor would not know for certain whether redevelopment would be permitted and he could not be said to be making a supply of building land. A similar problem would arise in respect of building land for housing which we want to remain exempt. How would a vendor know whether land he was going to sell was going to be used for offices or other commercial buildings, or for houses, or for a mixture of the two?" (20)

The Government had become convinced that taxing actual sales of building land was not the way to proceed. Therefore the Government devised a scheme which applied VAT at the time construction commenced on a self supply basis. This scheme is examined in the following section.

3.2.2.1 The Self Supply of Building Land Proposal (not enacted)

The scheme which was devised to overcome the difficulties arising out of the proposal to tax the actual sales of building land can be found in paragraphs 5, 6 and 7, Schedule 6A Finance Bill 1989. (21)

The revised proposal was that VAT should be applied at the time construction commenced. It was agreed that at this stage it would be beyond all doubt that the land was building land and the nature of the building (residential or commercial) could be identified.

VAT charged on land occupied before 1 April 89 was to be based on the historic cost value of the land. VAT charged on land acquired after 1 April 89 was to be based on the open market value of the land when brought into development.

The scheme as proposed required approval for a derogation from the EC Sixth Directive. It became clear as time went on that this would not be forthcoming because the proposal departed too far from the general tax structure provided for in the Sixth Directive. As a result the Government was forced to make yet further changes to their proposals which are examined in the following section.

3.2.2.2 The Self Supply of Finished Buildings Proposal (not enacted)

The Government abandoned its building land proposals on 18 May 1989 at the Standing Committee Stage of the Finance Bill 1989 and replaced it with a scheme which was supposed to focus on effective taxation of all non-domestic buildings at the time they are ready to be supplied for the first time.

Maas describes these new proposals as:

“...a somewhat nastier provision.” (22)

Johnson describes them as:

“...more penal than those on building land.” (23)

The amended scheme provided that, for new construction, VAT was to be assessed at the standard rate on the deemed self supply of buildings, except:

- (i) where construction commenced before 1 August 1989;
- (ii) in the case of 'new' buildings, where a taxable supply of the freehold had been made before the date of the deemed self-supply; or
- (iii) where the value of the supply would be less than £100,000.

Tax was to become payable on the first occasion during the period of ten years beginning with the completion of the building on which the developer:

- (i) granted an exempt interest in the building; or
- (ii) occupied the building when either he, or in the case of a VAT group, the representative member, was not a fully taxable person.

A 'developer' is anyone who constructs the building, orders, or finances its construction.

The amount of the deemed self-supply was to be the open market value of the freehold on the day on which the building was first ready for occupation or use.

The building was to be treated as ready for occupation or use if at least 90% of it was so ready (24).

VAT was also to be assessed at the standard rate on the deemed self-supply of reconstructions, enlargements and extensions to existing buildings where the total floor area was increased by at least 10%. However, tax was not to be charged where the developer had held an interest in the land on which the whole of the reconstructed building stood during the ten years ending on the day on which the reconstructed building was first ready for occupation.

The amount on which there was to be a deemed self-supply was to be the difference between the open market value of the freehold of the reconstructed building, and what would have been the open market value of the existing buildings on the day the reconstructed building was first ready for occupation.

Maas suggests that the amended proposals:

“...will effectively force developers to exercise the option to tax even where the purchaser/tenant is a VAT exempt trader.” (25)

This is because the amended proposals tax the fully developed value of the building when developed, effectively closing an earlier loophole which allowed the avoidance of VAT on the developer's profit element by granting a long lease at a premium.

The Government indicated that the new scheme would be less complicated and less uncertain. The new proposal would mean that the developer would not have to make a premature election to tax rents if he planned to let the building, or a declaration at the beginning of construction regarding selling the building as a standard rated building. Also, the developer would not have to fund VAT on the building land element from the beginning of construction, a major cash-flow advantage. But Buckett commented that:

“The amended scheme drew instant and widespread criticism from many in the financial, property and charity sectors.” (26)

The proposals allowed developers little time to amend their development appraisals, because they were announced less than three months before their intended start date. Some had already made prepayments to avoid tax on later developments on the basis of the earlier scheme which would be frustrated by the changes.

The new scheme, which would give rise to a much higher VAT charge, was seen by many as opportunistic and unacceptable. No other Community countries applied a similar basis of valuation to that which was proposed. The VAT Practitioners' Group and others indicated that parts of the proposed legislation were contrary to European legislation. (27).

3.2.2.3

Self Supply on Developers (enacted)

Faced with such widespread criticism the Government tabled further amendments to the self supply provisions on 6 July 1989 at the Report Stage of the Finance Bill 1989. These were enacted in paragraphs 5 & 6 of Schedule 6A to the Value Added Tax Act 1983 (as amended by paragraph 6 of Schedule 3 to Finance Act 1989) which are reproduced below:

“5.-(1) Paragraph 6 below shall apply on the first occasion during the period beginning with the day when the construction of a building or work within sub-paragraph (2) below is first planned and ending ten years after the completion of the building or work on which a person who is a developer in relation to the building or work-

- (a) grants an interest in, right over or licence to occupy the building or work (or any part of it) which is an exempt supply; or
- (b) is in occupation of the building, or uses the work, (or any part of it) when not a fully taxable person (or, if a person treated under section 29 of this Act as a member of a group, when the representative member is not a fully taxable person).

(2) Subject to sub-paragraph (3) below, the buildings and works within this sub-paragraph are-

- (a) any building neither designed as a dwelling or number of dwellings nor intended for use solely for a relevant residential purpose or a relevant charitable purpose; and
- (b) any civil engineering work, other than a work necessary for the development of a permanent park for residential caravans.

(3) A building or work is not within sub-paragraph (2) above if -

- (a) construction of it was commenced before 1 August 1989; or
- (b) a grant of the fee simple in it falls within paragraph (a) (ii) or (iv) of item 1 of Group 1 of Schedule 6 to this Act has been made before the occasion concerned.

(4) For the purposes of this paragraph a taxable person is, in relation to any building or work, a fully taxable person throughout a prescribed account period if -

- (a) at the end of that period he is entitled to credit for input tax on all supplies to, importations by, him in the period (apart from any on which input tax is excluded from credit by virtue of section 14 (10) of this Act); or
- (b) the building or work is not used by him at any time during the period in, or in connection with, making any exempt supplies of goods or services.

(5) Subject to sub-paragraph (6) below, in this paragraph and paragraph 6 below, developer, in relation to a building or work, means any person who-

- (a) constructs it;
- (b) orders it to be constructed; or
- (c) finances its construction, with a view to granting an interest in, right over or licence to occupy it (or any part of it) or to occupying it or using it (or any part of it) for his own purposes.

(6) Where -

- (a) a body corporate treated under section 29 of this Act as a member of a group is a developer in relation to a building or work; and
- (b) it grants an interest in, right over or licence to occupy the building or work (or any part of it) to another corporate which is treated under that section as a member of the group, then, for the purposes of this paragraph and paragraph 6 below, as from the time of the grant any body corporate such as is mentioned in sub-paragraph (7) below shall be treated as also being a developer in relation to the building or work.

(7) The bodies corporate referred to in sub-paragraph (6) above are any which under section 29 of this Act-

- (a) was treated as a member of the same group as the body corporate making the grant at the time of the grant;

- (b) has been so treated at any time when the body corporate by which the grant was made had an interest in, right over or licence to occupy the building or work (or any part of it); or
- (c) has been treated as a member of the same group as a body corporate within paragraph (a) or (b) above or this paragraph at a time when that body corporate had an interest in, right over or licence to occupy the building or work (or any part of it).

6.-(1) Where this paragraph applies the interest in, right over or licence to occupy the building or work (or any part of it) held by the developer shall be treated for the purposes of this Act as supplied to the developer for the purpose of a business carried on by him and supplied by him in the course or furtherance of the business on the last day of the prescribed accounting period during which it applies, or, if later, of the prescribed accounting period during which the building or work becomes substantially ready for occupation or use.

(2) The supply treated as made by sub-paragraph (1) above shall be taken to be a taxable supply and the value of the supply shall be the aggregate of -

- (a) the value of grants relating to the land on which the building or work is constructed, made or to be made to the developer, other than any grants to be made for consideration in the form of rent the value of which cannot be ascertained by the developer when the supply is treated as made; and
- (b) the value of all the taxable supplies of goods and services, other than any that are zero-rated, made or to be made, for or in connection with the construction of the building or work.

(3) Where the value of supply which, apart from this sub-paragraph, would be treated as made by sub-paragraph (1) above would be less than £100,000, no supply shall be treated as made by that sub-paragraph.”

The main features of the self supply provisions are as follows:

VAT is assessable at the standard rate on a deemed self-supply, except:

- (i) where construction commenced before 1 August 1989;

- (ii) in the case of 'new' buildings, where a taxable supply of the freehold had been made before the date of the deemed self-supply;
- (iii) where the building or work is not used by the developer, for a period commencing with first planning and ending ten years after completion, in making exempt supplies;
- (iv) where the building is designed as a dwelling or intended solely for a relevant residential or charitable purpose or civil engineering work for a permanent residential caravan park; and
- (v) where the value of the self supply would be less than £100,000.

Tax becomes payable on the first occasion during the period referred to at (iii) above when:

- (i) the developer grants an exempt interest in the building;
- (ii) the developer occupies the building when either he, or in the case of a VAT group of companies, the representative member, is not a fully taxable person; or
- (iii) if later, the building or work becomes substantially ready for occupation or use.

The 'developer' is defined as a person who constructs the building or work, orders it to be constructed, or finances its construction with the intention of letting it or occupying it for his own purposes.

VAT is assessable at the standard rate of the aggregate of:

- (i) the value of grants made to the developer relating to the land on which the building or civil engineering work is to be constructed; and
- (ii) the value of all the taxable supplies of goods and services, other than any that are zero-rated, incurred in connection with the construction of the building or civil engineering work.

The Report Stage amendment removed the reconstruction and extension of existing buildings from the scope of the self-supply charge. This was later amended by the VAT (Buildings and Land) Order 1991 which is considered in section 3.6.1.

The Finance Act 1989 received Royal assent and became law pushed through with the assistance of a large Government majority. The changes in VAT applicable to land and buildings were enacted in Schedule 3 (VAT: buildings and land zero-rating) Finance Act 1989 which substituted a new Group 8 Schedule 5; amended Group 8 (Protected Buildings); substituted a new Group 1 (land) Schedule 6 and 6A (buildings and land) into the Value Added Tax Act 1983.

The new legislation as it relates to waiver of exemption is discussed in the following section.

3.3.0 THE FINANCE ACT 1989

This section provides an explanation of paragraphs 2-4 of Schedule 3, Finance Act 1989 which relate specifically to the election to waive exemption.

Item 1, Group 1, Schedule 6 Value Added Tax Act 1983 exempts the grant or assignment of any interest in land, or right over land or of any licence to occupy land with certain exceptions.

Sub-Paragraph 2(1) of Schedule 3 Finance Act 89 states that:

“Subject to sub-paragraphs (2) and (3) below where an election under this paragraph has effect in relation to any land, if and to the extent that any grant made in relation to it at any time when the election has effect by the person who made the election, or where that person is a body corporate by that person or a relevant associate, would (apart from this sub-paragraph) fall within Group 1 of Schedule 6 to this Act, the grant shall not fall within that Group.”

This sub-paragraph gives effect to waiver of exemption, making taxable what would otherwise be exempt supplies of interests in land, except for a contract stating otherwise. This election is not binding on the heirs or assigns of the elector or associate nor on a new owner.

Sub-paragraph 2(2) of Schedule 3 Finance Act 89 states that:

“Sub-paragraph (1) above shall not apply in relation to a grant if the grant is made in relation to -

- (a) a building or part of a building intended for use as a dwelling or number of dwellings or solely for a relevant residential purpose; or
- (b) a building or part of a building intended for use solely as a relevant charitable purpose, other than as an offices.”

This sub-paragraph defines those buildings where it will not be possible to opt to tax. The HMCE interpretation of part (a) of this provision, given in paragraph 49 of VAT Notice 742 - 1 April 1989 is unambiguous:

“49. You cannot opt to tax any supply of a house, flat or other qualifying building or part of a building which is similarly used....” (28)

Similarly exemption cannot be waived for a building intended for use for a relevant charitable purpose. Such use is established only by the issuing of a certificate of qualifying use.

Sub-paragraph 2(3) of Schedule 3. Finance Act 89 states that:

“Sub-paragraph (1) above shall not apply in relation to a grant if -

- (a) the grant is made to a registered housing association and the association has given to the grantor a certificate stating that the land is to be used (after any necessary demolition work) for the construction of a building or buildings intended for use as a dwelling or number of dwellings or solely for a relevant residential purpose; or

- (b) the grant is made to an individual and the land is to be used for the construction, otherwise than in the course or furtherance of a business carried on by him, of a building intended by him for use as a dwelling.”

This sub-paragraph prevents waiver of exemption being applied to land and buildings sold or let to a registered housing association which has given the required certificate to the elector. Similarly waiver of exemption cannot be applied to the sale of land and buildings to an individual who intends to construct (otherwise than in the course or furtherance of a business) on it a dwelling for his own use.

Sub-paragraphs 2 (4), (5), (6) and (7) of Schedule 3, Finance Act 89 state that:

“(4) Subject to the following provisions of this sub-paragraph, no input tax on any supply or importation which, apart from this sub-paragraph, would be allowable by virtue of the operation of this paragraph shall be allowed if the supply or importation took place before the first day for which the election in question has effect.

(5) Subject to sub-paragraph (6) below, sub-paragraph (4) above shall not apply where the person by whom the election was made -

- (a) has not, before the first day for which the election has effect, made in relation to the land to which the election has effect any grant falling within Group 1 of Schedule 6 to this Act; or
- (b) has before that day made in relation to that land a grant or grants so falling but the grant or all the grants, -
 - (i) were made in the period beginning with the 1st April 1989 and ending with 31st July 1989; and
 - (ii) would have been taxable supplies but for the amendments made by Schedule 3 to the Finance Act 1989.

(6) Sub-paragraph (5) above does not make allowable any input tax on supplies or importations taking place before 1st August 1989 unless -

- (a) it is attributable by or under regulations to grants made by the person on or after 1st April 1989 which would have been taxable supplies but for the amendments made by Schedule 3 to the Finance Act 1989; and
- (b) the election has effect from 1st August 1989.

(7) Sub-paragraph (4) above shall not apply in relation to input tax on grants or other supplies which are made in the period beginning with 1st April 1989 and ending with 31st July 1989 if -

- (a) they would have been zero-rated by virtue of item 1 or 2 of Group 8 of Schedule 5 to this Act or exempt by virtue of item 1 of Group 1 of Schedule 6 to this Act but for the amendments made by Schedule 3 to the Finance Act 1989; and
- (b) the election has effect from 1st August 1989.”

Sub-paragraphs 2(4), (5), (6) and (7) of Schedule 3, Finance Act 89 provide the legal basis for the recovery of input tax attributable to supplies which would otherwise have been exempt but for the option to tax being exercised.

Sub-paragraph (6) provides for transitional provisions dealing with the period 1 April 89-1 August 89 which vary the normal rule (later to be amended) that input tax cannot be recovered before the effective date of the option. This is necessary because charges to VAT arising on new commercial construction and on the purchase of the freehold interest in new commercial buildings took effect on 1 April 89 but waiver of exemption was not made effective until 1 August 89. Without specific provisions allowing the recovery of input tax during this period difficulties would have arisen. Their effect is only to allow VAT to be deductible as a result of waiver of exemption in certain circumstances.

Sub-paragraph 3(1) of Schedule 3 Finance Act 89 states that:

“An election under paragraph 2 above shall have effect -

- (a) from the beginning of the day on which the election was made or of any later day specified in the election; or
- (b) where the election is made before 1st November 1989, from the beginning of 1st August 1989 or any later date so specified.”

This sub-paragraph provides for the effective date of election.

Sub-paragraphs 3(2) and 3(3) of Schedule 3 Finance Act 89 state that:

“(2) An election under paragraph 2 above shall have effect in relation to any land specified or of a description specified, in the election.

(3) Where such an election is made in relation to, or to part of, a building (or planned building), it shall have effect in relation to the whole of the building and all the land within its curtilage; and for the purposes of this subparagraph buildings linked internally or by covered walkways, and parades, precincts and complexes divided into separate units, shall be taken to be a single building (if they otherwise would not be).”

Sub-paragraph 3(2) enables an election to be made in respect of any land specified in the election.

Sub-paragraph 3(3) ensures that the whole building and all land within the curtilage of that building is included in any election even if that election is made in relation to part of the building or a planned building. This sub-paragraph extends the definition of a single building to include those parts of the building linked internally

or by covered walkways, parades precincts and complexes divided into separate units.

Sub-paragraphs 3(4) and 3(5) of Schedule 3 Finance Act 89 state that:

“(4) Where such an election is made in relation to agricultural land (including a building on agricultural land), it shall have effect in relation to any other agricultural land if that land is not separated from it by-

- (a) land which is not agricultural land; or
- (b) agricultural land in separate ownership.

(5) For the purposes of sub-paragraph (4) above-

- (a) land shall be taken not to be separated from other land if it is separated from it only by a road, railway, or something similar; and
- (b) land is in separate ownership from land in relation to which an election is made if the person by whom the election is made has no interest in, right over or licence to occupy it and, where that person is a body corporate, no relevant associate has any such interest, right or licence.”

Sub-paragraphs 3(4) and 3(5) have been added for completeness but relate to agricultural land which is outside the scope of this research.

Sub-paragraph 3(6) of Schedule 3 Finance Act 89 states that:

“An election under paragraph 2 above shall be irrevocable and, except where it is an election of a description specified in a notice published by the Commissioners, shall not have effect unless written notification of it is given to the Commissioners together with such information as the Commissioners may require.”

This sub-paragraph provides that once made an election is irrevocable. For an election to have effect a written notice must be made to HMCE except where they provide otherwise. VAT Notice 742 (29) requires that written notice must be given to the local VAT office not later than 10 days after the option to tax is exercised.

VAT Notice 742 made such a dispensation for 12 months following issue where the total consideration for all the supplies for the building or land for which a taxable person has opted is expected to be less than £20,000.

Sub-paragraph 3(7) of Schedule 3 Finance Act 89 states that:

“Except where the Commissioners otherwise allow, a notification required under sub-paragraph (6) above shall be given not later than the end of the period of thirty days beginning with the day on which the election is made.”

This sub-paragraph provides for the required period of notice of election, except where otherwise allowed by HMCE. There is no time limit within which one must exercise the option to tax. VAT Notice 742 (30) suggests that landlords should advise their tenants in advance if they propose to make an election to waive exemption.

Sub-paragraph 3(8) of Schedule 3 Finance Act 89 states that:

“In paragraph 2 above and this paragraph “relevant association”, in relation to a body corporate by which an election under paragraph 2 above has been made in relation to any building or land, means a body corporate which under section 29 of this Act -

- (a) was treated as a member of the same group as the body corporate by which the election was made at the time when the election first had effect;
- (b) has been so treated at any later time when the body corporate by which the election was made had an interest in, right over or licence to occupy the building or land (or any part of it); or
- (c) has been treated as a member of the same group as the corporate body within paragraph (a) or (b) above or this paragraph at a time when that body corporate had an interest in, right over or licence to occupy the building or land (or any part of it)."

This sub-paragraph deals with the concept of relevant associate in relation to corporate bodies. The necessity for the clause was explained by Peter Lilley at the Committee stage of the Bill as being required:

"To prevent that form of tax avoidance and distortion of competition." (31)

It was required to ensure that the VAT group rules could not be used to enable an exempt or partly exempt business to obtain a tax-free building for its own use when in other circumstances it would have been able to recover the full amount of VAT charged on purchases, repair, maintenance and refurbishment costs.

Sub-paragraph 3(9) of Schedule 3 Finance Act 89 states that:

"In paragraph 2 above 'registered housing association' means a registered housing association within the meaning of the Housing Associations Act 1985 or Part VII of the Housing (Northern Ireland) Order 1981."

This sub-paragraph deals with the definition of a registered housing association.

Paragraph 4 of Schedule 3 Finance Act 89 states that:

“(1) This paragraph has effect where rent is payable in consideration of the grant or an interest in, right over or licence to occupy any building or land to which an election under paragraph 2 above relates (or any part of such building or land).”

(2) If -

- (a) the rent relates to a period beginning before and ending after the first day for which the election has effect; and
- (b) the grant for which the rent is consideration, would apart from this sub-paragraph, take place before that day, the grant shall be treated as taking place on that day to the extent that it is made for rent relating to the part of the period falling on or after that day.

(3) If

- (a) the rent relates to a period beginning on or after the first day for which the election has effect; and
- (b) the grant for which the rent is consideration would, apart from this sub-paragraph, take place before that day the grant shall be treated as taking place on the first day of the period to which the rent relates.

(4) If -

- (a) the rent relates to a period beginning before the first day for which the election has effect; and
- (b) the grant for which the rent is consideration takes place on or after that day, tax shall not be chargeable on the grant by virtue of paragraph 2 above to the extent that it is made for rent relating to any time before that day.

(5) Where the rent is payable by a person in relation to a period when he is in occupation of a building completed before 1st August 1989 (or part of such a building) or land in which he was in occupation immediately before that date, any tax which would be chargeable by virtue of paragraph 2 above on the grant for which the rent is consideration -

- (a) except in the case of a charity, shall be chargeable as if the consideration were reduced by 50 per cent. if and to the extent that the rent relates to any part of the year beginning on the 1st August 1989 and ending on the 31st July 1990; and
- (b) in the case of a charity -
 - (i) shall be chargeable as if the consideration were reduced by 80 per cent, if and to the extent that the rent relates to or to any part of the year beginning on the 1st August 1989 and ending on 31st July 1990;
 - (ii) shall be chargeable as if the consideration were reduced by 60 per cent. if and to the extent that the rent relates to or to any part of the year beginning on the 1st August 1990 and ending on the 31st July 1991;
 - (iii) shall be chargeable as if the consideration were reduced by 40 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1991 and ending on 31st July 1992; and
 - (iv) shall be chargeable as if the consideration were reduced by 20 per cent. if and to the extent that the rent relates to or to any part of the year beginning on the 1st August 1992 and ending on the 31st July 1993.”

This paragraph deals with the charging of VAT after an election to waive exemption has been made. This paragraph also provides for the phasing in of VAT in the transitional period after 1 August 1989 with special provisions for charities.

In order to mitigate the impact on tenants of the landlord electing to waive exemption the Government introduced transitional reliefs which reduced the immediate effect of the tax on rents. The two reliefs are available where the conditions of building and occupation are satisfied. The first applies generally and provides for the VAT charged on rent between the 1 August 1989 and 31 July 1990

to be reduced by 50%. The second provides a more generous relief for charities which will not feel the full effect of waiver of exemption until after 31 July 1993.

3.4.0 POST LEGISLATIVE COMMENTARY

The preceding sections of this chapter have examined the development of the legislation which changed the VAT treatment of land and buildings in the UK following EC judgement case 416/85. This section goes on to consider the implications of these changes for those involved in commercial property by examining what the changes meant for those who develop, trade in and let commercial property.

3.4.1 THE MEANING OF THE VAT CHANGES FOR COMMERCIAL PROPERTY DEVELOPMENT

3.4.1.1 Land with Development Potential

The initial step in many commercial development projects will be for the developer to acquire a site or an option to purchase a site. An option is more usually taken before planning consent is obtained. If the planning application is successful the developer usually proceeds to acquire the site and either disposes of it at an enhanced value or develops it with or without the involvement of others.

If there is consideration for the grant of an option to purchase given by a site owner to a developer and this is made in the course or furtherance of a business then the site owner will have the option to tax the supply. The developer may recover VAT on the costs of acquisition and of obtaining planning consent if at that time he had an intention to use the land to make taxable supplies (ie to construct a commercial building). If the developer were to sell his option to purchase the site, VAT cannot be recovered. Similarly if his intention to create a taxable supply is not realised the VAT claimed will have to be repaid.

Having purchased the site with planning consent the developer will usually proceed to develop it. In some cases the developer may take an obligation to construct and tenant the scheme with the intention of selling to an investor on completion. The developer will contract with a builder to construct the building and a commercial agent to let the building. The developer will have to choose whether to opt to tax rents in this case. Alternatively, the building contractor and professional team may contract directly with the investor (joint venture) leaving the developer with only a project management role.

The developer will need to consider carefully at the planning stage of any development the possibility of incurring a self supply charge as set out in section 3.2.2.3.

3.4.1.2 Funding Developments

Typically with commercial developments a developer will seek funding for the development from an investment or financial institution. There may be implications for exempt/part exempt institutions who cannot recover VAT and will need to consider their tax position carefully in such circumstances. Lending money in the course or furtherance of a business is usually an exempt supply. The lender can recover VAT incurred on costs attributable to zero-rated lending but not exempt lending.

Some lenders may be unwilling to finance the VAT element of the purchase price on the basis that it can be recovered or some may offer short term bridging facilities for this element.

The lender may take in addition to interest charges a share of the profit. The VAT consequences in this case will depend on the relationship between the parties. If there is a partnership then the profit share falls outside the scope of VAT. In other cases the VAT consequences will depend on the contract between and the intentions of the parties.

3.4.1.3 Planning Gain

It is common practice for developers to carry out works for local authorities in addition to the proposed development in order to secure planning permission, such

as road improvements. From 1 April 1989 such infrastructure improvements became taxable at the standard rate and developers will render a VAT invoice to local authorities for such supplies.

3.4.1.4 VAT Liability on Disposal of the Development

The VAT liability on transfer by the developer to the investor will depend on the stage of construction, when this takes place and whether the developer elects to waive exemption.

If at the time of supply the building has not progressed beyond foundation level a freehold disposal will be exempt with the option to tax.

If the building, buildings or parts thereof, have progressed beyond foundation level at the time of supply, the disposal of the freehold interest will be zero-rated.

If the disposal is of the freehold interest in a completed building not designed as a dwelling the VAT liability of this supply will be standard rated if sold before the third anniversary of completion. After the third anniversary of completion the disposal of the freehold interest will be exempt with an option to tax. A building is complete when the architect issues the certificate of practical completion or it is first fully occupied, whichever happens first.

This assumes that the building is not covered by a certificate of qualifying use (ie. charitable use).

The potential impact of these VAT changes was quite apparent to commentators such as Hedley;

“VAT could have the effect of delaying or aborting developments in areas where there is a high proportion of VAT averse organisations.” (32)

Having examined the VAT implications of the new legislation for commercial property development, the following section goes on to consider the implications for those trading in commercial property.

3.4.2 THE MEANING OF THE VAT CHANGES FOR THOSE TRADING IN COMMERCIAL PROPERTY

The changes in VAT introduced in the Finance Act 1989 have meant that buying and selling commercial property as distinct from developing it may now be a mix of standard rated and exempt transactions. Prior to this transactions were nearly always exempt.

The introduction of the option to tax has meant that those who trade regularly in property have the option to recover any VAT which they may have incurred on purchase (where this is standard rated). This section examines what these changes

will mean for those trading regularly in commercial property and in particular the views of commentators on potential problems.

3.4.2.1 Surrenders, Assignments and Re-grants

Those considering surrenders, assignments or re-grants will need to think very carefully about the VAT implications of such transactions. The surrender of a lease is now a taxable supply at the standard rate where it is made for consideration and takes place in the course or furtherance of the lessee's business.

A surrender of a lease with more than 21 years to run is treated as a supply of goods, otherwise it is a supply of services. In most cases this is likely to be of little material significance.

Consideration must be received for the surrender to be standard-rated. Where for example a tenant receives nothing for surrender because the property is let at full market rent and has no intrinsic worth, there is no VAT charge.

It is the tenant who must account to HMCE for the VAT on surrender and care should be taken to distinguish between sums agreed being inclusive or exclusive of VAT. If the tenant fails to agree with the landlord that the consideration, say £100,000 is VAT exclusive he will have to account to HMCE for the VAT which at 17.5% will result in the tenant receiving only £85,106 instead of £100,000.

The landlord will be unable to recover the VAT which he pays to the tenant on surrender unless he has opted to tax the rents received for the building. Dick suggested that a possible solution to the problem may be:

“..for the tenant instead to assign his lease to a subsidiary of the landlord.”
(33)

As such the assignment would qualify as an exempt supply and no VAT would be chargeable on the consideration received by the tenant.

HMCE original view was that an assignment of a lease by a tenant to a company which is grouped with the landlord for VAT purposes should be treated as a VATable surrender (Notice 742B) (34). But they now accept that it is not, provided the assignee is not the landlord.

A surrender and re-grant will also give rise to a taxable supply. This situation arises where a tenant may decide to surrender one lease for another. Such a situation may present problems for the tenant if no money changes hands and HMCE may not accept his interpretation of the value of the new lease. Dick suggested that:

“One possibility here can be for the landlord to grant to a third party ("X") a mezzanine, or overriding, lease for the term desired but subject to the existing lease of the tenant.” (35)

This has the effect of converting the existing lease into a sub-lease and the new lease becomes the headlease. 'X' could become a trustee or nominee of the original tenant thereby avoiding a charge to VAT.

It is apparent that careful consideration should now be given to the VAT implications in these circumstances because the sums involved can often be large and there are costly traps for the poorly advised. But as Dick suggested:

“In many cases it will be possible, however, by structuring the transaction somewhat differently, to bring about a VAT neutral situation in which either no surrender takes place or any surrender which does take place can be ignored for VAT purposes.” (36)

3.4.2.2 Stamp Duty

The question arises under the new legislation as to whether stamp duty is payable on the purchase price, net or gross of VAT. HMCE' opinion is made clear in the following extract from a letter between them and the Confederation of British Industry:

“Subject to the important provision that it is essential to consider the terms of any particular instrument before determining the stamp duty position, I have to say we consider that stamp duty would be correctly chargeable in law on any VAT element in either the sale price of a new - or used - non-domestic building, or the rent charged therefore.” (37)

Thus vendors will generate an increase in transaction costs, because consideration for the supply including VAT will incur stamp duty on the total amount.

3.4.2.3 Fixtures, Fittings and Reverse Premiums

Fixtures are regarded in law as part of the building, but fittings are not and would normally be standard-rated for VAT purposes. HMCE have made a concession that where a freehold or leasehold grant is made and there is a single charge for the land, fixtures and fittings, there is no separate supply of fittings provided they are reasonable in scale and quantity having due regard to the building and its use.

Reverse premiums will normally be standard-rated. However, the position is not entirely free from doubt and a careful analysis of the precise details should be undertaken to confirm the exact VAT position.

3.4.3 THE MEANING OF THE VAT CHANGES FOR THOSE WHO LET COMMERCIAL PROPERTY

This section examines the meaning of the changes introduced in the Finance Act 1989 for those who let commercial property. The essential position post Finance Act 1989 is that leases, lettings and licences for buildings (or parts) not designed as dwellings are exempt with an option to tax. This assumes no certificate of qualifying use has been received.

3.4.3.1 Drafting Considerations

Fogel and Plumbe suggested that:

“Many landlords and tenants have been exploring with their advisers whether the impact of the new VAT rules (Finance Act 1989) upon rental values on review may be mitigated artificially by drafting techniques.” (38)

They suggested that landlords should consider whether a better rent could be obtained by offering a lease which would have a special appeal to an exempt tenant, i.e. one which guarantees that no VAT will be charged. In some market circumstances a tenant might be in a position to insist on such a covenant.

Any covenant not to charge VAT would need to bind the landlord's successors in title, because the option to tax can be exercised afresh if the building is disposed of. Fogel and Plumbe suggested that the landlord should covenant additionally to ensure on assignment that the new landlord enters into a direct covenant expressed to benefit the tenant and his successors.

Consideration will also need to be given to the implications for such a covenant on renewal being granted under the Landlord and Tenant Act 1954. Landlords may consider it would be better to ‘contract out’ of the 1954 Act to avoid this potential difficulty.

An exempt tenant may also be in a position to ensure that the rent review clause under the lease is drafted on the basis that the covenant not to charge VAT is excluded from the notional lease. This would ensure that the position at review would more accurately reflect the actual market. The tenant would argue for this on the basis that its own tax concession was a one off, whilst the landlord would resist on the ground that the tenant would be shielded from reality having secured more favourable terms.

The particular fear is that such drafting may in the end become so devoid from reality that the draftsman may be caught in his own trap. As Fogel and Plumbe commented:

“If you chose to enter the looking glass world you must connive at its own distorted logic!” (39)

Many leases provide for the tenant to indemnify the landlord for any professional fees. The tenant cannot recover VAT on these fees because he is indemnifying the landlord and a supply is not being made. From the landlords point of view the receipt from the tenant is outside the scope of VAT. The landlord is entitled to recover VAT on professional fees because they were supplied to him.

3.4.3.2 Managing Agents and Service Charges

Many property investors employ agents to attend to the daily running of their property holdings. Commentators indicated that when considering whether or not to opt to tax it would be necessary for landlords to:

“...take into account the extra work and expense in collecting the rents...”
(40)

This extra work will mainly arise as a result of the need to provide the tenants with tax invoices. Agents may issue invoices on behalf of their principal provided he issues the agent with a corresponding invoice. HMCE have recognised that this is clearly impractical for managing agents who may issue hundreds of rent demands per quarter. An agent may therefore apply for approval to self-bill his principal, ie issue himself with a tax invoice in the landlord's name, or the landlord may issue the agent with a single invoice for all rents collected on his behalf or provide the managing agent with a stock of invoices bearing the landlord's name and VAT registration number.

Leases commonly provide for a rental inclusive of service charges or for the landlord to charge and the tenant to pay a sum additional to the rent as service charges, maintenance charges or additional rent, for the upkeep of the whole building. Para.42 VAT Notice 742 states that:

“Provided the services supplied in return for the charges are towards the general upkeep of the structure and common areas of the premises and grounds or for the services of a person such as a caretaker or warden they are regarded as part of the consideration for the grant...” (41)

In this case the VAT treatment of the service charge will follow the VAT treatment of the rent. Thus if the landlord elects to waive exemption this will give rise to a VAT charge not only on rents but also service charges.

Alternatively in some cases heating, lighting or cleaning will be supplied to the tenants of offices as a supply separate from the grant of or right to occupy the premises and in this case VAT is chargeable on that supply at the appropriate rate.

A particular problem with VAT on service charges in circumstances where the landlord has not opted to tax rents is that it has to be included in the charge. In this case the tenants cannot recover the VAT because it has not been charged as such by the landlord but is merely an element of the service charge. The following remedies are based on Scott and McClellan's (42) suggestions for avoiding this problem:

- * supplying the services separately from the right to occupy the premises. These will then carry VAT at the standard rate which the tenants can recover.

- * it may be possible to supply the services through a third party company. Contractors would invoice the company who would

invoice the tenants. This would enable VAT registered tenants to recover the VAT charged.

- * the use of a common building maintenance fund which would be outside the scope of VAT if it were separate, belonged to the tenants and the landlord or agents made payments from the fund on behalf of the tenants. This would again enable the tenants to recover the VAT charged.

Problems may also arise in connection with service charges on mixed use property such as a shopping centre with retail units at ground floor level and residential flats over. The property will constitute a single building for the purposes of an election to waive exemption. If a service charge is levied this will be proportionally lower to the commercial occupiers because the landlord can recover input VAT on this portion of his costs. However that charged to residential occupiers will be much higher because the landlord cannot recover any input VAT on these costs.

3.4.3.3 Dilapidations

Payments for dilapidations at the end of a lease normally fall outside the scope of VAT as they are compensation for damage or disrepair.

3.5.0 TRANSITIONAL PROVISIONS

Neville Ross summarises the reasons why the Government chose to introduce transitional provisions thus:

“Because of the very substantive nature of the VAT changes (Finance Act 1989) and the fact that property is a long term business, Customs & Excise is proposing a number of transitional provisions so as to avoid certain existing situations creating unintended VAT consequences.” (43)

Essentially the Government chose to mitigate the impact of and avoid uncertainty surrounding the VAT changes in the treatment of land and buildings by the use of transitional provisions. The significance of these provisions on this research is their potential to influence the results obtained.

This section provides a detailed explanation of the transitional provisions introduced in paragraph 13 of the Finance Act 1989.

“13.-(1) Subject to sub-paragraph (3) below, the amendments made by paragraphs 1 and 2 of this Schedule shall not have effect in relation to a grant, assignment or other supply where-

- (a) it is made in pursuance of a legally binding obligation to make it which was incurred before 21st June 1988, and
- (b) if the Commissioners so require (whether before or after it is made), it is proved to their satisfaction by the production of documents made before that date that it is so made.”

This relief allows the retention of zero-rating for construction work, sales and grants of long leases of new buildings (including reconstruction and alteration

work on and sales of reconstructed protected buildings) provided the following conditions are met. Firstly the grant assignment or other supply must have been made pursuant to a legally binding obligation incurred before 21 June 1988. Secondly the Commissioners may require proof of this by the production of the relevant documentation.

“(2) Subject to sub-paragraph (3) below, the amendments made by paragraphs 1 and 2 of this Schedule shall not have effect in relation to a grant or assignment of an interest in, or any part of, a building or its site where -

- (a) the grant or assignment takes place before 21st June 1993,
- (b) the person making the grant or assignment was under a legally binding obligation incurred before 21st June 1988 to construct (or reconstruct) the building or to construct any development of which it forms part (other than an obligation to receive services or goods in the course of the construction or reconstruction).
- (c) if the Commissioners so require (whether before or after the grant or assignment is made), it is proved to their satisfaction by the production of documents made before that date that he was under that obligation, and
- (d) planning permission for the construction (or reconstruction) of the building was granted before 21st June 1988.”

This relief allows the retention of zero-rating for a grant or assignment of an interest in a building provided the following conditions are met. Firstly the grant or assignment must have taken place before 21 June 1993 and have been made by a person who was under a legally binding obligation incurred before 21 June 1988 to construct the building or a development of which it forms part. Planning

permission must have been granted before 21 June 1988. The Commissioners may also require proof by production of the relevant documents.

“(3) Where the grant or assignment is of a tenancy or lease-

- (a) if a premium is payable, sub-paragraph (1) or (2) above shall apply only to the extent that it is made for consideration in the form of the premium; and
- (b) if a premium is not payable, sub-paragraph (1) or (2) above shall apply only to the extent that it is made for consideration in the form of the first payment of rent due under the tenancy or lease.”

This sub-paragraph provides that where a grant or assignment of a tenancy or lease is made in consideration of a premium and rental or other payments, only the premium will be zero-rated under this provision. Where a premium is not payable on such a grant then the first payment of rent under the lease or tenancy only will be zero-rated.

“(4) The amendments made in paragraphs 1 and 2 of this Schedule shall not have effect in relation to a supply relating to a building or civil engineering work where-

- (a) the supply takes place before 21st June 1993,
- (b) the supply is made to the person constructing the building or work (or reconstructing the building),
- (c) that person was under a legally binding obligation incurred before 21st June 1988 to construct the building or work (or to reconstruct the building) or to construct any development of which it forms part (other than an obligation to receive services or goods in the course of the construction or reconstruction).

- (d) if the Commissioners so require (whether before or after the supply is made), it is proved to their satisfaction by the production of documents made before that date that he was under that obligation,
- (e) planning permission for the construction of the building or work (or reconstruction of the building) was granted before 21st June 1988, and
- (f) before the supply takes place the person constructing the building or work (or reconstructing the building) has given to the person making the supply a certificate in such form as may be specified in a notice published by the Commissioners stating that the supply is zero-rated (in whole or to the extent specified in the certificate) by virtue of this sub-paragraph.”

This relief allows the retention of zero-rating for a supply made before 21 June 1993 to a person constructing a building or civil engineering work (or reconstructing a building) provided the following provisions are met. Firstly the person constructing (or reconstructing) must be under a legally binding obligation to do so either in relation to the building or work concerned or to a development of which it forms a part. This obligation must be incurred before 21 June 1988. Planning permission must also have been granted before 21 June 88. The Commissioners may also require proof by production of the relevant documents. A certificate of zero-rating must also be given in the required form by the person constructing the building or work before the supply has taken place to the person making the construction supply.

“(5) Where a grant, assignment or other supply is zero-rated by virtue of this paragraph, it is not a relevant zero-rated supply for the purposes of paragraph 1 of Schedule 6A to the Value Added Tax Act 1983.

(6) Nothing in paragraphs 5 and 6 of that Schedule shall apply -

- (a) in relation to a person who has constructed a building if he incurred before 21st June 1988 a legally binding obligation to make a grant or assignment of a major interest in, or in any part of, the building or its site.”

This relief excludes the application of the developer's self supply charge to a developer who constructed the building, provided he incurred a legally binding obligation to make a grant or assignment of a major interest in the building or its site before 21 June 1988.

- “(b) in relation to a building or work if there was incurred before that date a legally binding obligation to make in relation to the building or work a supply within item 2 of Group 8 of Schedule 5 to the Value Added Tax Act 1983;”

This sub-paragraph excludes the developer's self supply charge in relation to a building or civil engineering work if a legally binding obligation to supply construction services of a type which were zero-rated before 1 April 1989, was incurred before 21 June 1988 in relation to that building or work.

- “(c) in relation to a person who has constructed a building if-
 - (i) he incurred before that date a legally binding obligation to construct the building or any development of which it forms a part, and
 - (ii) planning permission for the construction of the building was granted before that date, except where that person does not make a grant or assignment of a major interest in, or in any part of, the building or its site before 21st June 1993.”

This exclusion applies to a person who incurred a legally binding obligation to construct a building or any development of which it forms a part before 21 June

1988. There are two major conditions for the exclusion to be effective. First planning permission for the construction must have been granted before 21 June 1988. Secondly the person concerned must make a grant or assignment of a major interest in the building or its site before 21 June 1993.

“(7) If the Commissioners so require, proof of any matters specified in sub-paragraph (6)(a), (b) or (c)(i) above shall be given to their satisfaction by the production of documents made before 21st June 1988.”

This confirms that Commissioners may require documentary proof of the relevant information required in sub-paragraphs (6)(a), (b) or (c)(i).

Other transitional reliefs are provided for in sub-paragraphs 2(6) and 4(5) Schedule 3 Finance Act 1989 reproduced with commentary in section 3.3.0.

Ross concludes that:

“All of these reliefs are to be welcomed. Many would argue that they do not go far enough, particularly in relation to the relief for construction contracts.” (44)

Essentially the transitional provisions introduced will mitigate the impact of the new legislation. For example the full effect of the VAT charge on rents for tenants other than charities will not become apparent until after 31 July 1990.

3.6.0 SUBSEQUENT AMENDMENTS TO THE FINANCE ACT 1989

The numerous changes in the legislation on the VAT treatment of land and buildings culminating with those relating to the developer's self-supply charge introduced at the Report Stage of the Finance Bill 1989 necessitated subsequent amendment to the Finance Act 1989. These amendments are explained in this section because of their potential to influence the results of this research.

3.6.1 THE VALUE ADDED TAX (BUILDINGS AND LAND) ORDER 1991

This order which came into effect on 1 January 1992 deals principally with two areas, the option to tax and developer's self-supply. The latter broadened the scope of the charge and amended its valuation, whilst the former, (as comments Martin Scammell of Ernst and Young):

“...have all the hallmarks of hasty over-reaction to the problems which they are designed to solve.....” (45)

This section considers the Order's effect on the option to tax (articles 3 & 4), the need for change, the changes and the difficulties which have arisen and provides a resumé of the changes made to the developer's self-supply charge (article 5).

A particular problem with the option to tax had been in determining exactly what input tax could be recovered. For example, assume a landlord who has let on an exempt basis and then refurbishes the building. He would probably want to opt to

tax to recover input tax on the refurbishment, but would prefer to wait and see whether the eventual tenant was exempt or fully taxable. The Finance Act 1989 rules prevent this flexibility, because if the landlord wants to maximise the recovery of input tax an option must be taken as soon as possible.

In an attempt to overcome this problem Article 3 of the Order provides for the following amendments:

“3. Paragraph 2 of Schedule 6A to the Value Added Tax Act 1983(a) shall be amended by adding after sub-paragraph (7) the following sub-paragraphs-

“(8) Sub-paragraph (4) above shall not apply in relation to any election having effect from the day on or after 1st January 1992, except in respect of the input tax on a supply or importation which took place before 1st August 1989.

(9) Where a person has made an exempt grant in relation to any land and has made an election in relation to that land which has effect from any day before 1st January 1992, he may apply to the Commissioners for sub-paragraph (4) above to be disapplied in respect of any input tax on a supply or importation which took place on or after 1st August 1989, but the Commissioners shall only permit the disapplication of that sub-paragraph if they are satisfied, having regard to all the circumstances of the case and in particular to -

- (a) the total value of -
 - (i) exempt grants made,
 - (ii) taxable grants made or expected to be made, in relation to land; and,
- (b) the total amount of input tax in relation to the land which has been incurred before the day from which the election had effect,

that a fair and reasonable attribution of the input tax mentioned in paragraph (b) above will be secured.”

These new sub-paragraphs deal with the entitlement to recover input tax. For elections made on or after 1 January 1992 input tax incurred before election can now be recovered but not input tax incurred before 1 August 1989. For elections having effect before 1 January 1992 the elector may apply to the Commissioners to recover input tax incurred on or after 1 August 1989 which they can grant subject to them being satisfied on certain grounds.

Article 4 of this Order makes a number of amendments to the procedure for making elections to waive exemption:

“4. Paragraph 3 of Schedule 6A to the Value Added Tax Act 1983 shall be amended as follows

- (a) in sub-paragraph (1), there shall be inserted at the beginning of paragraph (a) the words “subject to the following provisions of this paragraph,”;
- (b) for sub-paragraph (6), there shall be substituted the following

“(6) An election under paragraph 2 above shall be irrecoverable and, except where it is an election of a description specified in a notice published by the Commissioners, shall not have effect unless -

- (a) in a case to which sub-paragraph (10) below applies, the Commissioners have given the permission required under that sub-paragraph;
- (b) in any other case, written notification of the election is given to the Commissioners not later than the period of thirty days beginning with the day on which the election is made, or not later than the end of such longer period beginning with that day as the Commissioners may in any particular case allow, together with such information as the Commissioners may require.”;
- (c) sub-paragraph (7) shall be omitted;

- (d) after sub-paragraph (9), there shall be added the following sub-paragraph -

“(10) Where a person who wishes to make an election in relation to any land (the relevant land) to have effect on or after 1 January 1992, has made, makes or intends to make, an exempt grant in relation to the relevant land at any time between the 1st August 1989 and before the beginning of the day from which he wishes to make an election in relation to the relevant land to have effect, he shall not make an election in relation to the relevant land unless he obtains the prior written permission of the Commissioners, which shall only give such permission if they are satisfied having regard to all the circumstances of the case and in particular to -

- (a) the total value of exempt grants in relation to the relevant land made or to be made before the day from which the person wishes his election to have effect;
- (b) the expected total value of grants relating to the relevant land that would be taxable if the election were to have effect; and
- (c) the total amount of input tax which has been incurred on or after 1st August 1989 or is likely to be incurred in relation to the relevant land, that there would be secured a fair and reasonable attribution of the input tax mentioned in paragraph (c) above to grants in relation to the relevant land which, if the election were to have effect, would be taxable.”

The most important addition is the new sub-paragraph (10) which provides that a person not already bound by an election on 1 January 1992 must obtain the prior written permission of HMCE if, between 1 August 1989 and the day he wishes the election to be effective, he has made or intends to make an exempt grant in relation to the land concerned. This may only be given if HMCE are satisfied that there will result a fair and reasonable attribution of input tax incurred before the effective date of election.

It is of particular concern to Scammell that:

“Customs have absolute discretion to refuse permission to opt. There is not even provision for a refusal to be appealed to the VAT tribunal....” (46)

There is also no timescale within which HMCE must reply. The procedure to obtain permission is set out in the Amendment 3 to HMCE Notice 742B, which indicates that as well as their own details and those of the property the taxpayer must give:

- “* the date from which you wish the option to have effect;
 - * the total value of your exempt supplies in respect of the property prior to that date (but disregarding any supplies made before to 1 August 1989);
 - * the expected total value of supplies in respect of the property ie., whether you will sell the property, lease it for a premium payment, lease it for annual rental payments, etc. In the case of a lease it will be sufficient for you to state the term granted, and the expected premium or annual rent; and
 - * the total input tax incurred on the property since 1 August 1989.”
- (47)

It is not surprising that commentators such as Scammell criticise these requirements on the basis that a substantial part of the required information may not be available at the stage at which the taxpayer may wish to apply.

“When exactly is the taxpayer likely to know all this?” (48)

The amendments contained in Article 5 of this Order extend the developer’s self supply charge to reconstruction, enlargement or extension of existing buildings. These amendments are set out in full in the Order. Briefly, the change only affects

work commencing after 1 January 1992. The charge does not apply in cases where the developer has held an interest in at least 75% of all the land concerned during the ten years ending with the first day when the self-supply charge would otherwise have been chargeable, except for reconstruction where 80% of the area of the floor structures of the existing building are removed. The charge does not apply to an extension, reconstruction or enlargement of an existing building where the developer has already been liable for such a charge.

Article 6 of this Order amends the value of the developer's self supply charge details of these amendments are set out in full in the Order (Appendix 3) (49).

It is entirely possible that the changes in the option to tax procedure may discourage the take-up of this option because of the requirement to obtain prior written permission and the need to provide detailed information on supplies. Similarly the extension of the developer's self-supply charge to reconstruction, enlargement or extension of existing buildings effective from 1 January 1992 has the potential to influence the results of this research. The impact of these amendments may be an important consideration when analysing the results of this research.

Scammell concludes his article with a summary statement on the new Order,

“At best, Customs have taken a sledgehammer to crack a nut. At worst, they have taken a sledgehammer to no purpose at all and there was no nut to crack.” (50)

3.7.0 SUMMARY AND CONCLUSIONS

This research was carried out against the background of the Government having recently introduced legislation changing the VAT treatment of land and buildings which would have far reaching consequences for the UK property industry:

“The scope & diversity of the new provisions amount to a radical rewrite of the VAT rules on property and construction.” (51)

The UK Government took steps once EC judgement (case 416/85) had been announced to minimise uncertainty and to allow time for consultation. Their proposals for implementation were brought forward as part of the Finance Bill 1989, a substantial piece of legislation. The debate, which followed relating to the VAT treatment of land and buildings, was characterised by numerous and late amendments with little time for the detailed consideration necessary for such extensive changes.

The need for such a large number of amendments of the new legislation is symptomatic of the Government's difficulty in satisfying their conflicting aims of implementing and at the same time mitigating the effects of the EC judgement (case 416/85).

Some interested parties, institutions and others did manage to influence the Government in key areas such as the attempts made to charge VAT on development

land. But in other areas such as the option to tax the proposals which were heavily biased towards landlords went through unamended.

Despite these apparent difficulties the Finance Act received Royal Assent and became law. This Act included transitional provisions which mitigated the impact of the new measures. Significant areas of the new VAT legislation remained unfinished requiring amplification by HMCE and subsequent amendment.

As a result orders were produced which even after a period of consultation, further complicated the issues and extended the effects of change into ever wider areas. Commentators concluded that the net result was a situation more complex than it need be and one where those involved in commercial property must take particular care to consider all the potential VAT implications in order to avoid serious mistakes.

There followed a period of uncertainty for the commercial property market where the impact of the changes in the VAT treatment of land and buildings introduced in the Finance Act 1989 were unknown. Commentators such as Hedley (52) suggested that these changes might have a significant impact on rents and capital values in certain sectors of the market.

1. Parliamentary Debates (Hansard), 25 April 1989. Sixth Series Vol. 151. HMSO pp. 833-834.
2. Mass, R., 17 June 1989. VAT On Commercial Development. Estates Gazette, p.84.
3. Official Journal of the European Communities Vol 20 No. L145 13 June 1977 Office for Official publications of the European Communities.
4. Goy, D., & Walters, J., 1989. VAT and Property, Sweet & Maxwell, p.141.
5. The Finance Bill Value Added Tax On Buildings & Land: Clause 17 And Schedule 3. A briefing note for the Standing Committee G: Finance Bill by the RICS 11 May 1989, p.3.
6. Parliamentary Debates House Of Commons Official Report 18 May 1989 Standing Committees Session 1988-89 Finance Bill Vol. VII. HMSO p. 123-124.
7. HM Customs & Excise, Value Added Tax. Notice 742. Land & Property, 1 April 1989 HMSO p.32.

8. Parliamentary Debate House of Commons Official Report 18 May 1989
Standing Committees Session 1988-89 Finance Bill Vol. VII. HMSO
p.126.
9. Soares, P.C., 23 March 1989, VAT On Property Taxation, p.624.
10. Parliamentary Debates House of Commons Official Report 18 May 1989
Standing Committees Session 1988-89 Finance Bill Vol. VII. HMSO,
p.122.
11. Soares, P.C., 1988-89, VAT Property Planning After The EEC Decision,
Longman 2nd Edition, Appendix 3, Customs & Excise Consultation paper
21 June 1988, pp.101-104.
12. Official Journal Of The European Communities Vol 20 No L145/3 13 June
1977 Office for Official Publications of the European Communities.
13. Official Journal Of The European Communities Vol 20 No L145/10 13 June
1977 Office for Official Publications of the European Communities.
14. Official Journal Of The European Communities Vol 20 No L145/20 13 June
1977 Office for Official Publications of the European Communities.

15. Official Journal Of The European Communities Vol 20 No L145/38 13 June 1977 Office for Official Publications of the European Communities.
16. Parliamentary Debates House Of Commons Official Report 18 May 1989 Standing Committees Session 1988-89 Finance Bill Vol. VII. HMSO pp.132-133.
17. Soares, P.C., 1988 VAT Property Planning After The EEC Decision, Longman 2nd Edition, Appendix 3, Customs & Excise Consultation Paper 21 June 1988, p.102
18. The Finance Bill Value Added Tax On Buildings And Land: Clause 17 And Schedule 3. A Briefing Note for the Standing Committee G - Finance Bill by the RICS 11 May 1989 p.4.
19. The Finance Bill Value Added Tax On Buildings And Land: Clause 17 And Schedule 3. A Briefing Note for the Standing Committee G - Finance Bill by the RICS 11 May 1989 p.4.
20. Parliamentary Debates House Of Commons Official Report 18 May 1989 Standing Committees Session Finance Bill 1988-89 Vol. VII HMSO p.133

21. Parliamentary Debates House Of Commons Official Report 18 May 1989
Standing Committees Session Finance Bill 1988-89 Vol. VII HMSO pp.
129-132
22. Mass, R., 17 June 1989, VAT On Commercial Development, Estates
Gazette, p.84.
23. Johnson, T., 27 May 1989, VAT On Development, Estates Gazette, p.88.
24. Buckett, A., 1989, VAT On Construction. Land and Property, The Tolley
Publishing Company Ltd, p.100.
25. Mass, R., 17 June 1989, VAT On Commercial Development, Estates
Gazette, p.84.
26. Buckett, A., 1989, VAT On Construction. Land and Property, The Tolley
Publishing Company Ltd, p.101.
27. Buckett, A., 1989, VAT on Construction. Land and Property. The Tolley
Publishing Company Ltd, p. 102.
28. HM Customs & Excise, Value Added Tax. Notice 742. Land & Property 1
April 1989, HMSO, p.31.

29. HM Customs & Excise, Value Added Tax, Notice 742, Land & Property 1
April 1989, HMSO, p.32.
30. HM Customs & Excise, Value Added Tax, Notice 742, Land & Property 1
April 1989 HMSO p.35.
31. Parliamentary Debates House of Commons Official Report 18 May 1989
Standing Committees Session 1988-89 Finance Bill Vol. VII HMSO p.118.
32. Hedley, C., 18 February 1989, VAT On Construction, Estates Gazette,
p.66.
33. Dick, J., 1 September 1990. VAT and Lease Surrenders, Estates Gazette,
p.43.
34. Dick, J., 1 September 1990. VAT and Lease Surrenders, Estates Gazette,
p.76.
35. Dick, J., 1 September 1990. VAT and Lease Surrenders, Estates Gazette,
p.76
36. Dick, J., 1 September 1990. VAT and Lease Surrenders, Estates Gazette,
p.76.

37. Buckett, A. 1989, VAT on Construction, Land and Property, Tolley Publishing Company Ltd, p.83.
38. Fogel, S., & Plumbe, G. 22 April 1989, VAT and Rent Review Clauses, Estates Gazette, p.76.
39. Fogel, S. & Plumbe, G. 22 April 1989, VAT and Rent Review Clauses, Estates Gazette, p.82.
40. Buckett, A., 1989 VAT On Construction. Land and Property, Tolley Publishing Company Ltd, p.74.
41. HM Customs & Excise, Value Added Tax Notice 742 Land & Property 1 April 1989 HMSO p.25.
42. Scott, H., & McLellan, D. 1989. VAT & Property. Butterworths, p.144.
43. Ross, N., 9 December 1988, Coping With The Transition, Estates Times, p.11.
44. Ross, N., 9 December 1988, Coping With The Transition, Estates Times, p.11.
45. Scammell, M., 20 February 1992, No Option? Taxation, p.496.

46. Scammell, M., 20 February 1992, No Option? Taxation, p.498.
47. Scammell, M., 20 February 1992, No Option? Taxation, p.499.
48. Scammell, M. 20 February 1992, No Option? Taxation, p.499.
49. SI 1991 No.2569 VAT. The Value Added Tax (Buildings and Land) Order 1991.
50. Scammell, M., 20 February 1992, No Option? Taxation, p.500.
51. Durkacz, V., 23 February 1989, Side Step The Penalties On Property. Accountancy Age, p.18.
52. Hedley, C., 18 February 1989, VAT On Construction, Estates Gazette, p.66.

CHAPTER FOUR

RESEARCH HYPOTHESES. METHODOLOGY AND

ALTERNATIVE RESEARCH METHODS.

4.1.0 INTRODUCTION

This chapter develops the conceptual thinking underpinning the two aims of this research, which are:-

- (1) To examine the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the English commercial property market; and,
- (2) To assess the perceived effects of waiver of exemption on rents in the English commercial property market.

The chapter takes each aim in turn, identifying the problem and developing concepts, variables and hypotheses.

Finally this chapter examines alternative data collection methods in the context of this research.

4.2.0 AIM ONE - TO EXAMINE THE EFFECTIVENESS OF
WAIVER OF EXEMPTION IN MITIGATING THE EFFECTS
OF THE EC JUDGEMENT (CASE 416/85) ON THE ENGLISH
COMMERCIAL PROPERTY MARKET

4.2.1 COMMISSION OF THE EUROPEAN COMMUNITIES
VERSUS UNITED KINGDOM OF GREAT BRITAIN AND
NORTHERN IRELAND (CASE 416/85)

The Court of Justice of the European Communities declared in its judgement in case 416/85 that by continuing to apply a zero rate of VAT to the provision of goods and services included in Group 8 (Schedule 5 Value Added Tax Act 1983) in relation to the construction of industrial and commercial buildings, (in so far as they were not provided to the final consumer), the UK had contravened the provision of Council Directive 77/388 of 17 May 1977 and had failed in its obligations under the Treaty of Rome. This case is examined in detail in section 2.4.0.

Faced with increasing uncertainty from the construction industry as to the viability of medium and long term projects as a result of the judgement, the UK Government announced on 21 June 1988, the same day as the judgement, that non-domestic construction services and the freehold sale of new non-domestic buildings and of building land for non-domestic developments (the latter was subsequently withdrawn) were to be taxed at the standard rate.

Had the judgement been implemented without mitigation it would have given rise to significant additional taxation. Large amounts of VAT incurred on commercial construction work and on the purchase of the freehold interests in new commercial property would have been irrecoverable. Opinions as to the possible amount of tax varied. In the Standing Committee debate on the Finance Bill 1989, which formed the basis for the new legislation, Mr Peter Lilley, Economic Secretary to the Treasury, indicated that the Government expected £450 million in revenue from private sector construction and property in 1989 (1). Whilst Hedley commented that:

“...the Building Employers Federation indicates that the total impact would have been £600m/ year..... We believe that the total effects would have been higher - probably more than £1,000m.” (2)

The Government's attitude towards the EC judgement (case 416/85) and the way in which it intended to deal with it is quite clear, as the following extract from Hansard demonstrates:

“The option to tax is an unusual facility, as the honorable Member for Wrexham pointed out. However, it is a crucial aspect of the way in which we have tried to minimise the burden of an unwelcome judgement on the business community and the construction industry in particular.” (3)

The Government's answer to this unwelcome judgement (case 416/85) was to introduce a mechanism referred to in the enabling legislation as an election to waive exemption, more commonly known as the option to tax. This allows taxpayers to

elect to make taxable what would otherwise be exempt supplies of interests in land, subject to certain exceptions.

The first aim of this research is to examine the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the English commercial property market.

Allowing persons making supplies to waive exemption has the effect of reducing the total revenue which would otherwise be derived from the extension of VAT. This is because in most cases the person receiving such supplies will themselves be fully taxable persons and so eligible for credit for the whole amount of the tax paid on such supplies. In the Standing Committee debate on the Finance Bill 1989 the Economic Secretary to the Treasury, Mr Peter Lilley said:

“In the current year we expect revenues of some £35 million from private sector construction and property rising to £110 million, as against £450 million which we might have secured had we not introduced limitations on the burden of the tax.” (4)

The Government could not make the election to waive exemption a mandatory requirement of the enabling legislation, thus avoiding the EC judgement (case 416/85) altogether, as this would have been unacceptable to the European Communities. The UK Government were under an obligation to implement the decisions of the European courts. Instead, an option was given which would allow recovery of the tax within European Community law.

Allowing an option provided the potential to frustrate the Government's aim of mitigation. In choosing not to opt to tax there could be no reduction in the tax burden.

Early research suggested that this might be exactly what was happening, recording a cautious reaction to waiver of exemption by property investors. This research will be examined in the following section.

4.2.2 EARLY RESEARCH

Moore and Lawrence writing shortly after the legislation enabling an election to waive exemption came into effect, reported a survey of 151 property investors, comprising banks, pension funds, insurance companies and property investment companies. The following extract from that article reproduced in Appendix 4 is a summary of the reactions of property investors when asked about their intentions regarding opting to tax their portfolios:

“....(1) Of those who have or will be electing, 90% are doing so building by building and by no means across the board. Many have elected on some properties already but are keeping their options open on others.

(2) Only slightly more investors have already elected than those who have not, and those who have not are evenly divided between those who plan to do so in the future and those who do not. The result is that by the end of October (1989) a majority of investors are likely to have elected on at least part of their portfolio.

(3) Although the majority of investors will have elected by the end of October (1989) there is no sign of a general rush to do so across the board.....

(4) Most of those who are or will be electing are obviously thinking carefully about the basis on which they will elect, and are only doing so where there is a clear financial advantage. Several say they will elect where money has been spent (on new development or on refurb) the VAT on which can be reclaimed, ie, the general trend is to make the decision on an individual basis, after consideration.....” (5)

It has not been possible to establish the survey methodology adopted by Moore and Lawrence. Attempts to contact Moore and Lawrence have met with no response. As a result a detailed critique is not possible. However, the sample may be unrepresentative as it appears to concentrate solely on the opinions of property investors, ignoring the experiences of others directly involved in commercial property such as property developers and occupiers.

Nevertheless the survey undertaken by Moore and Lawrence provides an indication of the reaction of part of the business community to the new legislation. It suggests that there was no immediate rush to elect to waive exemption, rather that property investors were giving careful consideration as to whether to elect or not and were only doing so where there was a clear financial advantage.

The results of this early research indicate a partial failure in the take up of the option. Effective mitigation of the EC judgement (case 416/85) will only occur when the tax burden which would otherwise have resulted from the judgement (case 416/85) is reduced. A failure to take up the option will result in no reduction in the tax burden. The results of this early research would suggest that the facility to waive exemption may not be entirely effective in mitigating the effects of the EC judgement (case 416/85).

4.2.3 THE ADVANTAGES AND DISADVANTAGES OF AN ELECTION TO WAIVE EXEMPTION

Section 4.2.1. demonstrates that allowing the option to tax provides an opportunity to frustrate the Government's aim of mitigation. Effective mitigation of the EC judgement (case 416/85) will occur when the tax burden which would otherwise have resulted from that judgement is reduced. This section considers the decision to opt to tax, because it is this decision which will determine whether or not the Government's aim of mitigation is frustrated and thus the effectiveness of waiver of exemption.

Scott and McClellan (6) suggest that the decision to elect to waive exemption will involve a risk/benefit evaluation of the advantages and disadvantages associated with that decision.

Thus the decision to elect to waive exemption may be considered as a function of the costs and benefits which flow from it:

Election to waive exemption = f(benefits/costs in making the decision to elect/not to elect to waive exemption)

It follows that if the benefits expected to be gained from making the decision to waive exemption outweigh the costs involved in such a decision then the decision to opt to tax will be made and vice versa. If the risks and benefits can be successfully

identified and ordered it may be possible to predict whether the decision to elect to waive exemption will be made. If it is possible to predict those circumstances when a decision to elect to waive exemption will or will not be made than it may be possible to assess the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85).

It may be possible to identify certain costs and benefits which may flow from the decision to elect to waive exemption. The principal benefit is that those who are fully taxable may recover input tax:

“The purpose of the election to waive exemption is to enable taxpayers to recover their input tax.” (7)

“The investor who purchases the freehold of a ‘new’ commercial building will have an overwhelmingly powerful incentive to opt to tax his rents since this will permit him to recover VAT paid on the purchase, which for a new building will be a substantial figure.” (8)

For example, if an institution buys a freehold interest in a new commercial building, VAT will be payable on the purchase price. Such VAT would be irrecoverable without the option to tax because if it intended to let the building such letting involves the making of exempt supplies. If the institution makes an election to waive exemption these supplies become taxable and it will be able to recover the VAT paid on the purchase price.

There may also be cash flow benefits to be gained from electing to waive exemption. Both landlord and tenant will want to hold monies due to HMCE as

long as possible. This may be achieved by landlords by allowing the taxpoint (the time when a supply is taken for VAT purposes to take place) for the rent to fall as early in the VAT quarter as possible so that the maximum use of those monies due to HMCE is made before they are actually paid over. The tenant in contrast will maximise the period before he has to account to HMCE if the tax point were to fall towards the end of the VAT quarter. The positioning of the tax point can thus be of importance to both landlord and tenant.

A business which is otherwise wholly or partially exempt can improve its overall tax position by opting to tax rents on all the buildings it owns. Broadly speaking, a business which makes exempt and taxable supplies can recover only so much of its input tax as is equivalent to the proportion of taxable supplies it makes overall. Consequently, the more taxable supplies it makes, the higher the proportion of its overall input tax that can be recovered.

Section 3.2.2 reviews the developer's self supply charge where it may be essential that the option to tax is made to avoid this charge:

“another reason for exercising the election is if the developer of a new building, or the investor funding it plans to grant leases of the building rather than sell it. In this case, opting to tax the leases is essential to avoid the self supply charge which applies as soon as an exempt occupation of the building takes place.” (9)

But making the decision to elect to waive exemption may not be without costs:

“..the most fundamental point is that if the option has been exercised a freedom has been taken away from the landlord, and effectively from his commercial successor.” (10)

If the owner has opted to tax and sells his interest the purchaser of that interest will almost certainly opt to tax otherwise he will incur the burden of the tax, as VAT would be charged on the sale.

The decision to elect is irrevocable (section 3.2.1.3). Landlords in particular must be extremely careful to ensure that this decision does not only provide a short term benefit, such as recovering input tax on repairs, but also ensures a long term cost, by reducing potential demand from exempt purchasers on disposal.

If a building has been built for an exempt tenant then the decision to opt to tax may depress rental levels, this may also affect yields and capital value. Section 4.3.0 will examine this in greater detail in connection with the second aim of this research.

Sub-paragraph 3(3) Schedule 3 Finance Act 1989 (section 3.3.0) stipulates that buildings linked internally by a covered walkway, parades, precincts and complexes are to be treated as a single building. This may create considerable problems for some landlords. For example if the landlord of a shopping centre were to elect on a small part of the centre then he would be treated as having elected to waive exemption on the whole.

The disadvantage may not be immediately apparent but,

“For those (tenants) unable to recover some or all of the VAT they suffer on expenditure there is of course a significant disadvantage.” (11)

The lessee of a building on which the landlord has elected to waive exemption will be required to pay VAT in respect of the rent charged and may not mind doing so, since if the lessee occupies the building for the purpose of a fully taxable business VAT incurred as a deductible input tax can be recovered. However, a problem arises when the tenant runs a business involved mainly in making exempt supplies since the tax cannot be recovered. Thus it is essential for the landlord to consider not only his present and expected future position but also that of his tenant and possible tenants when considering whether or not to elect to waive exemption.

Further difficulties may arise for tenants who wish to assign their lease of a building where the landlord has opted to tax (section 3.4.2.1). This may reduce demand from exempt tenants who will not be able to recover the VAT element on any premium or on rent.

The decision to elect to waive exemption will involve compliance costs such as acting as unpaid tax collector for HMCE, issuing tax invoices and dealing with customs control visits (section 3.4.3.2).

Stamp duty will be payable on the total of the value and the VAT thus giving rise to a double tax situation (section 3.4.2.2). This will increase transaction costs and may

discourage some exempt/part exempt purchasers who would be unable to recover the VAT.

It is not only the absolute significance of the benefits and costs to be gained or lost from the decision to opt to tax which may influence that decision, but also the relative importance of those benefits and costs. This may occur when the decision whether or no to opt to tax is made on the basis of more than one variable.

For example the benefits from opting to tax may result in short term advantage from the recovery of input tax but a long term disadvantage that VAT will have to be paid on the sale price. Thus the relative importance of the short term benefit or the long term risk may determine whether the option to tax will be made. In monetary terms the short term gain may far outweigh the long term cost.

Thus it is necessary to amend the functional relationship:

Election to waive exemption = f(the absolute and relative significance of the costs
and benefits which flow from that decision)

The decision whether or not to waive exemption may be based on the absolute and relative significance of the benefits and costs which flow from that decision. Having established the factors which determine whether or not an election to waive exemption will take place it is possible to establish hypotheses which may explain the effectiveness of waiver of exemption in mitigating the effects of the EC

judgement (case 416/85) in respect of the English commercial property market. These hypotheses will be examined in the following section.

4.2.4. THE EFFECTIVENESS OF WAIVER OF EXEMPTION IN MITIGATING THE EFFECTS OF THE EC JUDGEMENT (CASE 416/85) ON THE ENGLISH COMMERCIAL PROPERTY MARKET

The preceding sections of this chapter have considered the Government's problem which was to mitigate the effects of an unwelcome EC judgement (case 416/85) on the UK business community. Had this decision been implemented in full without some form of mitigation it would have given risen to significant additional tax burdens particularly for the commercial property sector. The Government's method was the introduction of the election to waive exemption, which provided the option for taxpayers to avoid the tax.

In providing choice the Government also provided the potential to frustrate their attempts at mitigation, because where an election to waive exemption is not made there is no possibility that the tax burden will be reduced.

It has been suggested that the decision to elect to waive exemption may be determined by the absolute and relative significance of the costs and benefits which flow from that decision.

It has been demonstrated that the costs and benefits which flow from the decision to elect to waive exemption can be identified. Based on the assumption that if the benefits expected to be gained from the decision to elect to waive exemption outweigh the costs involved then the decision to opt to tax is more likely to be made and vice versa, it follows that:

- (1) Where the absolute and relative significance of the benefits gained outweigh the absolute and relative significance of the costs incurred from the decision to elect to waive exemption it is expected that the decision to elect to waive exemption will be made;
- (2) Where the absolute and relative significance of the costs incurred outweigh the absolute and relative significance of the benefits gained from the decision to elect to waive exemption it is less likely that the decision to elect to waive exemption will be made; and,
- (3) Where the absolute and relative significance of the benefits and costs is equal then it is less likely that the decision to elect to waive exemption will be made. This is because the decision once made is irrevocable and the absolute/relative importance of the variables may change over time.

These hypotheses will be tested in the following chapter where a research method will be developed and implemented. The next section of this chapter is devoted to developing the conceptual thinking which underpins the second aim of this research.

**4.3.0 AIM TWO - TO ASSESS THE PERCEIVED EFFECTS OF
WAIVER OF EXEMPTION ON RENTS IN THE ENGLISH
COMMERCIAL PROPERTY MARKET**

This section develops the conceptual thinking which underpins the second aim of this research, which is to assess the perceived effects of waiver of exemption on rents in the English commercial property market.

Commentators' opinions of the effect of waiver on rents suggest a significant impact:

“In markets which are dominated by exempt tenants it is conceivable that there would be a 13% (VAT @ 15%) drop in rental and capital value if the option is exercised.” (12)

Whilst some commentators hypothesised as to the effect of waiver of exemption on rents, no evidence was available on what was actually occurring in the commercial property market.

The following sections examine the problem that waiver of exemption places an additional tax burden on exempt and part exempt occupiers. The concepts which underlie this part of the research are developed with reference to economic price theory.

Variables based on the determinants of market demand and supply are developed from initial concepts. From these variables hypotheses are put forward which may be tested and used to predict the effect of waiver of exemption on rents.

4.3.1 THE TAX BURDEN

This section examines the problem which an election to waive exemption by a landlord has for exempt and part exempt tenants.

The Finance Act 1989 enabled landlords to elect to waive exemption. The effect of an election to waive exemption by a landlord will result in tenants paying VAT on rents. As long as a tenant occupies a building for the purposes of a fully taxable business it will be able to recover the VAT as a deductible input tax.

“For standard-rated occupiers the charge of VAT on rents has no net effect on their occupation costs as they can recover the tax” (13)

If the tenant does not occupy a property for the purposes of a fully taxable business it will be unable to recover the VAT. These tenants are referred to as exempt or

part exempt because they cannot recover or can only recover part of their input VAT costs. They will bear the burden of the VAT which cannot be recovered:

“...the exempt occupier will be required to pay rent plus VAT, so increasing his total occupation costs as he will not be able to recover the VAT paid on rents.” (14)

The problem for exempt and part exempt tenants is that the effect of their landlord opting to tax is to place an additional occupation cost on them, in the form of an increased rent.

Having considered the problem for exempt/part exempt tenants, the following section examines economic price theory which may help to explain the effect of waiver of exemption on the rents of exempt and part exempt tenants.

4.3.2 ECONOMIC PRICE THEORY

This section considers economic price theory as a possible explanation of the impact of waiver of exemption on the commercial property market. The section begins by considering economic price theory, which explains the impact of taxes on the supply of and demand for space. The effect of elasticity on the incidence of the tax is discussed with particular reference to the division of the tax burden between landlord and tenant. Finally the practical application of economic price theory to the commercial property market is considered as a possible explanation of the impact of waiver of exemption on rents of commercial property.

4.3.2.1 The Theory

The supply curve for a space, (S1) section 4.3.2.2 below, shows the relation between its rent (per unit area) and the quantity landlords wish to provide per period of time. The curve is drawn on the assumption that all other factors that influence the quantity supplied remain constant and its upward slope indicates that the higher the rent the more landlords will wish to provide.

Economic price theory predicts that the effect of introducing a tax on the supply of space will be to shift every point on the supply curve vertically upwards by the amount of the tax (S2). This is because every quantity will be associated with a market rent which is higher by the amount of the tax after its imposition assuming there is no change in the willingness of landlords to supply space.

To determine what actually happens to rent, it is necessary to introduce the demand curve, (D1) section 4.3.2.2 below, into this analysis, because rent depends both on demand and supply.

The demand curve for space shows the relationship between rent and the quantity the tenant is able and willing to pay for per period of time. It is drawn on the assumption that all other determinants remain constant, and its downward slope indicates that the lower the rent, the more the tenant will desire to acquire.

The point at which the demand and supply curves intersect represents the market equilibrium rent. This is the point at which those who demand want to lease the same amount those who supply want to provide. The market in a state of disequilibrium will move towards market equilibrium.

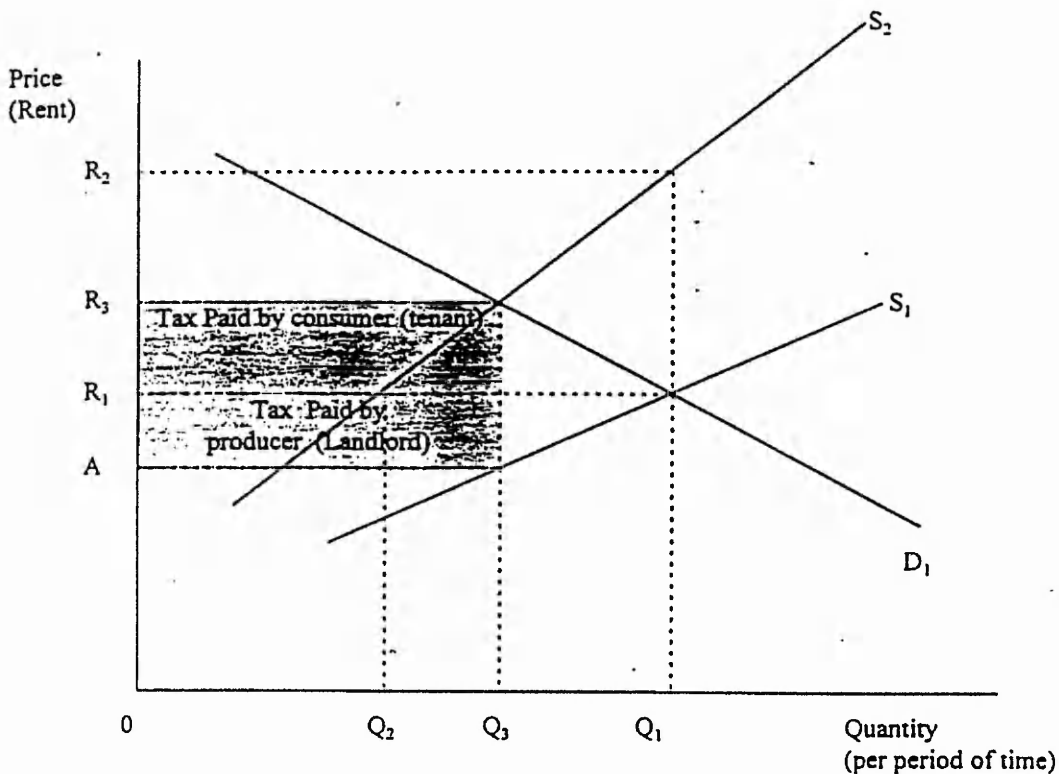
The effect of introducing a tax such as VAT is to create a state of market disequilibrium. The leftward shift of the supply curve, (section 4.3.2.2), causes excess demand (Q_1 less Q_2) to develop at the original equilibrium rent (R_1). There is a shortage and rents are bid up to (R_2). As rents rise so the quantity demanded falls from Q_1 to Q_3 .

Eventually a new market equilibrium post-tax, at rent (R_3) and quantity (Q_3) is reached by raising the rent paid by tenants and lowering the rent (less the tax) received by landlords in both cases by less than the amount of the tax. The following section goes on to illustrate the application of this theory to property taxes.

4.3.2.2 The Application of Economic Price Theory to Property Taxes

Economic price theory can be illustrated by reference to property taxes, such as VAT. Property owners often protest that the burden of property taxes makes investment unprofitable, while tenants believe that the taxes are fully borne by them in the form of rents. In actual fact economic price theory suggests that part of the tax is borne by the landlord and part is passed on to the tenant.

The Application of Economic Price Theory to the Commercial Property Market



By way of an example, assume that initially there were no tax on commercial property prior to the Finance Act 1989 and then one is introduced such as the election to waive exemption. If each landlord raises rents by the amount of the tax then economic price theory predicts that there will be a decline in the quantity of rented accommodation demanded (Q_1-Q_3). Higher rents (R_1-R_2) will encourage some tenants to move out and some to take less space.

The decline in the quantity demanded without a change in the quantity supplied will lead to a situation of oversupply. Landlords will find it difficult to replace tenants who move out. This situation will induce some tenants to offer lower rents (R_2-R_3).

Some landlords will accept these reduced rents rather than have their properties vacant for long periods. Once landlords have started to accept lower rents others will be forced to follow this trend or risk having vacant property for prolonged periods.

As rents fall there will be a gradual fall in the quantity of rented accommodation supplied, (Q1-Q3) because landlords will be less willing to rent for reduced returns and reduced rents may result in some proposed new developments being mothballed as they are no longer perceived as the optimum investment.

Eventually rents will reach a new equilibrium at which the quantity demanded equals the quantity supplied (R3Q3). This equilibrium will be higher than the pre-tax rent but lower than the rent which passes the whole burden on to tenants. Thus the burden of the tax will be shared by landlords and tenants.

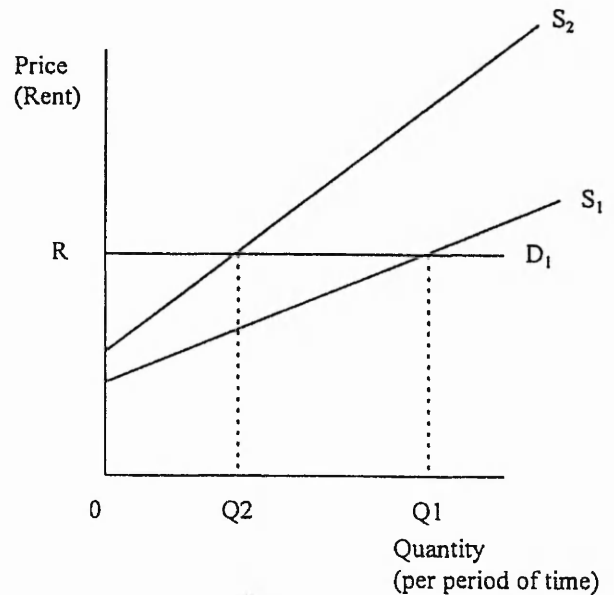
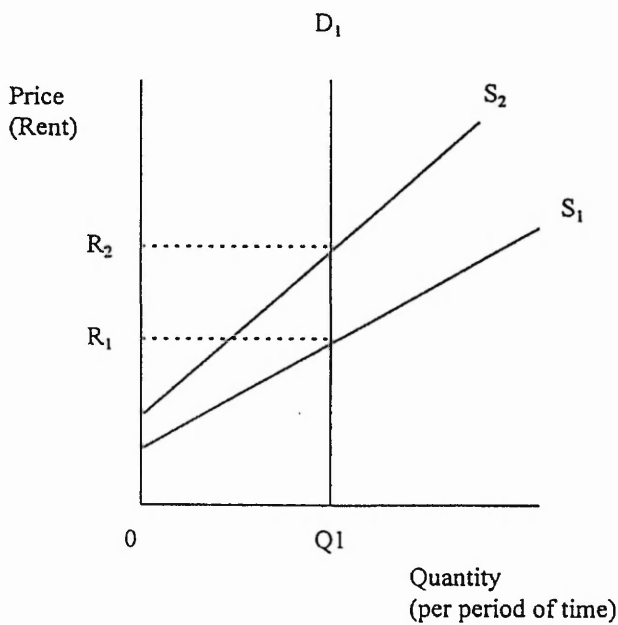
4.3.2.3 The Effect of Elasticity

This section considers the effect of elasticity on the incidence of the tax between landlord and tenant. The burden will vary depending on the slope of the demand and supply curves.

To illustrate diagrams i-ii. below show two supply curves representing pre- and post-tax situations combining them with different demand curves.

In diagram (i) the demand curve is perfectly inelastic and the equilibrium rent will increase by the full amount of the tax. In diagram (ii) the demand curve is perfectly elastic and the equilibrium rent is unchanged despite the shift in the supply curve. This suggests that the more inelastic the demand for space, the greater the rise in rent paid by the tenant and the less the fall in rent received by the landlord as a result of the imposition of any given tax.

The effect of a tax on equilibrium rent & quantity given demand curves of various elasticities



The steeper, more inelastic the demand curve at the equilibrium point the greater the proportion of the tax paid by tenants and the smaller the proportion of the tax paid by landlords.

Variations in the elasticity of supply may also influence the incidence and burden of the tax. One of the most important determinants of the impact of elasticity is the availability of substitutes. A change in the relative price of a factor of production with several close substitutes is likely to cause substantial substitution. A rise in rent may lead to a greater fall in the quantity of space demanded than if fewer substitutes were available.

4.3.2.4 A Possible Explanation of the Concept of Two Tier Markets using Economic Price Theory

Knight Frank Rutley Research (KFR) suggested that following the introduction of waiver of exemption,

“..the first of the major implications for the office market will be the creation of a two tier rental market in certain commercial centres.” (15)

This section considers how economic price theory may be used as a possible explanation of the development of this phenomenon. The concept of a two tier market may be illustrated by assuming that an exempt tenant has the choice between two buildings which are very similar, except that the landlord of one has opted to tax rents and the landlord of the other has not.

In the case of an elected building an exempt tenant would be required to pay rent plus VAT. This tenant's total occupation costs would be increased because the VAT paid on rent cannot be recovered. In the case of the non-elected building no VAT will be

charged on rent. There will therefore be a clear financial advantage to exempt tenants to occupy unelected buildings because no VAT will be incurred.

KFR argue that exempt tenants would show such a preference for non-elected buildings, that they would be prepared to pay a premium of up to the amount of VAT charged (currently 17.5%) over the market rent to secure a non-elected building.

KFR suggest that standard rated tenants who can recover VAT in full would be outbid by exempt tenants for non-elected buildings and standard rated tenants would converge on elected buildings. This would result in the development of a two tier market in terms of the tax status of buildings and occupiers as well as rent levels. This would be made up of non-elected buildings let at rents up to 17.5% above the market's base rent, predominantly occupied by exempt tenants and elected buildings let at the market base rent, predominantly occupied by standard rated tenants.

It is possible to use economic price theory as an explanation of the development of two tier markets. The diagram in section 4.3.2.2 can be used to illustrate the pre-tax supply (S1) and demand (D1) curves for offices occupied by fully taxable and exempt tenants. The Finance Act 1989 introduced the election to waive exemption enabling landlords to opt to tax rents. Where landlords have opted to tax rents economic price theory predicts that the supply curve for exempt tenants will shift to a new position (S2). The supply curve for fully taxable tenants remains unchanged, because they can recover the VAT in full.

This diagram shows that the price or costs of occupation has, for exempt tenants, increased $R1-R2$, assuming the same quantity ($Q1$) is demanded, as suggested by KFR. Thus exempt tenants costs of occupation have increased as a result of the tax whilst fully taxable tenants costs have not.

KFR argue that the difference in price (costs of occupation), $R2-R1$, if quantity demanded remains the same, represents the premium which exempt tenants would be prepared to pay to secure a non-elected building. Economic price theory suggests that this is not the case because the total incidence of the tax does not fall on the tenant, but is shared between landlords and tenants dependent on the elasticity of the demand and supply curves. The amount of premium is more likely to be represented by the difference $R3-R1$.

The argument put forward by KFR relies on the quantity of space remaining constant. In the short term this may be possible because tenants may experience difficulty in disposing of their existing lease. But in the long run there is the possibility of a change in equilibrium quantity as shown by economic price theory. KFR recognise that the imposition of the option to tax is likely to lead to increased mobility on the part of exempt tenants. This is shown in the diagram as a reduction in quantity $Q1-Q3$. Market equilibrium will eventually be regained at $R3Q3$ for exempt tenants.

KFR recognise that their analysis is based on a perfect market and that in reality this situation does not exist. There will not be an immediate and complete response by landlords and tenants to the new pricing regime which the option to tax allows. The

tenants' occupation costs may be only one of many factors influencing their decisions. The relative importance of these factors may dictate whether exempt tenants will enter the market when presented with the additional costs of VAT on rent.

KFR also recognise that there are few fully exempt tenants and that this will have a mitigating effect on the full impact of waiver of exemption. KFR suggest that this will lead to a range of premium rents in inverse proportion to the level of VAT which can be recovered.

Finally KFR suggest that the two tier market will be a temporary phenomenon because there will be a strong incentive for property owners to opt to tax rents and in the long run virtually all buildings will be elected for tax. The decreasing number of non-elected buildings will limit choice until the two tier market cannot be sustained.

In this section economic price theory and its underlying concepts have been considered as a possible explanation of the impact of waiver of exemption on the commercial property market, rental levels and two tier markets.

In the following section hypotheses are put forward based on economic price theory which may be tested and used to predict the effect of waiver of exemption on rents.

4.3.3 THE PERCEIVED EFFECTS OF WAIVER OF EXEMPTION ON RENTS IN THE ENGLISH COMMERCIAL PROPERTY MARKET

The preceding sections of this part of the chapter have considered the problem that for exempt and part exempt tenants the effect of their landlord opting to tax their rent is to place an extra occupational cost upon them as all or part of the tax cannot be recovered.

Economic price theory has been considered as a possible explanation of the effect of opting to tax rents and as a possible means of predicting its effect. Variables have been considered based on these concepts and it is recognised that the determinants of demand and supply in the context of the commercial property market will require a more detailed study beyond the scope of this initial research.

Based on economic price theory it may be hypothesised that the effect of the introduction of waiver of exemption on the commercial property market will be:

- (1) a reduction in the disequilibrium rent, (R2), paid by exempt/part exempt tenants, to the equilibrium rent, post tax (R3).
- (2) a reduction in the total quantity of commercial property offered to let.

Having developed the conceptual thinking which underpins the aims of this research, the following section goes on to consider data collection methods.

4.4.0 DATA COLLECTION METHODS

The final part of this chapter provides an examination of data collection methods in the context of this research. Expressed in general terms there are three basic forms of data collection methods based on observation, survey research and non-reactive techniques. Each is examined in turn below.

4.4.1 OBSERVATION

Nachmias and Nachmias commented that:

“Social science research is rooted in observation” (17)

The method's main virtue is directness, since it is possible to study behaviour as it actually occurs. For example in the context of this research data could be collected directly by being present during the decision-making process which would determine whether or not to elect to waive exemption. Being present as the decision was made would avoid the problems associated with the need for memory recall which may distort facts.

The method also allows phenomena to be observed in their natural environment avoiding the problems associated with research carried out in artificial settings, which may distort results simply because of a change in environment.

Observation as a data collection method has particular merits when the individuals studied are unable or unwilling to articulate themselves meaningfully. In the context of this research it would be particularly useful if the researcher were present to interpret the data rather than relying on the respondent to do so as some of the other methods considered require. For example requiring the respondent rather than the researcher to make a reasoned judgement about a series of decisions whether or not to elect to waive exemption on properties in the respondent's portfolio.

Nachmias and Nachmias suggest three main considerations must be dealt with if the obtained data is to be scientifically meaningful:

“..... what to observe, when to observe and how to record, and how much inference is required.” (18)

What to observe may include body movements, the relationship of the observed to the space around, and linguistic behaviour both in terms of the actual words spoken and associated factors such as clarity of diction, speed, etc.

It may be possible but not necessarily practical to carrying out observations for all times. This restraint requires the researcher to select observation units at points in time. In the context of this research only those events directly related to waiver of exemption would be observed which are likely to occur over a fairly short time span.

This method requires accurate recording based on either a deductive approach beginning with a conceptual definition, specifying indicators, standardising and

validating the result, and may be flawed if the conceptual definition is imprecise. Alternatively one may adopt an empirical approach, first selecting indicators and postponing definitions until some pattern emerges. The latter approach may present problems in interpreting the observations. These risks may be reduced by a series of data collections over time each refining and concentrating the concept.

Observational studies will require a degree of inference by the person carrying out the investigation. For example the need to identify factors which influenced the decision to elect to waive exemption. This requirement for inference may introduce error into the results if the person carrying out the observation is inexperienced. The degree of error may be reduced by training.

The types of observation may be classified as controlled, characterised by clear and explicit decisions about what, how and when to observe or non-controlled allowing greater flexibility.

Laboratory experiments are an example of controlled observation and may be criticised for their lack of realism. This problem may result from the observed being aware of the experimental nature of the situation and that certain responses are expected. The observed may tailor responses to suit the situation. This bias may be reduced by deception thus ensuring that the observed cannot be aware of the actual requirement. Difficulties may also occur if the person carrying out the experiment inadvertently influences the observed, possibly by communicating their expectations.

This problem may be overcome by the use of tape recordings or television cameras to eliminate communication or the use of experimenters with different expectations.

The results may also be influenced by the instruments of measurement, such as cameras, influencing the response of the observed. The time of measurement may also affect the response of the observed.

An example of non-controlled observation is field experimentation. Here the principal difficulty is one of control. This problem may in part be overcome by replication and reducing the size of the units.

This is the least controlled method of observation and probably the most suitable for this research of all the observed methods. This involves the researcher in membership or attachment to the group being studied. For example joining a property management team. The objectives of the researcher may not be known to the group, thus avoiding the possibility of influencing the response. In this case the observer must be careful not to influence the response by behaviour. There may also be problems with recording on the spot if the group is not aware what the researcher is doing.

These problems are overcome if the research becomes known to the group. But difficulties may still arise whilst on the one hand establishing and maintaining a rapport with the group but again not influencing their response.

Possibly the greatest drawback to this form of data collection in the context of this research is that it is not always possible or practical to observe directly the phenomena being researched. For example, whilst preferable, it would be impractical to be present at every decision (or even a large sample) taken to elect to waive exemption. This could be overcome by collecting data from a representative sample of those who have considered whether or not to elect to waive exemption.

4.4.2 PERSONAL INTERVIEW

This data collection method involves a face to face interview carried out by the researcher on the person having experienced the phenomena during which questions pertinent to the research being undertaken are asked by the researcher. For example the researcher would interview those responsible for taking the decision to elect to waive exemption.

Interviews should be identical for every respondent with questions of fixed wording and sequence. This ensures that when a variance in response occurs it is due to a difference between respondents and not the interview. This technique requires a common vocabulary between respondents ensuring that the questions have the same meaning for each, phrasing questions in a form which is equally meaningful to each respondent, identical context and sequence of questions. An example in the context of this research would be to avoid the use of technical jargon to a lay interviewee.

Another form of interview may involve the interviewer with respondents who are responsible for the decision to elect to waive exemption in a structured encounter but with the respondent given far greater freedom to express their definition of the situation. This technique focuses on subjective experiences allowing the opportunity for the researcher to obtain personal reactions and emotions. The situation will have been analysed prior to the interview which will proceed on the basis of a guide related to research hypotheses. The researcher will be alert to data that may be needed to clarify the problem.

Finally the interview may be without structure or set questions. Respondents are given almost complete freedom to recount their experience and the interviewer is also free to probe various areas and ask specific questions.

The principal advantage with this form of interview technique is that it allows flexibility in the questioning process. The less structured and scheduled the greater the flexibility provided. This technique allows control ensuring that the respondent answers the questions and in the correct sequence. The environment may be standardised and the interview carried out in private, the latter an important consideration in this research. This would ensure that there could be no collusion and preserve anonymity. Where time is particularly important to the research the interview can be carried out at a particular time. As a result of the degree of control the response rate is usually high. Finally this technique allows the researcher to collect supplementary information such as other variables which might influence the

decision to elect to waive exemption, an important consideration in the context of this research.

This technique also has certain disadvantages including high costs where travel is necessary to carry out the interview as in the case of this research, or where organisation, training and supervision of interviewers is required. The less standardised the interview the greater the risk of the interviewer adding bias or personal influence to the results. Factors such as race or sex may influence the respondents. Finally this technique does not allow anonymity. The interviewer may know the respondents who may feel unable to respond frankly particularly if the topic is market sensitive as in the case of this research.

4.4.3 TELEPHONE INTERVIEW

This quasipersonal method of interviewing carried out by telephone has benefits over the previous interview technique which include reduced costs and the possibility of reaching a significant percentage of the population. A telephone survey of respondents would be an entirely feasible method of data collection for this research.

The data obtained from this collection method may also be of increased quality as staff carrying out the interview are often located in a single office and can be closely monitored. Technological improvements in the telephone system now permit random sampling.

However, telephone interviews are not without their problems. A percentage of calls will inevitably be broken off before the interview has been completed. The method does not allow supplementary information about the respondent to be collected. Respondents might be unwilling to discuss market sensitive information such as property values and rents which would be required in undertaking this research.

4.4.4 MAIL QUESTIONNAIRE

In some circumstances this impersonal method of data collection may be particularly advantageous. It is cheaper than the previous methods considered so far. The possibilities of bias introduced in the personal interview situation can be totally eliminated with this method. Mail questionnaires allow the researcher to remain anonymous, an important consideration in the subject research where the information required is likely to be market sensitive. This method also provides for respondents to give a considered response possibly after consulting reference documentation. The data likely to be required for this research would benefit from a period of reasoned consideration before a response. Finally it is possible to provide a wide geographical coverage with this data collection method. A representative sample taken from the whole of the UK commercial property market would benefit this research.

This method requires simple questions which can be easily understood with the help of printed instructions by the respondent. An opportunity to clarify ambiguous answers and probe deeper is possible if a follow up technique is used. The researcher

has no opportunity to control the environment in which the answer is completed or to ensure that the correct person completes the questionnaire.

Perhaps the most serious problem for mail questionnaires is that they may fail to obtain an adequate response rate. What is an acceptable response rate? Opinions vary. Many questionnaires fail to achieve a response rate of more than 50%. Some maintain that the falling response rate is due to a saturation of society by this data collection method.

The effect of non-response may be to introduce bias into the results which is often difficult to interpret. If non-respondents constitute a representative group of that originally defined this will introduce a serious bias into the study.

The lack of response may be reduced by the use of sponsorship which may convince the respondent of the studies legitimacy and value, or by inducement possibly by offering a summary of the results. The use of a collaborating body with access to commercial property management data would assist this research. Nachmais and Nachmais page 183 refers to studies which have shown that colour and length make little difference to the response rate whilst format and typography may help. A covering letter may assist by convincing respondents to respond. The inclusions of a stamp addressed envelope for the reply is particularly important, as respondents may feel disinclined to respond if they have to pay the postage.

The selection of recipients will largely be governed by the research although an interest in the topic under consideration may increase the response rate. Nachmais and Nachmais page 184 refers to studies which have shown that follow-ups can significantly increase the response rate.

The method chosen for data collection for the subject research was mail questionnaires. The reasoning which underlies the choice of this method is set out in sections 5.3.1 and 6.3.1.

4.5.0 SUMMARY AND CONCLUSIONS

The purpose of this chapter has been to develop the conceptual thinking for the two aims of this research, which are:

- (1) To examine the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the English commercial property market; and,
- (2) To assess the perceived effects of waiver of exemption on rents in the English commercial property market.

The chapter began by considering the Government's dilemma which was the requirement by the EC to implement its decision (case 416/85) whilst at the same time

finding a suitable mechanism to mitigate the effects on an important sector of the UK economy.

The Government's chosen method of mitigation was to allow the option to make taxable what would otherwise have been exempt supplies of interests in land subject to certain exceptions. In allowing this option the Government provided a loophole whereby its attempts at mitigation could be frustrated.

It was suggested that the decision to opt to tax might be determined by the significance of the costs and benefits which flow from that decision. The following hypotheses were put forward which would determine whether or not the decision to elect to waive exemption would be taken:

- (1) Where the absolute and relative significance of the benefits gained outweigh the absolute and relative significance of the costs incurred from the decision to elect to waive exemption it is more likely that the decision to elect to waive exemption will be made;
- (2) Where the absolute and relative significance of the costs incurred outweigh the absolute and relative significance of the benefits gained from the decision to elect to waive exemption it is less likely that the decision to elect to waive exemption will be made; and,

- (3) Where the absolute and relative significance of the benefits and costs is equal then it is less likely that the decision to elect to waive exemption will be made.

In developing the conceptual thinking which underpins the second aim of this research the problem for exempt and part exempt tenants was considered. These tenants will bear some or all of the extra tax burden when their landlord opts to tax.

Economic price theory was considered as a possible explanation of the effects of waiver of exemption on rents. The following hypotheses were put forward, that the effect of the introduction of waiver of exemption on the commercial property market will be:

- (1) a reduction in the disequilibrium rent, paid by exempt/part exempt tenants, to the equilibrium rent, post tax; and,
- (2) a reduction in the total quantity of commercial property offered to let.

Finally an examination of the various data collection methods was undertaken in the context of this research.

The ultimate test of any hypothesis is the usefulness of its predictions. In chapters five and six the hypotheses developed in this chapter will be tested by developing and implementing a survey methodology and providing a detailed analysis of the results.

1. Parliamentary Debates, House of Commons Official Report, 16 May 1989.
Standing Committees, Session 1988-89 - Finance Bill, Vol. VII, p.69. HMSO.
2. Hedley, C., 18 February 1989 VAT On Construction, Estates Gazette, p.24.
3. Parliamentary Debates, House of Commons Official Report, 18 May 1989.
Standing Committees, Session 1988-89 - Finance Bill, Vol. VII, p.122.
HMSO.
4. Parliamentary Debates, House of Commons Official Report, 16 May 1989.
Standing Committees, Session 1988-89 - Finance Bill, Vol. VII, p.69. HMSO.
5. Moore, J., & Lawrence, A., 14 October 1989, To Elect Or Not To Elect,
Estates Gazette, p.81.
6. Scott, H., & McLellan, D. 1989, VAT and Property, Butterworths, p.130.
7. Parliamentary Debates, House of Commons Official Report, 18 May 1989
Standing Committees Session 1988-89 - Finance Bill, Vol. VII, p.121.
HMSO.
8. Scott, H., & McLellan, D. 1989, VAT and Property, Butterworths, p.133.

9. Moore, J., & Lawrence, A 14 October 1989, To Elect Or Not To Elect, Estates Gazette, p.81.
10. Ball, A., Touche Ross. 1989 VAT and Land. Construction & Property, 2nd Edition, CCH Editions Ltd, p.1324.
11. Ball A., Touche Ross. 1989 VAT and Land. Construction & Property, 2nd Edition, CCH Editions Ltd, p.1402.
12. Hedley, C., 18 February 1989, VAT On Construction, Estates Gazette, p.24.
13. Knight Frank Rutley Research 1989 The Impact Of VAT On The Commercial Property Market, p.10.
14. Knight Frank Rutley Research 1989 The Impact Of VAT On The Commercial Property Market, p.10.
15. Knight Frank Rutley Research 1989 The Impact Of VAT On The Commercial Property Market, p.10.
16. Maclellan, D., 1982 Housing Economics. Longman Group Ltd p.66.
17. Frankfort-Nachmias, C., & Nachmias, D. 1992, Research Methods In The Social Sciences, 4th Edition, Edward Arnold, p.199.

18. Frankfort-Nachmais, C., & Nachmais, D. 1992, Research Methods In The Social Sciences, 4th Edition, Edward Arnold, p.200.

CHAPTER FIVE

THE EFFECTIVENESS OF WAIVER OF EXEMPTION IN MITIGATING THE EFFECTS OF THE EC JUDGEMENT (CASE 416/85) ON THE ENGLISH COMMERCIAL PROPERTY MARKET

5.1.0 INTRODUCTION

This chapter begins by setting out the purpose of this part of the research which is to test the hypotheses developed in section 4.2.4. The method chosen and sampling frame for the pilot survey will then be discussed. This is followed by an explanation of the development of the pilot questionnaires, an analysis and evaluation of the response rate, a review of the methodology, method and an assessment of the amendments required to the main questionnaire.

The method chosen for the main circulation and sampling frame will then be explained. The response rate and aggregate data from the main questionnaire circulation are then analysed and evaluated with appropriate reference to variations in response by group and area.

The results and methodology will then be critically examined. The chapter ends with a summary of the conclusions drawn from an analysis and evaluation of the data to the aims and purpose of this part of the research.

5.2.0 PURPOSE

The purpose of this part of the research will be to test the hypotheses developed in section 4.2.4. From the hypotheses two principal issues arise:

- (1) To determine the take up rate of the option to tax; and,
- (2) To determine the absolute and relative importance of the factors which determine whether an option to tax is made or not.

If the take-up rate of the option to tax can be established, then an indication of the effectiveness of waiver of exemption as a means of mitigating the EC judgement (case 416/85) may be obtained.

If the relative and absolute importance of the factors which determine whether or not the option to tax is made can be established it may be possible to predict, given a certain set of circumstances, whether or not the option to tax will be made.

5.3.0 THE PILOT QUESTIONNAIRES

5.3.1 CHOSEN METHOD

Data collection methods set out in section 4.4.0 were reviewed in the context of this part of the research.

The researcher was conscious that the information required was likely to be of a sensitive nature. The mail questionnaire was identified as the only available method which would allow the recipient to remain anonymous.

It was recognised that there were likely to be potential difficulties with this technique. The environment in which the mail questionnaire would be completed could not be controlled to the same extent as personal or telephone interviews.

It was also acknowledged that a mail questionnaire might be subject to a low response rate with the resultant criticism of unrepresentativeness. However it would be possible with a carefully worded questionnaire and the use of incentives such as offering a results summary and stamped self-addressed reply envelope to reduce the level of non-response.

The survey method would need to be able to cope with a wide geographic sample to ensure that it was representative. The mail questionnaire was considered to be more effective than personal interview in sampling respondents from as wide a geographic area as possible.

A particular advantage associated with the mail questionnaire is its reduction of personal bias a particular problem for personal and telephone interview techniques.

A mail questionnaire would also allow time for the recipient to collect data and give a considered response, an important factor because of the likely technical nature of the questions to be asked.

It was concluded that the most appropriate data collection method would be by mail questionnaire survey. This method would preserve anonymity, would allow time for a reasoned response, would allow a representative sample and would minimise personal bias. With careful design and the use of incentives which included a self addressed return envelope and a promise of a summary of the results it was hoped that the particular problem with mail questionnaire surveys of a low response rate could be overcome. The following section goes on to consider the sampling frame for the pilot questionnaire.

5.3.2 SAMPLING FRAME AND DATA SOURCES

In most instances it is impractical to test the hypotheses by interviewing all possible respondents. Well selected subsets or samples may accurately reflect the characteristics of the whole.

To be successful the research will need to identify all possible respondents, referred to as the population, determine a sample size and select a representative sample.

The enabling legislation (Finance Act 1989) set out in section 3.3.0 defines all possible respondents by setting out which buildings may be subject to the option to tax and who may elect to waive exemption.

This research will concentrate on those who are able to make the decision whether or not to elect to waive exemption who are now referred to as property owners. Each property owner will be a sampling unit.

The option to tax is a relatively recent phenomena, and the literature review failed to reveal any official statistics or published research which might assist this research apart from the article produced by Moore and Lawrence (1) referred to in section 4.2.2. This article may be criticised as unrepresentative because it only seeks the opinions of investors.

It was therefore necessary to question property owners directly to establish data on which to test the hypotheses. The collaborating body, HMCE, might be able to provide data on the actual amount of increased tax revenue which the government had received as a result of the legislative amendments relating to the EC judgement (case 416/85), but this would not assist in testing the hypotheses.

Other potential data sources were considered and in particular it was felt that in-house surveyors and valuers employed by larger property owners represented a potentially important source of data.

Similarly, property owners often seek advice from property professionals when making decisions about their property portfolios. These professionals might also have access to important data. Several categories of professional were identified including chartered surveyors, incorporated valuers, solicitors and accountants.

From a sampling frame which included all property owners, their in-house surveyors, and professional advisers (chartered surveyors, incorporated valuers, solicitors and accountants) a sample was chosen based on the researchers local knowledge of property owners and their professional advisers in Lincolnshire. This ensured that those questioned conformed to the definition of property owners and their professional advisers discussed above.

Two areas were chosen based on the market town of Grantham and the city of Lincoln, to minimise any bias which the size of population centre may have on the results and because their location ensured that the researcher was able to use local knowledge.

5.3.3 DEVELOPING THE QUESTIONNAIRES

This section considers the development of the pilot questionnaires beginning with the recipients of the questionnaires, the contents of the questions, the questionnaire format, sequence and the instructions given to recipients, concluding with the development of covering letters. A pilot questionnaire to be sent to property

owners is developed initially and this basic questionnaire format is used to develop questionnaires for in-house surveyors and professional advisors.

5.3.3.1 Pilot Property Owners Questionnaire

The principal issues highlighted in section 5.2.0 form the basis of the questionnaire development. It was acknowledged that questions would need to be simple and easily understood if the questionnaire was to be successful.

The first question sought to establish whether the recipient knew of the option to charge VAT on rents. If it could be shown that some property owners were unaware of the option to tax then its effectiveness as a method of mitigation could be questioned. To ensure that the question was easily understood the phrase 'charge VAT on rents' was used in preference to 'option to tax rents'.

Similarly the phrase 'non-domestic property' represents a simplification of the exact definition of those properties which may be subject to an election to waive exemption.

Question two was developed to establish the take-up rate of the option to tax. To determine the proportion of properties on which the recipient charged VAT on rents, a graduated scale rising in increments of 20% was provided.

Two questions were then developed to confirm whether or not property owners had sought advice before making the decision to charge VAT on rents and from whom. The second question is not entirely closed allowing the recipient to add further categories of advisor if appropriate.

It was acknowledged that some landlords would attempt to restrict the ability to charge VAT on rents by including appropriate lease clauses:

“... a landlord and tenant are perfectly able to enter into an agreement that no election to waive exemption should be made....” (2)

Such restrictions would take time to evolve as few current leases provided for them and a question was developed to determine the extent of this potential problem.

Finally, a substantial question was developed to establish the factors which determine whether the decision to elect to waive exemption is made or not, and their absolute and relative significance. A matrix question format was used around a series of well-rounded statements based on the advantages and disadvantages associated with an election to waive exemption as discussed in section 4.2.3.

Respondents were asked to rank these statements in order of importance in making their decision. It was recognised that attention might be focused on the first statement at the expense of the others, introducing bias into the results.

A scored ranking was developed based on the statement being crucial, very significant, significant, slightly significant or of no significance in making that decision.

This question was open-ended to allow recipients the option to specify and rank additional factors which may have influenced their decision, thus avoiding the problems associated with a closed question which may not have included all factors.

The final pilot questionnaire developed for property owners is shown in Appendix 5.1.

The sequence of questions began with easier questions and progressed in a graduated sequence to those requiring more thought. It was hoped that this would gain the attention and interest of the recipient which would help to ensure a response.

Recipients were asked to tick appropriate boxes as their form of response. Instructions were given to return the questionnaire if a no response was received to question one as the following questions would be meaningless in that case. Finally at the base of the questionnaire respondents were encouraged to make additional comments if appropriate.

The covering letter shown in appendix 5.2 was sent with the questionnaire. It was designed to explain the purpose of the questionnaire, to give directions about how to complete it and to encourage a response.

A prepaid envelope was provided. Two further questionnaires were then developed to be sent to in-house surveyors and professional advisors. The development of these questionnaires is considered in the following sections.

5.3.3.2 Pilot In-house Surveyors Questionnaire

The questionnaire developed for property owners formed the basis for the questionnaire to be sent to in-house surveyors, because the issues to be tested were the same. Some minor amendments in phraseology were necessary to ensure that the questionnaire was relevant and understood by this sample.

Questions one, three and four were dropped from the property owners questionnaire as being irrelevant to in-house-surveyors.

In-house surveyors were asked two additional questions to test the results of the research undertaken by Moore and Lawrence (3) which concluded that the decision to opt to tax was being taken on a property by property basis and only where there was a clear financial advantage.

Questions five and six from the property owners questionnaire, were retained with minor amendments due to the employee status of recipients. The statements themselves remained the same as those of the property owners questionnaire.

The same covering letter, a similar set of instructions and the same sequence of questions were retained. The following section considers the development of a questionnaire to be sent to professional advisors. The final pilot questionnaire developed for in-house surveyors is shown in appendix 5.3.

5.3.3.3 Professional Advisors Pilot Questionnaire

This questionnaire retained the three questions common to the previous questionnaires which were adapted on the basis that they were to be completed by professional advisors.

The other questions developed for property owners and in-house surveyors were omitted either on the basis that they were irrelevant or that professional advisers would have been unable to answer them due to non-availability of data.

The same instructions, covering letter and sequence as for the previous two questionnaires were retained.

The final pilot questionnaire developed for professional advisers is shown in appendix 5.4.

Having developed the pilot questionnaires these were then circulated to the recipients whose responses are considered in the following section.

5.3.4 ANALYSIS OF RESPONSES TO PILOT QUESTIONNAIRES

The responses to the pilot questionnaires circulated on 3 October 1991 are set out in appendix 5.5. This section considers the response rate to the pilot questionnaires, and the methodology and method are reviewed with the benefit of the results.

5.3.4.1 Response Rate

47 (58.7%) of those sampled responded to the pilot questionnaires of which 43 (53.7%) were useable replies. In summary:

| <u>Respondents</u> | <u>Number Sent</u> | <u>Number Responded</u> | <u>Number Responded (useable)</u> |
|-----------------------|--------------------|-------------------------|-----------------------------------|
| Property owners | 13 | 8 (61.5%) | 6 (46.1%) |
| In-house surveyors | 5 | 5 (100%) | 5 (100%) |
| Professional advisers | 62 | 34 (54.8%) | 32 (51.6%) |
| ----- | | | |
| Total sample | 80 | 47 (58.7%) | 43 (53.7%) |

The best response rate was from the smallest group sampled, in-house surveyors. A lower response rate, of (61.5%) was achieved from property owners and the lowest response rate from professional advisors. Section 5.3.5.1 considers how this response rate might be maintained or improved for the main circulation.

It was recognised that because the researcher knew the recipients of the pilot questionnaire this could not be used as a test of response rate. The pilot questionnaire, which could not be considered a representative sample, was a test of methodology and method. These are considered in sections 5.3.4.2 and 5.3.4.3.

5.3.4.2 Methodology

The methodology for this part of the research was reviewed with the benefit of the results from the pilot questionnaires. The responses obtained to the two principal issues, the take-up rate of the option to tax and the absolute/relative importance of the factors which determine whether or not the option to tax will be made set out in appendices 5.5.2 and 5.5.8 were considered.

The results showed a variable take-up of the option to tax with most respondents opting on only a small percentage of their portfolio (1-20%). These results established the take-up rate of the option to tax and that it was possible to isolate the factors which determine whether or not the decision to opt to tax is made, their relative and absolute importance.

The pilot data appeared to provide satisfactory results to the principal issues of this part of the research.

5.3.4.3 Method

The method of data collection was reviewed following the pilot questionnaires. Whilst the response rate achieved 47 (58.7%) was less than that which might have been achieved from personal interview it was nevertheless considered acceptable.

Many respondents had not chosen to remain anonymous, often returning a covering letter with their response. In view of the level of response it was considered unnecessary to remove anonymity to allow a follow-up. It might also be important to retain anonymity for the main survey to ensure the response rate was maintained. With the benefit of hindsight further consideration should have been given to the non-response at this point in the survey.

The questionnaires had proved easily understood by respondents with the few identifiable difficulties being addressed as part of the redesign considered in the following sections.

The format, sequence, instructions and covering letter had all worked well with respondents.

In summary, the survey method appeared successful having produced an acceptable response rate and was without significant design problems.

5.3.5 ALTERATIONS AND AMENDMENTS TO THE PILOT QUESTIONNAIRES

This section considers the pilot questionnaire response rate, sample and provides a critical assessment of the alterations and amendments required to each questionnaire.

5.3.5.1 Response Rate

The best response rate had been from in-house surveyors. However the possibility of concentrating the main sample on this group alone was rejected because this could lead to an unrepresentative sample, by ignoring groups whom the pilot indicated had valuable data.

It was recognised that the non-responses from both property owners and professional advisors may introduce bias into the results. One possible reason for the reduced number of responses from professional advisors in particular may be the requirement to generalise in order to be able to respond. For professional advisors with a large client base this might be difficult.

The response rate might have been improved by follow-ups. These could not be carried out if anonymity was to be maintained because it was impossible to identify individual respondents. It would have been useful to know who the non-respondents were and if there were any general characteristics, but anonymity prevented the discovery of this information.

The pilot data showed no evidence of problems with data sources which might affect response rate, such as out of date information or an inability to direct the questionnaire to the correct recipient.

5.3.5.2 Sample

The results of the pilot questionnaire clearly justified the inclusion of professional advisors and in-house surveyors in the sample.

Consideration was given to the addition of HMCE as a fourth group to the property owners question on who advised them. It was concluded that this was unnecessary because the main purpose of this question was to confirm the basis of the sample and access to HMCE data would be available as this was the collaborating body.

One unusable response received from the professional advisors' sample was from a chartered surveyor involved only in agricultural work. It was decided that the main sample should be selected only from those surveyors involved with commercial property.

Although it was recognised that the responses from professional advisors required generalisation as they were being asked to comment on what might be a diverse client base, it was decided that the group should not be excluded because they represent an important source of data.

Comments received from property owners included 'we do not have any properties' despite the researchers knowledge to the contrary which suggested a reluctance to respond. The statement 'passed to accountant' further justified inclusion of this group in the sample.

The pilot sample had included a local authority and it was decided to exclude such bodies from the main questionnaire circulation on the basis of their special VAT treatment which might add bias to the results.

5.3.5.3 Questionnaires

This section considers alterations and amendments to questionnaires in terms of individual questions, instructions, format, sequence and the covering letter. A general overview suggested that little amendment would be necessary.

5.3.5.3.1 Property Owners Questionnaire

This questionnaire was reviewed and amendments to the following questions were considered on the basis of the pilot response.

In answering Question 4, one respondent had added 'consultant', whether a tax consultant or some other adviser. It was concluded that the question should not be amended on the basis of this ambiguous comment.

When asked to specify and rank other criteria at the end of Question 6, one respondent had added 'as property developers we must recoup all VAT on our costs'. This showed an inability to fully understand statement (a) but amending the wording of this statement was not considered necessary.

Another respondent had added after statement (d):

“ -Why-Future owner (if not 'connected person') has new option choice”.

This again suggested an inability to understand the statement. It was concluded that to clarify further by specifying the limitations placed on a future owner would lead to an unjustified extension of the statement having regard to the other successful responses.

Nevertheless it was decided to amend the wording of the initial instructions to improve the general context of the questions:

“Question 7. How significant are the following factors in making your decision to charge/not charge VAT on rents?.....”

It was apparent from responses to the question regarding the ranking of statements in the decision to opt/not opt to tax that the nature of property owners' property holdings may have a significant impact on their answers. It was decided that a question should be developed to establish the nature of the property holdings in an attempt to assess the impact of this possible bias in the results:

“Question 5. What percentage of your commercial property holdings are for;

Investment Development Other (specify)”

After reviewing the question sequence the additional question was included after the existing question four to maintain continuity in question development.

The instructions, format, and covering letter were reviewed on the basis of responses and there appeared to be no need for amendments.

The questionnaire to be used for the main circulation of property owners is shown in appendix 5.6.

5.3.5.3.2 In-house Surveyors Questionnaire

This questionnaire was reviewed and it was concluded that, based on a 100% response rate and no additional comments or apparent difficulties in answering any questions by respondents, that the only amendment required was rephrasing of the final question as that for property owners.

The question developed for property owners to determine the percentage of commercial property holdings held for investment, development or other purposes was added to this questionnaire.

The sequence of questions was reviewed in the light of this addition which was made after the previous question four.

The instructions, format and covering letter were also reviewed but because of no apparent difficulties no amendments were made.

The questionnaire to be used in the main circulation of in-house surveyors is shown in appendix 5.7.

5.3.5.3.3 Professional Advisors Questionnaire

Two respondents had indicated an inability to complete Question 1. because they felt unable to comply with the need to generalise about a range of clients. This had been recognised (section 5.3.5.1) as a possible reason for a non-response, but it was not felt appropriate to amend the question.

No apparent problems were experienced in answering question two.

When asked at the end of Question 3. to specify and rank any other criteria one respondent commented:

“Foreign investor prefers to avoid complications of VAT”

On reflection it was felt that any reluctance on the part of foreign investors to invest in the UK could have serious implications for the commercial property market. As a result it was decided to include a question to investigate the extent of the problem.

Comments on ‘other criteria’ added at the end of Question 3. were considered and all appeared representative of an inability to comprehend the range of issues involved. The statements in this question were reviewed and the wording was amended to ensure consistency.

In addition the question to determine the percentage of commercial property held for investment, development or other purposes was introduced.

The instructions for this questionnaire were reviewed as one respondent had failed to tick the boxes in question three. It was decided that the instructions at the top of the questionnaire were sufficiently clear and had not been misunderstood by any other respondents.

The sequence of the questionnaire was reconsidered having regard to the new questions and these were included after question two in an attempt to maintain continuity.

The questionnaire format and covering letter were also reconsidered and, as no apparent problems had arisen, no amendments were considered necessary.

The questionnaire to be used in the main circulation of professional advisors is shown in appendix 5.8.

5.4.0 METHOD

5.4.1 CHOSEN METHOD

This section considers the method of data collection chosen for the main questionnaire circulation. The chosen method of data collection for the pilot survey was reviewed. It was concluded that the questionnaire survey had achieved the requirements set out in section 5.3.1.

Whilst the previous section demonstrates that some minor amendment and refinement in questions was required, the responses indicated that most recipients had found the questionnaire easy to understand and were sufficiently interested in the subject to respond.

Alternative methods of data collection were reviewed in the light of the pilot results and whilst it was appreciated that these might offer benefits, such as the ability to probe around issues, there would also be inherent disadvantages such as the introduction of bias by personal influence.

It was concluded that the questionnaire survey technique had proved largely satisfactory for the pilot study and should be retained with those minor amendments to questions discussed in the previous section, for the main data collection.

5.4.2 SAMPLE

This section considers the choice of sampling frame and sample for the main questionnaire circulation.

The sampling frame for the pilot questionnaire set out in section 5.3.2 was reviewed in the context of the results and it was determined that there was no evidence to suggest the need for amendment. Evidence from the pilot survey supported the inclusion of in-house surveyors and professional advisers in the sample as important data sources.

It would not be possible for the researcher to exercise the same degree of control over the choice of recipient for the main circulation as for the pilot. Several possibilities were considered in attempting to find a listing for property owners in England. The rating list was considered but dismissed on the grounds that it is based on occupiers and not owners. No single comprehensive listing of property owners in England could be found and it was determined to use the Yellow Pages listings for property owners, property developers and property investors as a representative sample of the definition of property owners.

This sampling frame is by no means ideal as it may be incomplete. It is possible that not every property owner is listed in the Yellow Pages.

The sampling frame should not produce difficulties with clusters as each property owner will be listed individually but there may be problems with blanks as residential property owners may also be listed and these are not required.

In-house surveyors were identified by reference to listings in the Incorporated Society of Valuers and Auctioneers and the RICS current lists of members.

The sample of professional advisors would again include chartered surveyors and incorporated valuers, solicitors and accountants. Solicitors and accountants were also selected from their professional directories. Arbitrarily those companies with five or more partners were chosen.

Two regions were chosen for sample, Nottingham and Leeds, both major commercial centres and it was hoped to prove by a similarity in the results from each that these were representative of England.

Consideration was also given to the areas of study and it was decided that these should include not only city centres but also conurbations, to ensure inclusion of a diversity of commercial property types. The sample was split into two areas. The first termed, central location, was selected by reference to Standard Trunk Dialling(STD) codes (Nottingham/Leeds) directory listings for the groups under

consideration. The second termed, area location, was selected by reference to the Yellow Pages area maps for the remainder of organisations in Nottingham and Leeds directory listings.

Having chosen the method of data collection and identified a representative sample the main questionnaires were dispatched for return by 31 January 1992. The following section provides details of the results of that survey.

5.5.0 RESULTS OF MAIN CIRCULATION

5.5.1 RESPONSE RATE

184 (39.4%) recipients responded to the main circulation of questionnaires of which 136 (29.12%) were useable replies. In summary:

| <u>Respondent</u> | <u>Number Sent</u> | <u>Number Responded</u> | <u>Number Responded (useable)</u> |
|---|------------------------|-----------------------------|---------------------------------------|
| Property Owners | 170 | 63 (37.06%) | 47 (27.65%) |
| In-house surveyors | 37 | 14 (37.84%) | 12 (32.43%) |
| Professional advisors - chartered surveyors/ incorporated valuers | 131 | 55 (41.98%) | 32 (24.42%) |
| solicitors | 88 | 33 (37.5%) | 26 (29.54%) |
| accountants | 41 | 19 (46.34%) | 19 (46.34%) |
| ----- | | | |
| Total sample | 467 | 184 (39.40%) | 136 (29.12%) |

This was a particularly disappointing response rate contrasting sharply with that of the pilot questionnaire. It had been anticipated that professional advisors as a group might have some difficulty in responding because of the need to generalise when making their response. However this difficulty was not reflected in the responses received, which were equally low from all groups.

There was some evidence of the reasons for a non-response which are often associated with this survey technique. Twenty seven unusable questionnaires indicated that the recipients were not involved with commercial property and were unable to respond. Ten unusable questionnaires, all but two from property owners were returned 'no longer known at this address' indicating that the data sources were out of date. To some extent this situation had been compounded by the recession, during which an increased number of mergers and liquidation of property companies and their advisors had occurred.

There was also some evidence of a failure to direct the questionnaire to the correct recipient in large organisations, some of which had replied indicating that the questionnaire had been passed to another individual or office for a response. Other possible reasons for a non-response include lack of time in which to complete the questionnaire, the need to preserve confidentiality despite the assurances given and a perceived lack of direct benefit or interest.

It was not possible to use methods such as follow-ups in an attempt to reduce the level of non-response as the questionnaire required anonymity to be maintained.

Had the low level of response rate been anticipated before the main questionnaire circulation it is possible that this requirement may have been removed. The loss in responses due to a lack of confidentiality may have been outweighed by the increase in response rate achieved by follow-up. Many respondents had not wished to remain anonymous, enclosing complimentary slips or letters with their response.

The level of 29.12% is not untypical of response rates from mail questionnaires surveys.

5.5.2 ANALYSIS OF RESPONSES TO QUESTIONNAIRES

Descriptive statistics for each question have been produced from aggregate data based on a total count of respondents and the percentage of responses. These are reproduced in appendix 5.9. The methodology involves a simple visual analysis of each distribution with comments on regional/group variations.

5.5.2.1 Property Owners Questionnaire Question 1

The results of the main circulation as with those of the pilot identified a small number of respondents, 4 (8.9%) who were unaware that they could charge VAT on the rents of non-domestic property. These respondents are evenly spread throughout the sample.

It is possible that some property owners might have answered 'no' simply to avoid answering the questionnaire but this is unlikely as it would have been easier for them not to respond at all.

Based on these results it may be concluded that the effectiveness of waiver of exemption, has been reduced, due to a lack of knowledge. However, this reduction in effectiveness is restricted to less than ten percent of property owners.

5.5.2.2 Property Owners Questionnaire Question 2, In-house Surveyors and Professional Advisors Questionnaire Question 1

“Most of those who are or will be electing are obviously thinking carefully.....” (4)

A key issue in determining the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the English commercial property market is the take-up rate of the option to tax. It was anticipated that the results from these questions would assist in establishing the pattern of the take-up rate.

An analysis of the aggregate data shows that property owners are opting to tax a variable percentage of their portfolios. The results show that 20 (16.1%) respondents or their clients have not exercised the option to tax. Most respondents 37 (29.8%) or their clients have opted to tax only 1-20% of their portfolio. 17 (13.7%) have opted to tax 21-40%, 14 (11.3%) have opted to tax 41-60%,

13 (10.5%) have opted to tax 61-80% and 11 (8.9%) have opted to tax 81-99%. Twelve, (9.7%) have opted to tax all their portfolio.

The results are skewed towards a lower take-up rate of the option to tax. But a lower take-up rate per se will not be indicative of ineffective mitigation. For example property owners might still maximise their recovery of input tax by opting to tax in only those instances where there is the greatest liability to VAT, for example new development. This would result in fewer elections but still maximise VAT recovery.

One respondent to the survey undertaken commented:

“It is my general experience that clients do not wish to limit their options and consequently do not elect to waive exemption unless they are faced with potentially significant VAT losses e.g. upon construction, extensive repairs or refurbishment. However when faced with such a loss clients will usually make the election in order to recover VAT.”

An inherent problem is that the questions do not identify the amount of tax being recovered. If it were possible to identify this then the effectiveness of the option to tax could be assessed by comparing the amount of tax actually recovered against that which would otherwise have been irrecoverable. There is a need to establish not only whether an election to waive exemption has been made but also the amount of tax which is being recovered as a consequence.

An analysis of the results by reference to regional variation shows an increased level of high percentage elections in city centre locations. This may be due to a combination of higher property prices in city centre locations and a concentration of major redevelopments where property owners may need to ensure recovery of input tax.

An analysis by category of respondent also produces some variations from the results of the aggregate data. Most of the companies with in-house surveyors have opted to tax only a small percentage of their properties. Nine (75%) have opted to tax less than 40% of their portfolios and no respondent had opted to tax 100% of their companies' properties.

Similarly, professional advisors indicate a low take-up of the option to tax by their clients with 51 (66%) indicating that their clients have opted to tax 40% or less of their portfolios. An analysis of the responses from property owners shows that most, 12, (26%) have opted to tax all their portfolio but that the same percentage have opted to tax none of their portfolio. The remaining responses are spread fairly evenly throughout the remaining percentage groups.

This diverse response may be attributed to the range of scenarios available to property owners. For example property owners are more likely to opt to tax if they incur a high liability to VAT and vice versa.

Moore and Lawrence comment:

“The result is that by the end of October (1989) a majority of investors are likely to have elected on at least part of their portfolio.” (5)

The results of these questions support this opinion. A majority of low percentage elections may reduce the effectiveness of the option to tax in mitigating the effects of the EC judgement because there may be fewer opportunities to reduce the tax burden. However, further research will be required to establish the level of tax recovered.

5.5.2.3 Property Owners Questionnaire Question 3

This question was introduced to establish whether or not property owners had sought advice before making the decision to opt to tax. If property owners had sought advice there was the possibility that other important data sources might exist.

An analysis of the data shows that 31 (75.6%) property owners questioned had taken such advice. This confirms that there are other potential data sources for this research in addition to property owners. This response was maintained across all the groups questioned.

5.5.2.4 Property Owners Questionnaire Question 4

The results of the pilot questionnaire had highlighted three distinct advisory groups, managing agents, solicitors and accountants. This question was designed to authenticate the inclusion of these groups in the sample.

An analysis of the data indicates that 24 (61.5%) respondents had sought advice from accountants, 7 (18%) from managing agents, 6 (15.4%) from solicitors and 2 (5.1%) from others who include HMCE, the collaborating body, and a legal seminar. There was no evidence to suggest that these results had been influenced by regional variations because a similar response was maintained across the whole sample.

This further establishes the authenticity of extending the sample to include professional advisors. Individual responses show that some property owners sought advice from more than one professional advisor.

It might be argued that the use of accountants by the majority suggests that added weight should be given to the results from this data source as the most representative group after property owners.

5.5.2.5 Property Owners and In-house Surveyors Questionnaire

Question 5, Professional Advisors Questionnaire Question 3

It became apparent from the results of the pilot that the reason for holding property might have an important influence on the decision to opt to tax. For example where the decision to opt to tax might have an important impact on tenants, owners holding property for investment might be less willing to opt to tax. Tenants who cannot recover VAT might seek to pay less rent. Property owners holding property for development (ie the capital return) and onward sale to an owner occupier might be less concerned about the impact of the option to tax on tenants.

This question was introduced to establish the percentage of commercial property holdings held by those questioned or their clients for investment, development or other purposes.

An analysis of the results indicates that 55.1% of the property portfolios under consideration were held for investment, 25.7% for development and 14.5% for other purposes.

Respondents indicated property held for other purposes included refurbishment, subletting, dealing, income purposes, residential, land and surplus with most specifying owner occupation as property held for other purposes. Whilst representing a relatively small percentage of the results (14.5%) these answers might indicate problems with the definition of property held for investment or

development. For example property held for refurbishment might be considered an investment property. The questionnaire should have included a specific definition of each category. The categories might also have been extended to include surplus properties and properties held for owner occupation, omitting the need for an 'other' category.

It can be argued that a sample with a higher percentage of property held for investment might also include fewer elections to waive exemption. In contrast a sample with more property developers may produce a higher percentage of elections.

The results of the aggregate data from these questionnaires do show a skew towards a lower percentage of elections where the sample has been shown to comprise a higher percentage of properties held for investment as opposed to development.

These conclusions are supported by an analysis of the results from some geographical sub-groups, for example property owners in the Leeds area:

Proportion of properties where VAT charged on rents -

| Percentage groups | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|----------------------|----|-------|--------|--------|--------|--------|------|
| Number of responses: | 2 | 3 | 1 | 0 | 0 | 0 | 0 |

Composition of portfolios-

| | Investment | Development | Other |
|----------------------|------------|-------------|-------|
| Percentage response: | 50% | 35.6% | 6.8% |

In this sample there are only low percentage elections where 50% of properties are held for investment. In contrast the sample from property owners in the Leeds STD group where 26.8% of properties are held for development show a high percentage of elections:

Proportion of properties where VAT charged on rents -

| Percentage groups | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|----------------------|----|-------|--------|--------|--------|--------|------|
| Number of responses: | 2 | 1 | 2 | 1 | 3 | 1 | 6 |

Composition of portfolios-

| | Investment | Development | Other |
|----------------------|------------|-------------|-------|
| Percentage response: | 63.1% | 26.8% | 10% |

It may be concluded from these results that there may be a broad correlation between the number of options to tax and the reasons for holding property. Further detailed research will be required to establish this link.

**5.5.2.6 Property Owners Questionnaire Question 6, In-house Surveyors
Questionnaire Question 4, Professional Advisors Questionnaire
Question 2**

“In order to maximise not only the initial rent obtainable from the tenant, but also the rent at review, the landlord might try to have the lease drafted on the basis of certain assumptions relating to VAT.” (6)

Most respondents 115 (87.1%) or their clients indicated that they do not have or are unaware of covenants in leases which prevent the charging of VAT on rents. But 17 (12.9%) have or are aware of such lease covenants.

KFR (7) suggest that landlords may contract not to charge VAT on rents in an attempt to secure a premium rent. Lease covenants which prevent charging VAT on rents may have an impact on the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85). By deliberately contracting out of charging VAT on rents the opportunity to recover input tax is lost and will frustrate the mitigating mechanism.

Those who have experienced a lease which contains a covenant preventing VAT being charged on rents are spread throughout the sample. There is however a concentration of respondents noting such a covenant in city centre locations possibly as rents are higher and the VAT element may be more significant, or because of the concentration of national multiples in these areas with access to good professional advice.

Solicitors were the group to report the largest number of such covenants, possibly due to their direct involvement in the drafting of leases. These covenants may not yet have come to the attention of other property professionals.

5.5.2.7 In-house Surveyors Questionnaire Question 2:

“(1) Of those who have or will be electing, 90% are doing so building by building, and by no means across the board.” (8)

This question was introduced to test the accuracy of the above statement. The results tend to support those of Moore and Lawrence with 9 (75%) respondents from this sample indicating that their decision to charge VAT on rents had been made on an individual property by property basis, whilst 3 (25%) respondents have not made the decision on that basis.

This suggests that most respondents are thinking carefully before making the decision, possibly considering the advantages/disadvantages associated with opting to tax on each property.

It should be borne in mind when analysing this data that the sample is very limited with only twelve useable responses from this group of which four were owner occupiers. The results from this data may not apply to the remainder of the sample or the total population.

Whilst this is a very small sample it does show some regional variation with those reporting a ‘no’ response being confined entirely to city centre locations.

5.5.2.8 In-house Surveyors Questionnaire Question 3.

“...and are only doing so (opting to tax) where there is a clear financial advantage” (9)

These results show that a significant number of respondents, 10 (83.3%) have exercised the option to tax only where there has been a clear financial advantage.

This highlights the importance of financial advantage in making the decision to opt to tax, which has been a determining factor for most of those questioned. To some extent these results are confirmed by those in section 5.5.2.10 below, where statements which may have the highest financial impact are ranked with the highest significance in making the decision to opt to tax by most of those questioned.

The results show some regional variation with those responding ‘no’, as with the previous question being entirely confined to city centre locations.

It appears from the aggregate data that most respondents are maximising the effectiveness of waiver of exemption by opting to tax at the point of maximum financial advantage or exposure to taxation. This suggests that the actual number of elections is less significant in determining the effectiveness of waiver of exemption in mitigating the effects of the EC judgement than the ability to maximise the recovery of tax.

5.5.2.9 Professional Advisors Questionnaire Question 4

This question was introduced to establish whether there was any evidence that overseas investors were unwilling to invest in UK property as a result of its VAT treatment. A loss of overseas investors may have serious implications for value in certain sectors of the UK commercial property market.

Most respondents, 75 (97.4%) were unaware of any overseas investors who had been unwilling to invest in the UK as a result of the VAT treatment of its property. However, a small percentage, 2 (2.6%) had experienced some unwillingness to invest on the part of overseas investors for this reason. Further research will be required to establish the precise extent of this problem, in particular to determine how many of those sampled actually have overseas clients.

5.5.2.10 Property Owners Questionnaire Question 7, In-house Surveyors Questionnaire Question 6, Professional Advisors Questionnaire Question 5

Considering the relative importance of each statement, the results of the main circulation show that the ability to recover VAT, which charging VAT on rents ensures, is a crucial factor for most respondents or their clients in making the decision to charge/not charge VAT on rents.

Statement (c) is less significant to the majority of respondents or their clients than statement (a) but more significant than the other statements.

Statement (e) whilst significant to the majority of respondents or their clients is less significant in making the decision to charge/not charge VAT on rents than statements (a) and (c) but more significant than the remainder.

Statement (d) is less significant in making the decision to charge/not charge VAT on rents than statements (a),(c)and(e) but more significant than statement (b).

Statement (b) is of least significance in making the decision to charge/not charge VAT on rents for most respondents or their clients.

These results are supported by the conclusion of In-house Surveyors Question Three which showed that the option to tax was only being exercised where there was a clear financial advantage to do so.

Based on these results and the earlier hypotheses, the decision to opt to tax is most likely to be made in circumstances where there is a clear financial advantage to be gained from the recovery of input tax.

In circumstances where there is less financial advantage to be gained from the decision to opt to tax or that decision may have a significant impact on another party then it is less likely that the decision to opt to tax will be made.

If the level of financial advantage were known in each case where the option to tax had been made this might substantiate the hypotheses.

Having considered the relative importance of each statement in making the decision to charge/not charge VAT on rents, the following paragraphs go on to consider the absolute importance of each statement based on the results of the aggregate data. To assist with the analysis this data has also been subjected to the following comparative analysis:

- (a) tests to identify symmetrical and non-symmetrical distributions; and,
- (b) tests to identify the presence of significant differences and strong areas of agreement between categories of respondent.

Each statement has been analysed by a description of the distribution and a comment, where appropriate, making reference to significant variations in the responses from regions/groups. The methodology again involves a simple visual analysis of each distribution.

“a. Charging VAT on rents enables the recovery of VAT on landlords’ repairs, construction costs, service charges, managing agents’ fees, etc.”

Distribution: Not Symmetrical

“...the purpose of a landlord making an election is to enable him to recover input tax.” (10)

The results indicate that most respondents or their clients 52 (38.8%) consider statement (a) to be crucial in making the decision to charge/not charge VAT on rents. 40 (29.8%) consider statement (a) to be very significant and 21 (15.6%) significant. Only 13 (9.7%) consider statement (a) to be slightly significant and 8 (6%) of no significance.

The ability to recover input tax is shown to be crucial to most respondents or their clients in making the decision to charge VAT on rents. There is also a clear skew towards the significance of statement (a) in making the decision to charge VAT on rents.

A possible explanation of the variance in response may be that the decision to opt to tax is influenced by the nature of property holdings, ie for investment or development. Developers may incur significantly more VAT than investors as a result of VAT charged on construction costs. If developers wish to maximise their profits and VAT recovery positions they will opt to tax to enable the recovery of input tax. The recovery of VAT may be particularly significant to those undertaking development. The higher the percentage of developers in the sample the greater the significance of this statement.

The results in section 5.5.2.5 show the sample to comprise holdings of 25.7% for development compared to 52 respondents (38.8%) who have ranked this statement as crucial. This suggests that the recovery of input tax may also be important to

some investor as well. Investors may also be involved in redevelopment, a problem with the non-specific terms used in this question.

The general trend of the results from the aggregate data is also maintained throughout regional and group samples.

“b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.”

Distribution: Not symmetrical

Most respondents or their clients, 58 (43.3%) indicated that the increase in management costs which result from charging VAT on rents was a slightly significant factor in their decision to charge/not charge VAT on rents. 30 (22.4%) indicated that statement (b) was of no significance to their own or their clients decision. 26 (19.4%) indicated that this was a significant factor in their decision. 12 (8.9%) indicated that it was very significant and 8 (6%) that it was crucial.

There is a clear skew towards the insignificance of this factor in making the decision to charge VAT on rents. These results which are maintained throughout regional and group samples, are entirely consistent with the actual increase in management costs which is likely to be relatively insignificant as a result of charging VAT on rents.

“c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents.”

Distribution: Not symmetrical

“The landlord must be quite sure that the irrevocable option to tax an existing lease does not give him a short term advantage, but store up problems in the long term when he comes to sell his main interest in the property when he will still be bound to charge VAT.” (11)

These results clearly demonstrate the significance of statement (c) to most respondents or their clients in making the decision to charge/not charge VAT on rents. 37 (27.8%) of respondents indicated that statement (c) was crucial to their decision, 30 (22.6%) that it was very significant and 37 (27.8%) that it was significant. Only 18 (13.5%) indicated that it was slightly significant and 11 (8.3%) that it was of no significance.

Charging VAT on the sale of a commercial property will result in the addition of 17.5% to the purchase price. Most purchasers will be able to recover that VAT if they opt to tax but those who are exempt or part exempt cannot or can only recover part.

The variance in response with 11 (8.3%) respondents or their clients indicating that this statement was of no significance in their decision to charge/not charge VAT on rents may be explained by an intention on the part of these respondents or their clients not to dispose of their interest.

Trends in regional/group samples are less distinct, but responses received from solicitors show a marked increase in the significance of statement (c) above other groups. This may be as a result of a heightened awareness in the legal profession of the need to ensure that the vendor is indemnified against any VAT liability on disposal.

“d. Charging VAT on rents will limit the options of a future owner of the property.”

Distribution: Not symmetrical

Most respondents indicated that they or their clients considered statement (d) to be significant or slightly significant in making the decision to charge/not charge VAT on rents. 21 (15.6%) indicated that that statement (d) was of no significance in their own or their clients decision. 22 (16.4%) indicated that statement (d) was very significant and 19 (14.2%) that it was crucial.

There is a more even spread of responses to this statement with a skew towards the insignificance of the limitations placed on future owner's options.

The spread of responses may be explained by the number of scenarios available to property owners. For example investors who might be less likely to sell in the short/medium terms might consider statement (d) insignificant. Developers constructing an office block, for an exempt occupier who could not recover VAT which might be charged on the purchase price, might consider this statement

crucial. The results may be less distinct if exempt/part exempt respondents make up a smaller percentage of the sample.

The general trend of the aggregate data is maintained in regional/group samples.

“e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.”

Distribution: Not symmetrical

Most respondents, 46 (34.3%) indicated that the effect on tenants was a significant factor in their own or their clients decision to charge/not charge VAT on rents. 22 (16.4%) indicated that statement (e) was very significant and 20 (14.9%) crucial. In contrast 36 (26.9%) indicated that statement (e) was only slightly significant in their own or their clients decision and 10 (7.5%) that it was of no significance.

The significance of the effects of charging VAT on the rents of tenants in making the decision to charge/not charge VAT on rents is apparent from these results. The variance in response may once again be explained by the reason for holding property. A mixed portfolio of fully taxable and exempt tenants may produce a response around the mid-point of the range.

The results from the aggregate data are broadly maintained in regional and group samples, but chartered surveyors and incorporated valuers rank this statement of

higher significance than the other groups. These individuals, because of their involvement in the management of commercial property may be particularly sensitive to the impact of any legislative changes on tenants.

The returned questionnaires also highlighted some 'other' significant factors in making the decision to charge/not charge VAT on rents. These included, the avoidance of a self supply charge, cashflow, transfers as going concerns, to ensure consistency, the extension to linked buildings and location. Whilst not of significance to the majority, as anticipated when considering the nature of the statements included in the questionnaires, there are other factors which might influence the decision to charge/not charge VAT on rents.

The following section includes a critical examination of the methodology, response rate, data and quality of response.

5.6.0 CRITIQUE

5.6.1 METHODOLOGY

The aim of the first part of this research was to determine the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) in respect of the English commercial property market.

Chapter four considers methodology, in particular the Governments attempt to mitigate the effects of an unwelcome EC judgement (case 416/85) on the UK business community by the introduction of waiver of exemption to reduce the tax burden which would otherwise have been experienced.

In allowing the option to tax the government provided an opportunity to reduce the effectiveness of this mechanism, because where no election to waive exemption is made there will be no opportunity to reduce the tax burden.

It was suggested in chapter four that the decision to opt to tax might be determined by the absolute and relative significance of the advantages and disadvantages which flow from that decision. By determining whether the decision to opt to tax had been or would be made, it might be possible to predict the effectiveness of waiver of exemption.

Questionnaires were developed which sought to establish the take-up rate of the option to tax and the relative/absolute significance of the factors which determined whether or not the option to tax was made.

Whilst the questionnaires establish in broad percentage terms the take-up rate of the option to tax, this by itself is insufficient to determine the effectiveness of waiver of exemption. This may be established by the extent to which the tax burden which would otherwise have been incurred is reduced.

The questionnaires also establish the absolute and relative significance of the factors which determine whether the decision to opt to tax will be made or not. But the hypotheses relies on a link between these factors and the take-up rate of the option to tax.

In order to test the hypotheses it will be necessary to link statements (a-e) with the take-up rate of individual respondents. If it can be shown that a high percentage take-up of the option to tax occurs in circumstances where the statement has a high absolute and relative significance (and vice versa) then the hypotheses will be substantiated.

The hypotheses also rely on the majority response to each statement being taken as correct. It may be incorrect to apply the aggregate view to the whole population.

Whilst the questionnaires have satisfied the requirements of the issues identified in section 5.2.0 these are insufficient to satisfy the aims of the research.

5.6.2 RESPONSE RATE

The response rate for the main circulation is considered in section 5.5.1. It is apparent that the level of non-response has introduced significant bias into the research. It has not been possible to improve the level of response due to the requirement to preserve anonymity.

An analysis of the response rates for pilot and main samples suggests the problem to be due to data sources. It was possible with the pilot circulation to direct the questionnaires more accurately, based on the researcher's personal knowledge of the area. This was not possible for the main sample. It is apparent that the data sources used were out of date resulting in several returned questionnaires from the main sample 'not known at this address'. This type of response was not experienced with the pilot.

The low response rate particularly from individual categories of respondent may lead to the criticism of overworking data. For example it is difficult to justify applying the response to In-house Surveyors Questionnaire, Questions Two and Three, to the whole population, based on a response from only twelve respondents. It would have been possible to include In-house Surveyors Questions Two and Three in the property owners questionnaire, at the expense of lengthening it, thus increasing the response to these questions.

5.6.3 DATA

It was recognised at an early stage that the response from professional advisors would require generalisation based on a number of different clients whose properties and aims might be very different. Property Owners, Question Two and In House-Surveyors/Professional Advisors, Question One, also requires some generalisation about diverse portfolios.

This leads to a further criticism, that it may be incorrect to aggregate the data from the three main sample groups, property owners, in-house surveyors and professional advisors, because each group is dissimilar.

Some property owners may be clients of professional advisors also included in the sample. The effect of this will be that the data may include an element of double counting.

Section 5.5.2.5 suggested that Property Owners/In-House Surveyors, Question Five and Professional Advisors, Question Three contain some inherent weaknesses. This question was added to each questionnaire following the pilot survey and sought to establish the composition of the various respondents' portfolios. The terms 'investment' and 'development' may be open to different interpretation and some doubt must be cast on the data from these questions as a result. It would have been more appropriate either to find terms incapable of different interpretation or to have included precise definitions of the terms.

Professional Advisors, Question Three asked:

“What percentage of your commercial...”

this should have read:

“What percentage of your clients' commercial...”

It would have been possible to shorten the length of all questionnaires forming the main sample by excluding those questions designed to confirm the accuracy of extending the sample to include professional advisors. It would have been sufficient for the pilot to confirm this.

The response to Professional Advisors, Question Four, in respect of overseas investors is largely meaningless in its present format, because it fails to identify how many respondents have overseas clients.

As highlighted with the pilot, the responses to the request for details of 'other' factors which may have been significant in making the decision to charge/not charge VAT on rents also demonstrate the difficulty experienced by some respondents in fully appreciating each of statements (a)-(e). Such comments included,

“amount of VAT paid on construction costs”

“it will limit certain tenants”.

Having considered the results of the main questionnaire circulation the next section goes on to critically examine these results, the methodology and method of the first aim of this research. Each sampled unit may not be the same and arbitrary changes in the sampled units may introduce bias into the results.

5.6.4 QUALITY OF RESPONSE

A primary criticism of this survey method is the lack of control which the researcher has over who fills out the questionnaire or the environment in which it is completed. Both will influence the quality of response.

The letters and comments received with responses to the main circulation suggested that the data may be biased as a result of this problem. For example one respondent comments:

“I have quickly researched the subject and completed your questionnaire accordingly...”

Another indicated that he had passed the questionnaire to his accounts clerk for completion. Clearly an individual other than the intended respondent completed that questionnaire.

The letters received also contained evidence of a failure to direct the questionnaires to the correct recipient. For example one respondent replied:

“I have passed your enquiry to our commercial property lawyer...”

and another,

“I think the information you are seeking is more likely to be available at our headquarters in Birmingham...”

These problems were not experienced with the pilot data.

Errors may also arise because of a respondent's lack of knowledge, poor memory, misunderstanding the question or because consciously or unconsciously there is a wish to give an incorrect answer.

5.7.0 CONCLUSIONS

This chapter began by identifying two key issues necessary to establish the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the English commercial property market. These were:

1. to determine the take-up rate of the option to tax; and,
2. to determine the absolute and relative importance of the factors which determine whether the option to tax is made or not.

Questionnaires were developed and distributed based on these key issues.

The results from these questionnaires have established that property owners are opting to tax a variable percentage of their property portfolios, with most having opted to tax on only a small percentage (1-20%).

It was concluded in chapter four that the effectiveness of waiver of exemption might be determined by measuring the take-up rate of waiver of exemption. Considering the take-up rate in isolation has proved to be incorrect.

It is possible that property owners may elect to waive exemption on only a small number of their properties. But the evidence from these results shows that they will opt to tax where there is a clear financial advantage to be gained. This will maximise their recovery of input tax and maximise the reduction in the tax burden which resulted from the EC judgement (case 416/85). In this case waiver of exemption would prove to be an effective mechanism for mitigation despite a relatively small number of elections. The take-up rate of the option to tax therefore needs to be linked to the resultant recovery of input tax.

Some evidence was obtained to suggest a lack of knowledge about the option to tax which may reduce the effectiveness of waiver of exemption as a result. Evidence was also found to suggest an increase in the number of covenants that prevented charging VAT on rents. This may frustrate effective mitigation by contracting out of the enabling legislation. The results also showed that this may be a developing problem.

These results may have established the relative and absolute importance of five key statements in making the decision whether or not to charge VAT on rents. The recovery of input tax was found to be the most significant factor in making this decision.

Most respondents appear to be assessing the benefits and costs of opting to tax on the basis of financial advantage. In circumstances where a significant financial

advantage can be gained from the recovery of input tax then it is more likely that the decision to opt to tax will be made.

In order to prove conclusively the hypotheses set out in section 4.2.4 it will be necessary to link the absolute and relative importance of the factors which determine whether or not VAT is charged on rents with the take-up rate of the option to tax in each case and the recovery of input tax. This has not so far been achieved with the questionnaires designed.

It must be borne in mind when considering the results of this research that a significant bias has been introduced because of the level of non-response. Some doubt must also be cast on the quality of response as a result of the comments received. In retrospect it may have been more appropriate to have taken a smaller more selective sample ensuring less generalisation and removed anonymity to allow follow-ups and a better response rate.

In conclusion, further research will be required to establish conclusively the effectiveness of waiver of exemption in mitigating the effects of the EC judgement on the English commercial property market. In particular this will need to concentrate on the extent to which waiver of exemption has succeeded in reducing the tax burden which would have resulted had the option to tax not been introduced. It must also be borne in mind that the results in their present form represent a contribution to knowledge.

1. Moore, J., and Lawrence, A., 14 October 1989. VAT: To Elect Or Not To Elect? Estates Gazette, pp.78-81.
2. Goy, D., and Walters, J., 1989. VAT and Property, Sweet and Maxwell, p.154.
3. Moore, J., and Lawrence, A., 14 October 1989 VAT: To Elect Or Not To Elect? Estates Gazette, p78-81.
4. Moore, J., and Lawrence, A., 14 October 1989. VAT: To Elect Or Not To Elect? Estates Gazette, p.81.
5. Moore, J., and Lawrence, A., 14 October 1989. VAT: To Elect Or Not To Elect? Estates Gazette, p.81.
6. Scott, H., and McClellan, D., 1989. VAT and Property, Butterworths, p.136.
7. Knight Frank Rutley. Research 1989 The Impact of VAT on the Commercial Property Market, p.18.
8. Moore, J., and Lawrence, A., 14 October 1989. VAT: To Elect Or Not To Elect? Estates Gazette, p.81.

9. Moore, J., and Lawrence, A., 14 October 1989. VAT: To Elect Or Not To Elect? Estates Gazette, p.81.

10. Goy, D., and Walters, J., 1989. VAT and Property. Sweet & Maxwell, p.159.

11. Scott, H., and McClellan, D., 1989. VAT and Property, Butterworths, p.130.

CHAPTER SIX

THE PERCEIVED EFFECTS OF WAIVER OF EXEMPTION ON RENTS IN THE ENGLISH COMMERCIAL PROPERTY MARKET

6.1.0 INTRODUCTION

This chapter begins by setting out the purpose of this part of the research which is to test the hypotheses developed in section 4.3.4. A survey method and pilot questionnaires are developed to test methodology and method. The response rate and responses to pilot questionnaires are then considered in the context of amendments required to methodology, questionnaires, method and sampling frame.

The response rate and aggregate data from the main sample are analysed and evaluated with appropriate reference to variations in response by group of respondent and area.

The results of the main sample and methodology are then critically discussed. The chapter ends with a summary of the conclusions drawn from an analysis and evaluation of the data obtained.

6.2.0 PURPOSE

Section 4.3.1 highlighted a problem for exempt and part exempt tenants, that a decision by their landlord to charge VAT on rent places an additional occupational cost on these tenants in the form of irrecoverable VAT.

Economic price theory was considered as a possible explanation of the effect of waiver of exemption on rent. This theory, when applied to the commercial property market, predicts a reduction in the disequilibrium rent paid by exempt/part exempt tenants, to the equilibrium rent, post tax and that the quantity of rented accommodation supplied will also fall over time.

It was resolved initially to test whether there had been any market reactions to the VAT changes introduced in the Finance Act 1989, particularly any which supported the hypotheses set out in section 4.3.4. This was achieved by asking respondents to confirm or deny the market reactions suggested by commentators in articles around the time of the introduction of the Finance Act 1989.

It was apparent that the impact of these legislative changes would be dependent on a number of key issues, which were:-

- (1) tax status - because the impact was likely to be greatest on part exempt and exempt tenants who could recover only part or no VAT charged on rent;

- (2) how occupiers were dealing with any increase in occupational costs resulting from being charged VAT on rents - because there would be several potential options open to part exempt and exempt occupiers to deal with any additional tax burden; and,
- (3) changes in the amount of accommodation offered to let - linked to the wider tax costs associated with the Finance Act 1989, such as the self supply charge. This might manifest itself as a reduction in the willingness of part exempt/exempt occupiers, investors and developers to become involved in new development.

The following section develops these key issues into a series of questionnaires to test the hypotheses of this part of the research.

6.3.0 THE PILOT QUESTIONNAIRES

6.3.1 CHOSEN METHOD

The principal data collection methods set out in sections 4.4.0 were reviewed in the context of this part of the research.

The researcher was particularly conscious of the sensitive nature of the information which would be required to satisfy the aims of this part of the research. It was recognised that issues such as tax status and rents paid might be commercially

sensitive and there would be an overwhelming need to preserve anonymity in order to ensure a satisfactory response rate.

A mail questionnaire, whilst impersonal would allow the recipient to remain anonymous, which would not be possible if personal and telephone interview techniques were used.

It was recognised that the environment in which the mail questionnaire would be completed could not be controlled to the same extent as personal or telephone interviews. But it would provide time for the recipient to give a considered response, necessary because of the questionnaires' technical content.

It was acknowledged that a mail questionnaire might be subject to a low response rate with the resultant criticism of unrepresentativeness. However it would be possible to reduce the level of non-response by incentives such as a self-addressed reply envelope or by offering a summary of the results. Careful choice of the sampling frame and construction of the questionnaires would also assist in overcoming this problem.

In order to ensure a representative sample the chosen survey method must be able to deal with a wide geographical coverage. Whilst it would be possible for both personal and telephone interview techniques to cover the area under consideration their suitability to access potential recipients may be lower than for the use of a mail questionnaire.

Finally, the mail questionnaire ameliorates the possibility of personal bias, a particular problem for personal and telephone interview techniques.

It was concluded that the most appropriate data collection method would be by mail questionnaire survey. This method would preserve the recipient's anonymity, allow wide geographical coverage and minimise personal bias. With careful design and sampling it was hoped that the potential problem of non-response could be avoided. The following section goes on to consider the sampling frame recognised as an important issue to ensure an acceptable level of response.

6.3.2 SAMPLING FRAME

Hedley suggested that:-

“Downward pressure on rents will be felt only in markets dominated by exempt tenants who cannot reclaim VAT.” (1)

and offered the following table of those at most risk based on typical VAT recovery rates:

| <u>“organisation</u> | <u>% VAT Recovery</u> |
|-----------------------------|-----------------------|
| Building societies | 0% |
| Clearing banks | 10% - 30% |
| Life insurance companies | 0% - 5% |
| General insurance companies | 0% - 50% |
| Merchant banks | 35% - 40% |
| Securities houses | 10% - 60%” (2) |

Hedley's table begins to identify exempt and part exempt tenants on which this research must concentrate if the aims are to be satisfied. Waiver of exemption has no effect on fully taxable tenants who can recover the VAT charged in full.

KFR suggested that the effects of the legislative changes introduced in the Finance Act 1989 would:

“...only develop if exempt tenants make up a significant proportion of office users in the market concerned...” (3)

The following table shows as a percentage of total organisations in selected locations some of the VAT averse organisations (cannot recover VAT) identified by KFR (4):

| <u>location</u> | <u>postcode</u> | <u>percentage of VAT averse organisations in location</u> |
|------------------|-----------------|---|
| Central London | | |
| City | EC1 | 13% |
| | EC2 | 42% |
| | EC3 | 54% |
| | EC4 | 31% |
| Regional Centres | | |
| Bristol | BS1 | 17% |
| Leeds | LS1-3 | 14% |
| Sheffield | S1 | 9%” |

These locations may represent the most appropriate areas of research because they are the areas where those occupiers at the greatest risk are concentrated.

From this total population a sampling frame was chosen for the pilot questionnaires based on occupiers (whether owner-occupier or tenant), surveyors, investors and

developers. All were likely to have experienced the impact of the changes in VAT introduced in the Finance Act 1989.

A conscious decision was made not to restrict the sample to exempt/part exempt categories.

A random selection of recipients was made from a survey of occupiers in the Orton Southgate district of Peterborough; investors and developers were based on a survey of developments being undertaken in Peterborough at that time and surveyors from Peterborough based on listings for commercial surveyors/valuers in the RICS (5) and Incorporated Society of Valuers & Auctioneers (6) directories.

Peterborough was chosen in preference to an area highlighted by Knight Frank Rutley as containing the highest percentage of VAT averse organisations because this would enable the researcher to travel by car to identify potential recipients.

6.3.3 DEVELOPING THE QUESTIONNAIRES

This section considers the development of the pilot questionnaires beginning with recipients and questionnaire content, the format and sequence of questions, the nature of instructions to be given to recipients and development of a covering letter.

Section 6.2.0 identifies the principal issues which must be addressed and these form the basis of the questionnaires to be designed.

The recipients of questionnaires have been identified in section 6.3.2. Development began with the questionnaire to be circulated to occupiers.

6.3.3.1 Occupiers Pilot Questionnaire

In order that it should be simple and easily understood the pilot questionnaire for occupiers was split into three sections; the first establishes information about their tax status and nature of the recipient's occupation; the second, for tenants, provides information about how the cost of irrecoverable VAT charged on rents has been dealt with by them and the final section, for owner occupiers, assesses the impact of the VAT changes introduced in the Finance Act 1989 on owner-occupiers who intend to develop their own premises.

Commentators suggested that the impact of the extension of VAT in the Finance Act 1989 would be felt most by exempt and part exempt tenants.

“The main difficulties are for exempt suppliers.” (7)

The first question sought to establish the tax status of the recipient and to remove those from the sample who were fully taxable by instructing them to return the questionnaire.

It was recognised that the impact of the VAT changes introduced in the Finance Act 1989 would be different for tenants and owner-occupiers. The impact on tenants

would be in the form of VAT charged on rents. The impact for owner-occupiers would be as a result of VAT charges from activities such as acquisition, refurbishment or development. The second question sought to establish the nature of occupation either as owner-occupier or tenant.

Each category of occupier was then directed to the relevant section of the questionnaire.

The purpose of section A was to establish how exempt/part exempt tenants had dealt or would deal with the additional tax burden which would result from their landlord opting to charge VAT on rent. Three scenarios were immediately apparent, tenants would be paying VAT on rent, would have paid VAT on rent or might pay VAT on rent. Each would require different treatment.

The first question sought to establish whether tenants were paying VAT on rent and the second whether the tenant had ever paid VAT on rent.

Those who had or were paying VAT on rent were directed to Question A3. which sought to establish from a series of options how they had dealt with the additional tax burden. In particular this question sought to establish that some tenants might endeavour to pay a lower rent on review.

This question presents the recipient with a series of strategies for avoiding the extra burden of the tax. Hedley suggested that a number of options were open to exempt/part exempt tenants:

“In so far as higher rental costs have to be paid, some exempt occupiers will take less space or move to a slightly cheaper area, or both; others may choose to pay the extra.” (8)

“In markets which are dominated by exempt tenants, it is conceivable that there would be a 13% (VAT @ 15%) drop in rental and capital value”. (9)

These options formed the basis of the choices offered to recipients of the questionnaire. The use of a matrix approach allowed the recipient to rank the statements in terms of relative and absolute significance. The question was left open allowing respondents to add other strategies which may have been devised.

Because some recipients of the pilot questionnaire might not have experienced VAT being charged on their rent by their landlord, a further question was included to cover this scenario. It is identical in form to Question A3, but takes into account the fact that their landlord may not yet have elected to waive exemption.

It was recognised that this question would involve an element of subjective judgement on the part of tenants whose landlords had not charged VAT on rents which might bias the results. Part exempt/exempt tenants were then directed to Question A5.

Some commentators had suggested that occupiers might be prepared to pay to secure an unelected building:

“They (exempt users) would in fact be prepared to pay a premium of up to 15% (VAT @ 15%) over the market rent in order to secure occupancy of a non-elected building.” (10)

Question A5. sought to establish whether, and by how much, those tenants who indicated that they had or would be most likely to move as a consequence of VAT being charged on rents had or would be prepared to pay a premium (as a percentage of rent paid) or more rent to secure a building where no VAT is charged on rent.

Section B was designed specifically to assess the impact of the VAT changes introduced by the Finance Act 1989 on exempt owner-occupiers who intend to develop their own premises.

KFR suggested that:

“Stemming from the new legislation there are considerable implications for exempt owner-occupiers who develop their own premises.....” (11)

Part or fully exempt owner-occupiers are now subject to the self supply charge introduced by the Finance Act 1989 where they develop their own premises. Section 3.2.2 provides details of the self supply charge as set out in the Finance Act 1989 and section 3.6.0 the subsequent amendments.

KFR concluded that:

“The VAT charge on land may discourage the development of new sites by exempt companies. They may be more attracted to refurbish their existing properties.” (12)

The effect of these tax changes may be a distortion in the market because fewer part exempt and exempt owner-occupiers are willing to become involved in development which may produce a consequential fall in the quantity of accommodation available for occupation/to let.

The impact of the self supply charge would be felt most by part exempt and exempt owner-occupiers because they could recover none or only a proportion of VAT and had developed new premises since 1 August 1989. Questions B1-3. of this section sought to establish whether respondents were likely to have been subject to the VAT changes introduced in the Finance Act 1989 such as a self supply charge when the new property was substantially ready for occupation.

Question B4. was developed to establish whether there had been a change in respondents' attitudes towards the development of new premises since the Finance Act 1989. A format was used which allowed respondents the opportunity to score their answer in order of significance.

It was recognised that the impact of the new legislation might take time to filter through to the market and respondents were next asked directly whether they had incurred a self supply charge. For the avoidance of doubt it was considered

appropriate to provide recipients with a definition of self supply as part of this question.

As respondents might have carried out more than one development project where a self supply charge had been incurred they were asked to comment on the percentage of cases where they had incurred such a charge.

KFR (13) also alluded to an anomaly which had been created by the VAT changes introduced in the Finance Act 1989. It was unclear from the legislation whether a company purchasing a large site with the intention of developing part only in the short term, retaining the balance for future expansion would be able to recover or required to pay VAT on the entire site or only on that part which had been developed.

Question B7. was developed to test what was happening in practice.

To cover the possibility that respondents might have more than one site where this had occurred they were asked in Question B8. to provide details of the number of instances where this had occurred.

The pilot questionnaire developed for occupiers is shown in appendix 6.1.

The sequence of questions was determined by the need to exclude certain categories of respondent from certain sections of the questionnaire.

It was recognised that this would increase the complexity of the questionnaire and might lead to a reduced response. Having established the initial division of the questionnaire, each section began with simple questions to establish certain facts about the respondent before asking them to answer the key questions which were necessary to satisfy the aims of this part of the research.

The instructions to recipients have largely been covered in the preceding paragraphs on question design. The initial section of the questionnaire required directions to exclude fully taxable owner-occupiers/tenants from the questionnaire and to direct owner-occupiers/tenants to relevant sections.

Section A also required a series of instructions directing recipients to appropriate questions as a result of the multivarious scenarios applicable to VAT payments on rent.

The covering letter shown in appendix 6.2 was developed to be sent with the questionnaire. It was designed to explain the purpose of the questionnaire, to give directions about how to complete it and to encourage a response.

A prepaid envelope was provided to encourage a response. Three further questionnaires were developed to be sent to investors, developers and surveyors. The development of these questionnaires will be considered in the following sections.

6.3.3.2 Investors Pilot Questionnaire

It was considered that the tax status of investors might affect their response. The first question, which was the same as that used for occupiers, sought to establish whether they were exempt, part exempt or fully taxable for VAT.

To reinforce the results of the first aim of this research investors were asked two questions taken from section 5.3.3 (as amended) which were equally relevant to this research. The first sought to establish the take-up rate of the option to tax and the second to establish the composition of the recipients property portfolio.

Commentators had drawn a series of conclusions about the likely effect of the VAT changes introduced in the Finance Act 1989 on the commercial property market.

These included:

“As new development land is bought the effect of VAT on property and construction will be to reduce land values where there is a high representation of exempt tenants.” (14)

“In order to retain flexibility in the tax treatment of their buildings both exempt companies and investors may favour the purchase of pre-1989 properties” (15)

“...investors may decide to hold back from the funding or purchase of new freeholds and rather wait until the property is more than three years old, when a purchase would no longer attract a mandatory VAT charge.” 16)

“The imposition of VAT will certainly affect the willingness of some financial service companies and others to bid for development sites for their own occupation.” (17)

“The introduction of VAT on new construction will inevitably increase the relative attractiveness of refurbishment schemes which now suffer 15% VAT with no ability to reclaim.” (18)

It was resolved to take each suggested effect and to test whether these were being experienced in reality. Each comment was adapted into a context appropriate for this research. Question Four was designed on a matrix approach which asked recipients to assess the truth of each statement based on their own experience. The aim was to test whether commentators’ opinions were borne out in practice.

Commentators had suggested that the extension of VAT in the Finance Act 1989 might result in the viability of some schemes coming into question:

“VAT could have the effect of delaying or aborting developments in areas where there is a high proportion of VAT-averse tenants.” (19)

To test this comment recipients were asked, based on their own experience, to indicate the extent to which the VAT position will affect whether a scheme will proceed. Recipients were offered a graduated response based on their opinion of significance.

The same covering letter as that used for occupiers was retained for this questionnaire. It was concluded that no specific instructions need be included as part of the questionnaire, the completion of which was self explanatory. A similar approach to sequencing of questions was used as that for previous questionnaires. The pilot questionnaire developed for investors is shown in appendix 6.3.

6.3.3.3 Developers Pilot Questionnaire

It was concluded that the first three questions of the questionnaire to be sent to investors could be retained for the questionnaire to be sent to developers based on a similar reasoning for their inclusion.

The third question from the investors questionnaire was also retained for developers, on the basis that developers retained by investors to develop commercial property would be able to express an opinion based on investors' reaction to the VAT changes introduced in the Finance Act 1989.

However, statement (a) was considered too subjective for developers to answer in its existing form and was revised to provide a statement based on developers' reaction to the recovery of input tax.

Question Four from the investors questionnaire was retained for this questionnaire on the basis that it was equally applicable for developers to express an opinion on the impact of VAT on the viability of schemes.

Questions B5-8. from the occupiers questionnaire were retained for this questionnaire on the basis that developers were likely to have experienced the self supply charge.

The same covering letter to be used for the other questionnaires in this sequence was used for developers. It was concluded that no specific instructions to recipients were necessary as the questionnaire was self explanatory. A similar approach to the sequence of questions was used as for the previous questionnaires. The pilot questionnaire developed for developers is shown in appendix 6.4.

6.3.3.4 Surveyors Pilot Questionnaire

It was concluded that the surveyors pilot questionnaire would comprise an amalgam of the questionnaires developed for occupiers, investors and developers. Surveyors, because of their involvement with occupiers, investors and developers would be in the unique position of being able to express an opinion on their clients' reaction to the VAT changes introduced in the Finance Act 1989.

The first three questions of this questionnaire were retained from the surveyors questionnaire developed for the first aim of this research, section 5.3.3.2 (as amended in section 5.3.5.3.2).

Question Four of this questionnaire represents a synthesis of the statements provided to occupiers, investors and developers based on commentators suggestions as to the impact of the VAT changes introduced by the Finance Act 1989 on the UK commercial property market.

The same covering letter was used as that developed for the other questionnaires in this sequence. No specific instructions to recipients as to how to complete the questionnaire were considered necessary. The final pilot questionnaire developed for surveyors is shown in appendix 6.5. Having developed the pilot questionnaires these were then circulated to the recipients for return by 23 March 1992. The responses are considered in the following section.

6.3.4 ANALYSIS OF RESPONSES TO PILOT QUESTIONNAIRES

6.3.4.1 Response Rate

The responses to the pilot questionnaires are shown in appendix 6.6. Descriptive statistics for each questionnaire have been produced from aggregate data based on a total count of respondents and the percentage of responses. Section 6.3.2 sets out the sampling frame for the pilot questionnaires. 26 (45.6%) of those sampled responded to the pilot questionnaire of which 16 (28%) were useable. In summary:

| <u>Respondents</u> | <u>Number Sent</u> | <u>Number Responded</u> | <u>Number Responded (useable)</u> |
|---------------------------|--------------------|-------------------------|-----------------------------------|
| Occupiers - fully taxable | 21 | 10 (47.6%) | 7 (33.3%) |
| exempt/part exempt | 11 | 5 (45.4%) | 1 (9%) |
| Investors | 6 | 3 (50%) | 2 (33.3%) |
| Developers | 14 | 5 (35.7%) | 4 (28.6%) |
| Surveyors | 5 | 3 (60%) | 2 (40%) |
| <hr/> | | | |
| Total sample | 57 | 26 (45.6%) | 16 (28%) |

There is a marked difference in response rate between the different groups. The best useable response 2, (40%) was received from surveyors and the lowest 4 (28.6%) was received from developers.

Sections 6.3.5.1 and 6.3.5.2 consider the implications of these results for the main sample and how the useable response rate might be improved.

6.3.4.2 Methodology

The methodology for this part of the research was reviewed with the benefit of the results from the pilot questionnaires.

The purpose of the pilot was to establish whether it would be possible to test market reaction to the VAT changes introduced in the Finance Act 1989 by means of a mail questionnaire developed from commentators suggested market reactions.

Despite being based on a limited sample the results of the pilot questionnaires provide evidence that there has been a market reaction to the legislative changes. Based on this evidence it was concluded that the initial approach had been valid and that it was appropriate to proceed with the next stage of the research which was a more representative study of the perceived effects of the impact of waiver of exemption on capital values and rents.

6.3.4.3 Method

The method of data collection was reviewed with the benefit of the pilot data. It was recognised in section 6.3.1 that a particular issue for this survey method was the response rate.

Commentators have indicated that response rates as low as 10% and as high as 90% have been recorded for this survey method. This presents particular difficulties in assessing what constitutes an acceptable level of response. Moser and Kalton suggest that:

“A poor response rate must constitute a dangerous failing and if it does not rise above say 20 or 30 percent the failing is so critical as to make the survey results of little if any value.” (20)

There had been a particularly low response rate from developers and exempt/part exempt occupiers to the pilot questionnaires. It was apparent from the pilot results that there were faults in the design of this questionnaire and it was considered that the redesign of certain questions would be sufficient to improve the response rate. It was considered that the low response rate from these categories were not primarily the result of sampling errors, although, it was recognised that the choice of sample for the main circulation would be crucial in achieving a satisfactory response rate.

The format, sequence, instructions and covering letter had mostly worked well. This survey method had allowed respondents to remain anonymous and to give a considered response possibly after consulting their records. The use of mail questionnaires had effectively ameliorated any criticism on the grounds of personal bias and had allowed a representative geographical coverage.

It was concluded that the mail questionnaire survey method had proved satisfactory and that this should be retained for the main sample.

6.3.5 ALTERATIONS AND AMENDMENTS TO THE PILOT QUESTIONNAIRES

This section considers the pilot questionnaire response rate, sample and provides a critical assessment of the alterations and amendments required to each questionnaire.

6.3.5.1 Response Rate

The overall response rate of 26 (45.6%) was considered acceptable but a significant reduction (17.6%) had occurred between this and the number of useable questionnaires 16 (28%). The reason for the reduction in the number of returned/useable responses needed to be identified and addressed before the main circulation.

One respondent had indicated that he/she was unable to respond due to pressure of work and it was recognised that this was a valid and unavoidable reason for a non-response.

The level of response was reconsidered by category of respondent. A particularly low number of useable responses had been received from exempt/part exempt occupiers and developers. It was recognised that there were problems with the construction of these questionnaires and it was anticipated that the amendments discussed in section 6.3.5.3. would be sufficient to resolve the problem.

6.3.5.2 Sample

The results of the pilot circulation highlighted some problems with the pilot sample which needed to be avoided when selecting the main sample. One surveyor indicated that:

“.....we have little or no evidence to assist with the answers...”

Two respondents returned the questionnaire indicating that it was not applicable to their companies. Another indicated that they were not involved with property matters at a local level and suggested that their head office should be contacted. It was concluded that more care would be required with the data sources and selected respondents for the main sample to overcome these problems.

It was recognised that the response from surveyors, as with the aim one questionnaires (5.3.5.1) would require generalisation as they were being asked to comment on what might be a diverse client base. It would be impractical to ask this group to comment on each client in isolation and a non-response would almost certainly result. This group should not be excluded from the main sample as it had already been shown to be a valuable data source.

6.3.5.3 Questionnaires

This section considers the alterations and amendments required to individual questionnaires in terms of individual questions, instructions, format, sequence and covering letter. A general overview would suggest that the care spent in designing each questionnaire had been justified.

6.3.5.3.1 Occupiers' Pilot Questionnaire

This pilot questionnaire produced a single response. However, this questionnaire was reviewed and amendments to the following questions were made.

It was recognised that the amount of VAT which could be recovered might influence recipients' response. A new Question Two was added to determine how much VAT respondents could recover:

“Q2. What percentage of VAT are you able to recover?

0% 1-20% 21-40% 41-60% 61-80% 81-99% 100%”

This question was inserted after Question One to concentrate respondents' minds on tax status in this part of the questionnaire.

Pilot Question Two was amended to provide for those occupiers who might be both owner and tenant, a situation which had been highlighted by the single respondent to this pilot questionnaire. The directions were amended, instructing recipients to answer both sections A and B if they were owner occupier and tenant.

Section A, Pilot Questions A1. and A2. were not amended. However, significant alterations were made to Pilot Questions A3. and A4. It was concluded that the matrix format of these questions used for the pilot was not producing the response in the desired form. The problem with this format was that it allowed more than one statement to be ranked as most likely, least likely, etc. What was really required was the order in which respondents would choose to adopt each statement as a means of avoiding the extra VAT cost.

Recipients were asked to order a number of options based on a scale from 1 - most likely, to, 6 - least likely.

It was considered appropriate to provide clarification to Question A5. b.(ii) by specifying that the premium should be expressed as a percentage of current rent,

because the pilot question was ambiguous as to how the amount of premium was to be expressed.

No amendments appeared necessary to Section B and this was retained unaltered for the main questionnaire circulation.

A review of the sequence of questions was carried out based on the requirement to add a further question and amendments were made as discussed above.

Instructions to recipients were reviewed on the basis that the single respondent had gone on to answer Question A5, despite not ranking Questions A3a/A4a, as 'most likely' and had gone on to answer Sections A and B despite being fully taxable. The recipient had effectively ignored apparently clear directions and no amendments were considered necessary.

The format and covering letter were reviewed on the basis of responses to the pilot and no amendments were considered necessary because there had been no apparent difficulties.

The questionnaire to be used for the main circulation of occupiers is shown in appendix 6.7.

6.3.5.3.2 Investors' Pilot Questionnaire

This questionnaire was reviewed with the benefit of the pilot and minor amendments were made. A question was introduced to determine the percentage of VAT that recipients were able to recover. The sequence of questions was reviewed based on the need for this addition which was made after question one to concentrate respondents attention on tax status in this part of the questionnaire.

A minor amendment was made to Pilot Question Three asking respondents to specify the 'other' reason for holding commercial property. One respondent to the pilot had indicated holdings of 1% investment, 2% development and 97% other. It was considered important to know what the 'other' holdings were as this might influence the response. Percentage signs were also added to the boxes in this question to reinforce the statement that a response should be given in percentage terms.

The design of the instructions, format and covering letter were also reviewed following the pilot circulation and as no apparent difficulties had been experienced with these issues no amendments were considered necessary.

The questionnaire to be used in the main circulation of investors is shown in appendix 6.8.

6.3.5.3.3 Developers' Pilot Questionnaire

This questionnaire was reviewed with the benefit of the pilot results and the following alterations were considered necessary.

As with the occupiers and investors questionnaires, a question was added to determine the percentage of VAT that recipients were able to recover and again this was inserted after the first question.

Minor amendments were made to Pilot Question Three asking respondents, as with the investors questionnaire, to specify when indicating some other form of property holding. Percentage signs were also added to the boxes to ensure a response in these terms.

It was noted that some respondents had answered 'not applicable' to some statements in the Pilot Question Four. This question was reviewed and it was felt that this response was because of the reference to 'investors' in statements b, d-f. These statements were reworded where possible to a developers standpoint or were omitted.

The design of the instructions, format and covering letter were reviewed with the benefit of the pilot results and no amendments were considered necessary on the basis that there were no apparent problems.

The questionnaire to be used in the main circulation of developers is shown in appendix 6.9.

6.3.5.3.4 Surveyors' Pilot Questionnaire

This questionnaire was reviewed with the benefit of the pilot survey results and the following amendments were made. One respondent had answered 'not applicable' to Pilot Questions One and Two. The reason for this response was not apparent and it was considered that this reaction did not justify amendment of these questions.

Minor amendments were made to Pilot Question Two with the addition, as for developers and investors of percentage symbols in the boxes to reinforce the nature of response required. Respondents were also asked to specify when indicating property to be held for 'other' reasons.

The inclusion of Pilot Question Three was reviewed on the basis of a comment from one respondent "we don't deal with overseas clients". It was decided that this question should remain.

It was recognised that some amendment would be necessary to Pilot Question Four. A new statement b. was introduced covering the development of new sites. One respondent indicated against pilot statements g. and k. "depends on tax status". Pilot statements f, i, j and k. were amended to specify the tax status. Pilot statement f. was also amended being considered to be too short and ambiguous.

The design of the instructions, sequence, format and covering letter were also reconsidered with the benefit of the pilot results and as there were no apparent problems with these issues no amendments were considered necessary.

The questionnaire to be used in the main circulation of surveyors is shown in appendix 6.10.

6.4.0 METHOD

This section considers the method, sampling frame and sample for the main questionnaire circulation.

6.4.1 CHOSEN METHOD

A review of the pilot survey method was undertaken in section 6.3.4.3 with the benefit of the pilot results.

Despite the sensitive nature of some information requested, a response had been received to potentially sensitive issues such as tax status and rent liability. The approach adopted appeared to have achieved its aim to preserve recipients' anonymity whilst ensuring an acceptable level of response.

On the basis that the problems with questionnaire design could be overcome, the pilot method had not suffered from an inadequate response rate often associated with this survey technique. It was concluded that the pilot method had produced an acceptable response rate.

In general the questionnaires had proved easily understood by most respondents with any identifiable difficulties being addressed as part of the amendments. The format, sequence and covering letters had generally worked well. Respondents had shown sufficient interest in the subject area to ensure an acceptable response.

The possibility of using other survey methods based on observation, personal and telephone interview was again reviewed. However to preserve anonymity it was decided to proceed on the basis of mail survey questionnaires for the main sample.

It was recognised that the choice of sampling frame and sample would be crucial if a satisfactory response rate was to be achieved. A significant amount of time was spent in establishing the sampling frame, sample and data sources. These will be considered in the following section.

6.4.2 SAMPLE

The sampling frame for the pilot questionnaires set out in section 6.3.2 was reviewed with the benefit of the pilot results. It was concluded that the principal categories of recipient - occupiers, investors, developers and surveyors, had been correctly identified based on the level and content of responses. These categories were retained for the main circulation.

The areas chosen for the main questionnaire circulation were based on KFR's table (21) which provides details of VAT averse organisations as a percentage of total organisations in selected locations.

It was concluded that the most successful response would be achieved in areas where there was a high concentration of those at greatest risk. Some areas of the City of London contain particularly high concentrations of VAT averse organisations. Two postcode areas EC2 and EC3 with the highest concentrations of VAT averse organisations, 42% and 54% respectively, were chosen for the main circulation.

In an attempt to ensure that the results were as representative as possible a second area based on the regional centres highlighted in KFR's table (22) was chosen to compare and contrast the results from EC2/3. The UK regional centre with the highest percentage of VAT averse organisation was Bristol (postcode BS1) with 17% and this was chosen.

Research was undertaken to identify potential data sources for the main questionnaire circulation. Hedley's table (23), reproduced in section 6.3.2. provides details of the typical recovery rates for certain organisations. This identifies certain groups including building societies, clearing banks, life insurance, general insurance, merchant banks and securities houses as having particularly low VAT recovery rates.

It was concluded that the sample should also concentrate on these categories because these would be at greatest risk from the legislative changes introduced in the Finance Act 1989.

No single satisfactory data source could be identified. A combination of data sources was used for each principal category of recipient and these are shown in appendix 6.11.

6.5.0 RESULTS OF MAIN CIRCULATION

The main questionnaires were circulated for return by 29 June 1992. This section considers the results of the main circulation, beginning with details of the response rate then providing a detailed analysis of the responses to questionnaires.

6.5.1 RESPONSE RATE

166 (37.1%) recipients responded to the main circulation of questionnaires and of these, 101 (22.6%) were useable replies. In summary;

| <u>Respondents</u> | <u>Number Sent</u> | <u>Number Responded</u> | <u>Number Responded (Useable)</u> |
|--------------------|--------------------|-------------------------|-----------------------------------|
| Occupiers | 187 | 61 (32.6%) | 45 (24%) |
| Investors | 77 | 28 (36.4%) | 10 (13%) |
| Developers | 133 | 55 (41.3%) | 30 (22.6%) |
| Surveyors | 50 | 22 (44%) | 16 (32%) |
| ----- | | | |
| Total sample | 447 | 166 (37.1%) | 101 (22.6%) |

The level of useable responses was particularly disappointing. It was immediately apparent that there was a significant difference (13.5%) between the number of returned questionnaires and returned questionnaires which were useable. This will be considered further in section 6.6.2.

There was also a significant variance in the level of response between categories of recipient, with 22 (44%) surveyors responding, the highest response and 61 (32.6%) occupiers responding, the lowest. This difference in response between categories is even more marked for useable responses with 16 (32%) useable surveyors responses, the highest useable response, and only 10 (13%) of useable developers responses, the lowest useable response. This will also be examined in section 6.6.2. below.

There now follows an analysis of the responses received to the main questionnaire circulation.

6.5.2 ANALYSIS OF RESPONSES TO QUESTIONNAIRES

Descriptive statistics for each questionnaire are reproduced in appendix 6.12 from aggregate data based on a total count of respondents and the percentage of responses. The methodology involves a visual interpretation of the histogram of the frequency of responses. Aggregate data has been used where possible to provide a more representative response.

A limited response from the Bristol area presented difficulties in comparing and contrasting results by area. For example there were only three occupiers who responded from Bristol.

The analysis begins with the results from the occupiers questionnaire and then continues with an analysis of the data from investors, developers and surveyors questionnaires. Comments on variations with pilot, category and area data are made where appropriate.

6.5.2.1 Occupiers, Investors & Developers Questionnaires, Question 1

One of the two key issues of this part of the research, identified in section 6.2.0, was tax status. It was argued in that section that the impact of the VAT changes

introduced in the Finance Act 1989 were likely to be greatest on exempt and part exempt individuals or companies who could recover no VAT or only part. It was concluded that the response from different tax groups might be different and tax status might be an important influence on the results. The first question to occupiers sought to establish occupiers' tax status.

The results show that the sample from occupiers, investors and developers comprised 8 (11.7%) exempt respondents, 44 (64.7%) part exempt respondents and 16 (23.6%) fully taxable respondents.

Fully taxable occupiers were asked to return the questionnaire. The results from occupiers concentrate on exempt/part exempt respondents. It might be argued that the results are biased towards responses from those who can recover some VAT, being the majority, 44 (64.7%).

The sample of occupiers contained 7 (15.5%) exempt, 34 (75.5%) part exempt and 4 (8.8%) fully taxable respondents. The sample of investors contained 2 (20%) exempt, 5 (50%) part exempt and 3 (30%) fully taxable respondents. The sample from developers contained 1 (3.3%) exempt, 17 (56.6%) part exempt and 12 (40%) fully taxable respondents. Thus the sample of investors and developers contained a proportionally higher number of part exempt and fully taxable respondents than occupiers. This may be significant and will be considered when analysing the results from other questions.

Knowledge of the tax group on its own is insufficient. The extent to which respondents can recover VAT might also be an important influence.

6.5.2.2 Occupiers, Investors & Developers Questionnaires, Question 2

Question 2. represents a further refinement on the tax status issue by identifying the percentage of VAT which respondents could recover. The part exempt category of respondents may recover between 1%-99% VAT and their relative ability to recover VAT might affect their response. For example VAT might be less significant to occupiers who can recover 99% VAT, whilst to those who can recover only 1%, but are still part exempt, it might be a significant cost.

The results show that 11 (14%) respondents could not recover any VAT and were exempt. This contrasts with 9 (11.7%) indicating that they were exempt in Question One. 14 (18%) indicated that they could recover all VAT and were fully taxable. This contrasts with the 16 (23.6%) in Question One who indicated that they were fully taxable. This difference will be examined in section 6.6.4. below.

The remaining 53 (68%) recovered varying amounts of VAT and were thus part exempt. The frequency distribution for part exempt respondents is not normal. There is a concentration of respondents, 22 (28%) in the 1-20% recovery band. The level of respondents in the mid ranges 21-80% reduces significantly to 3 (4%), 9 (11.5%) and 8 (10.5%) respectively. There is a slight increase in the number of part exempt respondents, 11 (14%) in the final band 81-99%.

An analysis of the results by category from occupiers, investors and developers is shown in appendix 6.12.2.2

An analysis of the responses to each question by exempt and part exempt groups has not been carried out because the numbers were considered unrepresentative and the results from part exempt respondents may vary even by band. The ability of this sample to recover VAT should be borne in mind when considering the results from other questions because this may have influenced the response.

6.5.2.3 Occupiers Questionnaire, Question 3

It was recognised when developing this questionnaire that there were three principal types of occupation, owner-occupier, tenant or those that were both owner-occupier and tenant. A decision was made to question owner occupiers and tenants separately and the first question directed respondents to appropriate parts of the questionnaire.

The results show that the sample contained 5 (12%) occupiers, 17 (40%) tenants and 20 (48%) who were both occupier and tenant. Tenants were directed to section A and occupiers to section B with those who were both owner occupiers and tenants answering both sections. The results are considered below.

6.5.2.4 Occupiers Questionnaire, Section A, Question A1

It was recognised when developing this questionnaire that recipients may be paying VAT on rent when questioned, might have paid VAT on rent in the past but are not presently doing so or might never have paid VAT on rent. This would affect the responses to subsequent questions. Questions A1. and A2. were introduced to categorise recipients in readiness for the principal Questions A3/A4.

The results show a relatively low number 12 (30%) actually paying VAT on rent at the time they were questioned. This may be compared with the results from aim one (5.5.2.2) which also show a variable take-up of the option to tax with most respondents making elections on 1-20% of their portfolio.

6.5.2.5 Occupiers Questionnaire, Section A, Question A2

Question A2. was introduced to categorise respondents in readiness for subsequent questions. A high number of respondents 21 (87.5%) have paid VAT on rent but did not appear to be doing so at the time of questioning. This might suggest a movement away from buildings where the landlords have opted to tax and should be considered in conjunction with the results to Statement A3/4a. below.

6.5.2.6 Occupiers Questionnaire, Section A, Questions A3/4

These questions were developed to assess the second issue of this part of the research, discussed in section 6.2.0. This was to establish how exempt/part exempt tenants were dealing in practice with the additional cost which their landlord charging VAT on rent placed upon them. In particular it was hypothesised that the results would show a reduction in rent. Hedley had commented that:

“In so far as higher rental costs have to be paid, some exempt occupiers will take less space or move to a slightly cheaper area, or both; others may choose to pay extra.” (24)

Statement - “(a) Move to a building where no VAT is charged on rent.”

A majority of respondents indicated that they were more likely to move to a building where no VAT was charged on rent. The significance of VAT apparently outweighed the significance of the costs associated with relocation. The results are quite evenly spread about the mid-point but the distribution is not symmetrical. This response appears to support the comments made on the results to Question A2. above which suggests that fewer respondents are now paying VAT than once were and may have moved to avoid this additional cost. There are other practical issues to moving which are not always apparent to tenants, such as the ability to dispose of their existing lease. This may account for the distribution of the results because some occupiers may be aware of the difficulties and others unaware.

Statement - “(b) Secure a lower rent on review”

Respondents gave a very clear response that they were most likely to endeavour to secure a lower rent on review where their landlord had opted to tax. One respondent comments “although unlikely”. This is an important fact, because respondents may want to reduce rent as a result of their landlord opting to tax, but this may not be possible in practice because rent is generally determined by the market and not factors such as increases in taxes. A rent review may also be some time away if the review pattern is five years or longer. However, commentators have suggested that, over time, the market may take this cost increase into account:

“In places like parts of the City, where the market is dominated by financial service companies, it would be surprising if general rental levels did not turn down to reflect any VAT added to rent.” (25)

Statement - “(c) Occupy less floor space”

Respondents indicated that occupying less floor space was a less likely option to avoid the extra VAT cost. In practice this is possibly the least viable of all the options presented to respondents. It may not be practical because of technicalities or lease terms to reduce the size of their occupation and this may account for the variable response.

Statement - "(d) Pass on as higher product prices."

Respondents indicated that to pass on the increased cost in the form of higher product prices was also a less likely option. To some extent this may be dependent on economic circumstances and those persisting at the time of the questionnaire were of a recessionary nature (see Appendix 1). Increasing prices may be a more viable option for some rather than others and this may account for the distribution of results.

Statement - "(e) Accept reduced profits and pay the VAT."

Most respondents indicated that they were more likely to accept reduced profits as a mechanism for dealing with the additional occupation cost of VAT being charged on rent. In reality it may be the most practical solution for occupiers to absorb the VAT thus avoiding economic and legal problems associated with other alternatives for avoiding this extra cost. Whether or not occupiers were able to follow this option may account for the variance in responses.

Respondents were also given the option to provide details of other methods they had adopted to avoid the cost of VAT charged on rent. These included negotiating with their landlord either not to opt to tax or for compensation in some other form, opting to tax themselves and passing the VAT on to their sub-tenant, or purchasing the freehold.

This question was developed to provide an ordered response based on tenants' strategies to avoid the cost of VAT charged on rents. Aggregating the data shows that securing a lower rent on review was the most likely option, followed by moving to a building where no VAT is charged on rents. It is apparent that both reduced rents and moving are reactions to a new tax, predicted by economic price theory. These are closely followed in sequence by passing on the cost as higher product prices. Accepting reduced profits or occupying less floor space are scored as the least likely options to avoid this extra cost.

The responses received have produced some reactions to the strategies offered to avoid the costs of VAT on rent. The most likely reaction was to secure a lower rent on review but the practical implications of achieving this may be less apparent. What is clear is that occupiers' responses are closely linked to their personal circumstances and tax status. For example it may be more practical for occupiers who can recover 99% VAT to absorb this additional cost than those who can only recover 1%.

These results should be considered in conjunction with those in 6.5.2.17 below where these statements are assessed by surveyors.

6.5.2.7 Occupiers Questionnaire, Section A, Question A5

It is possible that occupiers who had indicated that they were most likely to move as a result of their landlord opting to tax were most likely to be prepared to pay more

rent or a premium to secure an unelected building. These occupiers were prepared or able to take on the costs associated with relocation and for them VAT was clearly an important issue. This question was therefore directed at these occupiers.

Four respondents (8.9%) indicated that they would be prepared to pay a premium or more rent to secure a building where no VAT is charged on rent. None were prepared to pay as much as 15%, the amount of VAT charged. One respondent was prepared to pay 1-5% more rent as a percentage of rent paid, three, 6-10% more rent as a percentage of rent paid and one 6-10% of current rent as a premium.

Although this is a very small sample and the results may be based on a subjective judgement, nevertheless they establish that some occupiers would be prepared to pay more rent or a premium to secure an unelected building. This response is also supported by the pilot data. In reality the choice between paying more rent or a premium may be subject to a number of other factors, such as taxation which may also account for the variance in response.

These results which demonstrate the possibility of different rent levels for elected and unelected buildings should be considered in conjunction with those in section 6.5.2.17 below where surveyors are asked to express an opinion on the development of two tier markets. The results from Statement A3/4b. above also support the opinion that exempt/part exempt occupiers are considering rent closely in relation to the opted status of buildings.

6.5.2.8 Occupiers Questionnaire, Section B, Question B1

The first three questions in Section B were developed to establish whether respondents were likely to have been subject to the impact of VAT on development and to assess the impact that this might have on the results. These questions also began to concentrate respondent's minds on development before the more important questions in this section.

The responses to Question B1. show that 12 (50%) respondents held land for development. Whether land is held for development or not may influence respondents' answers to the subsequent questions. For example where no land is held for development it is unlikely that the respondent will incur a self supply charge or consider the impact of VAT on development significant. Thus the results from Questions B4-8. should be read in conjunction with the results to Question B1-3.

6.5.2.9 Occupiers Questionnaire, Section B, Question B2

Question B2. demonstrates that 16 (69.5%) respondents have developed new premises since 1 August 1989. These respondents may have a positive contribution to make to later questions on the self supply charge and the development of new premises.

6.5.2.10 Occupiers Questionnaire, Section B, Question B3

Finally in this sequence of questions (B1-3) respondents were asked to indicate whether they intended to develop new premises and 14 (61%) indicated that they did. Those respondents who answered positively may have had to take into account the potential VAT implications when considering the development of new premises and may have an actual rather than a subjective contribution to make to the subsequent questions.

6.5.2.11 Occupiers Questionnaire, Section B, Question B4

“The VAT charge on land may discourage the development of new sites by exempt companies.” (26)

An important issue for this part of the questionnaire to be answered by owner-occupiers, was to establish whether the extension of VAT in the Finance Act 1989 might discourage the development of new premises.

The results show that most, 11 (37.9%) consider the introduction of VAT on development to have been a significant influence on their attitude towards the development of new premises. However, the distribution of results is not normal and is skewed towards a lower significance with 6 (20.7%) indicating that VAT had no significance and 7 (24.2%) that it was of little significance. In contrast for 3 (10.3%) respondents VAT had been a crucial influence and for 2 (6.9%) it was very significant.

It may be concluded that VAT is of varying significance to those exempt/part exempt owner-occupiers involved in the development of new premises. The level of significance may be dependant on a number of factors, including tax status. This sample contains 44 (64.7%) part exempt respondents, 6 (14%) of which can recover 81-99% VAT, which may mean that VAT is less significant to those sampled.

Other factors such as need, competition and the amount of tax to be paid may all have an influence on the responses. For example if it is imperative that a development goes ahead regardless of costs, VAT may become less significant. Alternatively the nature of the scheme may be such that VAT liability is negligible.

What is clear is that this data cannot be considered in isolation. The sample is limited and reference to historic data would be necessary to establish an actual decline in development over time. The results of the next question on the incidence of the self supply charge may help to explain the apparently limited impact of VAT on development.

**6.5.2.12 Occupiers Questionnaire, Section B, Questions B5-B6
and Developers Questionnaire, Questions 7-8**

“By far the best thing about self supply is that it hardly ever happens...”
(27)

Section 3.2.2 considers in detail the self supply charge and its potential impact on the commercial property market. This question was introduced to establish the

incidence of self supply charges. Where there is less exposure to high levels of VAT such as might be incurred with self supply charges, then the impact of VAT on commercial property might be less significant.

The results show that only four respondents (7.5%) had incurred a self supply charge. This is a low response particularly since 16 (69.5%) respondents had developed new premises since the introduction of the charge. This may be because the nature of respondents developments had not triggered a charge to the tax. For example respondents may have a long standing interest in the land which will diminish the impact.

The percentage of cases also demonstrates the incidence of the tax in relation to total number of developments undertaken by respondents. Three respondents had incurred the tax on all their developments. One respondent had incurred the tax on only 1% of developments undertaken.

These results suggest that the incidence of the self supply charge has been limited. This may be a factor explaining the lower significance of VAT in respondents' attitude towards the development of new premises. The reactions of some commentators may have been to overstate the potential impact of the self supply charge. But there may in fact have been insufficient time for the charge to have been incurred in practice.

**6.5.2.13 Occupiers Questionnaire, Section B, Questions B7-8,
Developers Questionnaire, Questions 9-10**

“Consider the situation where a developer purchases a twenty acre site on which to develop a business park and initially only builds one unit on one acre of the site.

If this unit is used to provide an exempt supply will the developer face a VAT charge based on the entire 20 acres?” (28)

These questions were developed to establish what was happening in practice in answer to KFR’s question. Three respondents (6%) indicated that they had to pay VAT on total site value where only a part of the site had been developed. Of these one incurred the charge on all sites, one on 50% of sites and one on 1% of sites which had been partially developed.

It must be borne in mind that this is a relatively small percentage of the total sample. But this apparent anomaly in the Finance Act 1989 may have had an impact on the willingness of owners to develop larger sites. Further research will be required to establish the extent to which individuals have been discouraged from such development as a result of this issue.

**6.5.2.14 Investors & Developers Questionnaires, Question 3, Surveyors
Questionnaire, Question 1**

This question was introduced to reinforce the results of the aim one questionnaires (5.5.2.2). It also provided an indication of the level of subjective judgement on

issues associated with the option to tax which respondents may have had to use in order to complete the questionnaires.

The results as with those of the aim one questionnaires show a variable take-up of the option to tax. The distribution is not normal and there is a clear skew towards a lower percentage take-up. 8 (14.5%) respondents or their clients had not opted to tax any of their properties. 6 (11%) respondents or their clients had opted to tax all their portfolio. Most respondents, 22 (40.5%) or their clients had opted to tax 1-20% of their portfolio. The second largest number of respondents or their clients, 9 (16.5%) had opted to tax 81-99% of their properties. A smaller number of respondents or their clients had opted to tax properties in the mid ranges 21-40%, 41-60% and 61-80% with 5 (9%), 2 (3.5%) and 3 (5.5%) respectively.

This response is broadly repeated throughout the individual categories of respondent, with the exception that investors show a proportionally lower level of options and developers a proportionally higher level of options, much in line with their VAT recovery position.

These results have implications for this research. For example if surveyors had no experience of the option to tax some of the answers to question 6.5.2.17 might be subjective and less reliable. The results from this question will be considered when assessing the other results from investors, developers and surveyors questionnaires.

**6.5.2.15 Investors & Developers Questionnaires, Question 4, Surveyors
Questionnaire, Question 2**

This question was introduced because it was felt that the reason for holding property might have an impact on the results. It shows the proportion of those questioned involved in investment or development and provides an indication of the level of subjective judgement which may have been necessary to answer the questionnaire.

The results show that this sample was made up of respondents or their clients who held 67% of their property for investment, 28% for development. Without exception the 5% of property held for other purposes was held for trading occupancy.

The results show that the sample contained individuals who held property both for investment and development which indicates that a lower level of subjectivity was required to answer the following questions than might otherwise have been the case.

Most property was held for investment and the results on investment issues must be the most reliable as respondents had most experience of this property type. Once again the results from this question should be considered with those from the following question where recipients were asked to express an opinion based on their own experience.

6.5.2.16 Surveyors Questionnaire, Question 3

This question was included to reinforce the result of the aim one questionnaires (5.5.2.9). It was developed to establish whether there was any evidence that overseas investors had been unwilling to invest in UK property because of its VAT treatment.

In support of the aim one results, most respondents, 14 (93.3%) were unaware of overseas investors who had been unwilling to invest in UK property because of its VAT treatment. However, one respondent had experienced some unwillingness on the part of overseas investors to invest in UK property because of its VAT treatment. There is therefore superficial evidence to suggest that the VAT treatment of UK property has influenced overseas investors decisions. No further evidence has been found to corroborate this statement.

6.5.2.17 Investors and Developers Questionnaires, Question 5, Surveyors Questionnaire, Question 4

This question was developed to cover a primary issue for this part of the research. How in reality had the commercial property market reacted to the VAT changes introduced in the Finance Act 1989? The question was based on commentators' suggested reactions of the commercial property market at the time of these legislative changes. Respondents were asked to assess each statement on the basis of experience. The results were not entirely what had been expected and in some

cases conflicted with the results of earlier questions. Chapter three sets out in some detail the legislative changes introduced in the Finance Act 1989 which should be read in conjunction with these results. The results for each statement are examined in turn below.

Statement - "Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents."

Since developers would almost certainly opt to tax to recover VAT on construction costs, exempt investors when purchasing a new let commercial building would be faced with the choice of either opting to tax rents or paying VAT on the purchase price. Commentators had suggested that continuing with the option to tax in such circumstances would be virtually inevitable. KFR comment:

"Investors are unlikely to revoke this (the option to tax) as it would mean they would have to absorb the VAT element." (29)

Most respondents, 13 (52%) agreed with this statement indicating that it was always true. The distribution of responses is not symmetrical and there is an obvious skew towards the accuracy of the statement with 9 (36%) recording it as mostly true and 3 (12%) indicating that it was sometimes true.

In reality there may be instances where investors might choose not to opt to tax when acquiring a building but these will almost certainly be the exception, particularly if there is a heavy VAT penalty in not continuing with the option to tax.

It appears that the decision may be dependent on the amount of VAT to be paid and this may explain the variance in response. The reaction of respondents might suggest that the decision to opt to tax is financially motivated in this case.

Some variance was recorded by group response to this statement with relatively more surveyors, 8 (61.5%) recording this statement as mostly true. This may be due to the need for surveyors to express a composite response from what might be a varied client base.

Statement - "Site bids will be reduced when VAT cannot be recovered."

This statement was based on Hedley's comment that:

"..in the long term developers will alter their site bids to achieve a satisfactory rate of return." (30)

Hedley argued that some account would have to be taken of irrecoverable VAT if profit margins were to be sustained and a reduction in site bids represented one possible option to deal with this extra cost.

Most respondents, 17 (33%) felt this statement to be mostly true. The distribution of results is not symmetrical and there is a clear skew towards the accuracy of the statement, with 14 (27%) indicating that in their experience the statement was always true and 12 (23%) indicating that it was sometimes true. However, 6

(11.5%) felt that the statement had little truth and 3 (5.5%) indicated that it was never true in their experience.

Responses by category are essentially similar indicating a variable degree of perceived truth in this statement, but with most commenting that it was mostly true.

In reality reducing site bids is only one of the options available to deal with the additional burden of irrecoverable VAT and this may account for the spread of responses. For example profit margins might not be sustained at previous levels. The importance of demand and competition may also be significant, requiring profit margins to be trimmed rather than site bids, particularly if it is imperative that the site is secured.

Statement - "Investors who cannot recover VAT favour unelected buildings to retain flexibility in tax treatment."

This statement was based on the following comment by KFR:

"In order to retain flexibility in the tax treatment of their buildings both exempt companies and investors may favour the purchase of pre-1989 properties." (31)

KFR suggest that exempt investors and companies might prefer unelected buildings to retain tax choice. This would avoid the need for an automatic election to waive

exemption that is required on acquisition of an elected building to avoid VAT being incurred on the purchase.

Most respondents, 9 (37.5%) indicated that in their experience this statement was mostly true. The distribution is not symmetrical and there is a clear skew towards the statements accuracy with 7 (29%) indicating that it was always true and 6 (25%) indicating that it was sometimes true. Only a relatively small number of respondents, 2 (8.5%) indicated that the statement had little truth.

An analysis of responses by category shows a similar spread of responses to the aggregate data but more investors than surveyors indicated that the statement was always true.

In reality, whilst the statement makes excellent sense, problems may occur. For example, unelected buildings may not always be available. KFR also stress the importance of a concentration of exempt occupiers sufficient to influence the market. These factors may account for the distribution of responses.

Statement - "Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes."

This statement was based on KFR's comment that:

"...investors may hold back from funding or purchase of new freeholds."

(32)

because all freehold sales of 'new' buildings within a three year period of being ready for occupation are standard rated. Hedley also commented that:

"The imposition of VAT will certainly affect the willingness of some financial service companies and others to bid for development sites for their own occupation." (33)

Most respondents, 9 (39%) felt that this statement was sometimes true. The distribution of responses is not symmetrical. There is a clear skew towards the accuracy of this statement with 7 (30.5%) indicating that in their experience the statement was mostly true and only 1 (4.5%) indicating that it was always true. 6 (26%) felt that the statement had little truth. These results are broadly maintained by reference to category of respondent.

These results contrast with those of Section B of the Occupiers Questionnaire which show that the development of new schemes has continued despite the change in their VAT treatment. Commentators opinions, such as Hedley's, on the reaction of part exempt/exempt investors to development seem to have been confirmed on the basis of these results.

Statement - "Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years."

This statement as with the proceeding statement was developed from KFR's concern that investors may hold back from funding or purchasing new freeholds until after

the three year period during which they would attract mandatory VAT. KFR commented that there are two options for developments completed prior to 1 August 89, but not three years old and unoccupied, which fall within the transitional arrangements:

- “ - wait three years and sell an ‘old’ building, or,
- sell an untaxed leasehold to an investor with an option to purchase the freehold after the three year period has expired.” (34)

This statement was introduced to establish whether there was any evidence to suggest that investors had followed the latter option.

The results to this statement are evenly spread with 5 (29.4%) respondents indicating in each case that it had little truth, was sometimes true and was mostly true. 11.8% of respondents indicated that the statement was always true.

An analysis of the results by category of respondent shows 3 (42.9%) investors in EC2/3 indicating that in their opinion it had little truth. Other categories of respondent are broadly similar.

The aggregate data shows a varying reaction to this statement. There was a high level of non-response to this individual statement which duplicates the coverage of the previous statement and deals with a temporary phenomena. However it is clear that some respondents have an opinion on this option. 64.7% of the sample are

involved in investment although not all are exempt. Thus some responses are subjective and this may account for the variance in response.

Statement - "Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay."

This statement appears to make excellent business sense because those involved in new construction would pay VAT on site costs in addition to building costs.

In support of the results from Section B of the Occupiers Questionnaire, most respondents, 9 (41%) indicated that they considered this statement had little truth. The distribution of responses is not symmetrical and an overall higher number, 13 (59%) considered the statement to contain more truth rather than less with 7 (32%) indicating that the statement was sometimes true, 4 (18%) indicating that it was mostly true and 2 (9%) indicating that it was always true. Responses from individual categories reflect the aggregate data.

It appears that some exempt investors will favour refurbishment because of the extra VAT liability associated with site costs on new development. But whether they favour refurbishment or not will depend to a large extent both on their VAT recovery position and the VAT liability associated with a particular scheme. For example it is conceivable that a large refurbishment scheme may incur as much VAT as a smaller new build. There are also practical issues such as insufficient buildings to refurbish or that refurbishments may not be in demand.

Statement - "Tenants who cannot recover VAT paid on rent want to pay a lower rent."

Evidence of potential variations in rent is an important issue for this part of the research. This statement was developed as one of the possible options for exempt tenants who had to pay VAT on rent which could not be recovered. Hedley offered the following comment on the impact of charging VAT on rents:

"In markets which are dominated by exempt tenants, it is conceivable that there would be a 13% (VAT @ 15%) drop in rental and capital value if the option is exercised." (35)

The results from the Occupiers' Questionnaire, Questions A3/4. show that securing a lower rent on review was a strong option for tenants having to deal with an additional VAT burden. Most respondents to this question considered this statement to be always or mostly true with 16 (31.5%) and 18 (35.5%) respectively. 10 (19.5%) indicated that the statement was sometimes true, 6 (11.5%) felt it had little truth and 1 (2%) indicated that it had no truth. An analysis of the data by category of respondents shows a broadly similar pattern of responses.

It appears that exempt tenants want to pay a lower rent to offset irrecoverable VAT charged on rent. But this may not be possible in practice because of the way in which rent is assessed at review.

Statement - "Developers will opt to tax every new freehold commercial building to ensure the recovery of VAT on construction costs and site purchase."

The ability to recover VAT on construction costs and site purchase was seen by some commentators as a major benefit of the legislative changes introduced in the Finance Act 1989, producing an overwhelmingly powerful incentive to opt to tax.

The results from this question show that most respondents, 25 (55%) found this statement to be mostly true. The distribution of responses is not normal and there is a clear majority who found this statement to be more rather than less accurate. 11 (24.2%) indicated that the statement was always true and 5 (11%) found the statement to be sometimes true. Only 1 (2.2%) indicated that the statement had little truth and 3 (6.6%) felt that it had no truth. The data assessed by category of respondent produce a broadly similar response to the aggregate data.

These results appear to show that in reality most developers will opt to tax new freehold commercial buildings to recover VAT but there will be a small percentage of instances where they will not. In these cases the developer might be selling to an exempt investor or occupier who could not recover VAT.

Statement - "Developers who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay."

As with the similar statement presented to investors, it seems to make good practical sense for exempt developers to favour refurbishment as this would avoid any liability to pay VAT on site costs.

Most respondents, 11 (46%) felt that this statement was sometimes true. Significantly larger percentages of respondents than for previous statements indicated that this statement had little or no truth, 4 (16.5%) and 5 (21%) respectively. Only 1 (4%) felt that the statement was always true and 3 (12.5%) indicated that it was mostly true.

In reality, as with investors, the actual amount of VAT to be paid for each scheme under consideration will probably be a more important determinant in the developers' choice rather than a straight forward discrimination in favour of refurbishment. Two respondents commented "don't know any" (exempt developers) or "will create a tax vehicle to recover VAT". This may account for the variance in response which in some cases may be a subjective judgement, although the sample does contain responses from some exempt developers.

Statement - "Developers who cannot recover VAT will be discouraged from the development of new sites."

This statement was based on KFR's comment that:

"..the VAT charge on land may discourage the development of new sites by exempt companies." (36)

The results support this statement with 21 (48%) respondents indicating that the statement was mostly true and 2 (4.5%) indicating that it was always true. The distribution of responses is not normal with 12 (27%) indicating that the statement

was sometimes true, 7 (16%) indicating that it had little truth and 2 (4.5%) indicating that they considered it was never true.

An analysis of the data by category of respondent shows surveyors generally indicating that in their opinion the statement had less truth than other categories of respondent. Six (46.2%) surveyors in EC2/3 indicated that the statement was only sometimes true.

To some extent these results contradict those from Section B of the Occupiers Questionnaire which show that new development continues. A distinction may be drawn on the basis that this statement refers to exempt developers whilst the Occupiers Questionnaire was answered by some part exempt taxpayers who could recover significant percentages of VAT. There is some evidence that exempt developers have been discouraged from the development of new sites. The responses have limited validity because the results show only one respondent who was an exempt developer.

Statement - "Tenants who cannot recover VAT will take less floor space to offset irrecoverable VAT."

Hedley commented that:

"In so far as higher rental costs have to be paid, some exempt occupiers will take less space or move to a slightly cheaper area, or both; others may chose to pay the extra." (37)

Most respondents, 10 (66.6%) indicated that there was little truth in the statement. A further 3 (20%) indicated that there was no truth in the statement. The distribution of the results is not normal with only 2 (13.3%) felt that the statement was sometimes true.

These results also concur with those from occupiers who were asked a similar question (A3/4c). This is possibly the least likely option because of difficulties with taking less space under an existing lease or methods of production or service provision which may require the space already occupied.

Statement "Tenants who cannot recover VAT will pay a premium or more rent to secure an unelected building."

This statement is based on KFR's comments that:

"They (exempt occupiers) would in fact be prepared to pay a premium of up to 15% (VAT @ 15%) over the market rent in order to secure occupancy of a non-elected building." (38)

Most respondents, 6 (40%) felt that this statement was sometimes true and 3 (20%) indicated that it was mostly true. No respondent felt that it was always true. The distribution of results is not normal with 5 (33%) indicating that the statement had little truth and 1 (7%) indicating that it had no truth.

These results agree with those of occupiers who were asked a similar question (A5.) in their questionnaire. It can be concluded that there is evidence that some tenants are prepared to pay a premium or more rent to secure an unelected building. These results should also be considered in conjunction with the statement below.

Statement - "Tenants who cannot recover VAT will move to avoid having to pay VAT on rent."

The results clearly refute Hedley's comments (39). A high number of respondents, 10 (71.5%) were of the opinion that the statement had little truth. However the distribution of the results is not symmetrical with 7% considering that the statement was always true, a further 3 (21.5%) felt that the statement had some truth.

These results should be considered in conjunction with those from occupiers who were asked a similar question (A3/4a.). The response was far less distinct, with a majority indicating that a move was a more likely option.

The difference may be the result of the difference between the two categories questioned. Surveyors are more likely to be aware of the practical difficulties such as lease disposal associated with tenants who wish to relocate. Hence a majority of surveyors responded that this statement had little truth. Tenants, however, might consider relocation as a viable option to deal with increased occupation costs, but may not be fully aware of the practical implications such as relocation costs.

Statement - "A two tier market has developed in certain commercial areas."

This statement was derived from KFR's suggestion that:

"The first of the major implications for the office market will be the creation of a two tier rental market in certain office centres." (40)

The results show a more even response with 40% respondents indicating in both cases that the statement had little truth or was sometimes true. The distribution of results is not symmetrical with a further (20%) indicating that the statement was mostly true.

It may be concluded that there is some evidence to support the opinion that a two tier rental market has developed in some commercial centres. This opinion is reinforced by the results of Occupiers Questionnaire, Question A5. which confirms that some tenants are prepared to pay a premium or more rent to secure an unelected building. KFR go on to suggest in their article (41) that certain criteria such as a strong market and a concentration of exempt occupiers will be required for such a market to develop. This may explain the variance in response.

6.5.2.18 Investors & Developers Questionnaire, Question 6

"The imposition of VAT will certainly affect the willingness of some financial service companies and others to bid for development sites for their own occupation." (42)

This question was developed to establish the effect of VAT on development following the legislative changes introduced in the Finance Act 1989.

The results show that most respondents, 15 (41.7%) considered that VAT will have a significant effect on whether a scheme will proceed. The distribution of results is not normal but comes close to it. Respondents are almost evenly balanced on either side of the majority response with 9 (25%) indicating that VAT was very significant and 3 (5.5%) indicating that it was crucial. 8 (22.3%) indicated that VAT was slightly significant and 2 (5.5%) indicating that it had no significance.

In reality there are a number of issues such as tax status of respondents, amount of VAT which a scheme incurs and level of profit required, the relative importance of which may influence whether a development will proceed. This may explain the variance in responses.

In each case the respondents personal circumstances may influence their response. For example fully taxable individuals may only be exposed to situations where the VAT can be fully recovered. For them it may have limited significance. The percentage of fully taxable respondents in the sample may have an impact on the results. This is illustrated by the response from developers in Bristol. This group with a high percentage tax recovery rate have ranked VAT as of low significance in responding to this question.

In concluding this section, which provides an analysis of the results of the main questionnaire circulation, it is apparent that the commercial property market has reacted to the changes in VAT introduced in the Finance Act 1989. There is evidence that exempt/part exempt tenants are trying to reduce rents on review as a result of VAT being charged on rent. Part exempt/exempt tenants are also considering moving premises as a potential option for dealing with the extra costs of VAT on rent.

A fall in the quantity of accommodation offered to let is less obvious but there is evidence from the questionnaires that VAT is now a significant issue in the development process and that some exempt investors and developers have been discouraged from the development of new premises which may result in an overall reduction in the level of available stock.

Having considered the results of the main questionnaire circulation these are critically examined in the following section.

6.6.0 CRITIQUE

This section contains a critical examination of the methodology, response rate, data and quality of response for the second aim of this research.

6.6.1 METHODOLOGY

The second aim of this research was to assess the perceived effects of waiver of exemption on rents in the English commercial property market.

Questionnaires were developed to assess the perceived effects of waiver of exemption on the English commercial property market by comparing respondents' actual experience with predictions made by commentators on market reactions at the time that these VAT changes were introduced in the Finance Act 1989.

With the benefit of hindsight the need to preserve anonymity proved false and the usefulness of follow ups largely ignored. The removal of anonymity to allow follow ups might have added significantly to the research improving response rate and allowing deeper probing on important issues.

Economic price theory predicts that the increase in rents due to the imposition of VAT will produce a decline in the quantity of rented accommodation demanded. Some tenants will be encouraged to move out or take less space.

The results from this research demonstrate that exempt/part exempt tenants are likely to move to avoid the extra cost of VAT charged on rents, but less likely to occupy less space.

Economic price theory predicts that an increase in the level of vacant space produces a situation of oversupply. Landlords will find it difficult to replace tenants who move out. Oversupply will induce some prospective tenants to offer lower rents. These will be accepted by landlords rather than have properties vacant for long periods. Other landlords will be forced to follow this trend of reducing rents.

The results of this research have shown that exempt tenants want to pay a lower rent and that part exempt/exempt tenants are most likely to try to secure a lower rent on review to deal with this extra cost. But this may be a temporary phenomena;

“Such rental adjustments will be once-and-for-all and there should be no subsequent influence on the rate of rental growth.” (43)

Economic price theory predicts that as rents fall there will be a gradual fall in the quantity of rented accommodation supplied because some new developments will become less viable. The results from this research produce less evidence of a decline in new developments.

The methodology has proved successful because the questionnaires have produced evidence which satisfies the issues set out in section 6.2.0. The results have also produced evidence which goes some way to satisfying the hypotheses set out in section 4.3.4.

6.6.2 RESPONSE RATE

Section 6.5.1. sets out the response rate to the questionnaires. It is immediately apparent that the low aggregate response has introduced a significant problem of unrepresentativeness into this research. What were the opinions of the 63% who did not respond?

Individual recipients who did not respond could not be identified and it has not been possible to use follow-up techniques to reduce the level of non-response. As with the aim one responses a number of respondents returned their questionnaires with letters identifying themselves, which suggests that the initial requirement to preserve anonymity was probably overstated.

The level of responses tabulated in section 6.5.1. shows a significant difference between the number of returned and useable questionnaires. There is some evidence to suggest that the reasons for this might be because of problems with data sources used to derive the sample. It is apparent that in some instances these were out of date particularly in EC2/3 where 12 developers and 8 investors questionnaires were returned 'not known at this address' or 'gone away'. The situation was further complicated by the economic recession persisting at the time of circulation (Appendix 1.). In some cases mergers of building societies had taken place.

There is also evidence to suggest further problems associated with sampling. A number of respondents indicated that they were only involved in residential not commercial property. A small number also indicated that they were only involved in property investment in the United States. Some respondents, identified as investors, indicated that they were not investors and some identified as developers commented that they were not developers.

There was also evidence of a failure to direct the questionnaires to the correct recipient. Some respondents also indicated that the questionnaire had been passed to a department at their headquarters.

Inevitably there were a small number of questionnaires returned because the recipients were too busy or did not wish to be involved.

Each of these problems contributed to the low level of useable responses and the associated unrepresentativeness which has been introduced into the results. This might have been overcome by concentrating on data sources, selecting a smaller sample, removing anonymity and using follow-up techniques to ensure an acceptable level of response.

6.6.3 DATA

The low useable response rate produced particular problems associated with the analysis of data. The small number of respondents, particularly from Bristol and by

category of respondent, meant that it was difficult to compare and contrast the results by area or by category. For example a response from three occupiers from Bristol could not be considered representative. This small response rate presents particular difficulties in interpreting data from matrix questions where a trend or pattern is impossible to detect.

It might also be argued that it was incorrect to aggregate data from different dissimilar groups. It may also be incorrect to aggregate data from the Occupiers Questionnaire, Questions A3. and A4. because Question A3. has been answered by respondents who have experienced VAT being charged on rents, whilst Question A4. requires subjective judgement.

Another problem encountered with the responses to Questions A3/4. was that a small number of respondents failed to give an ordered response, ordering some statements equally. This presented some problems in assessing the relative importance of each option.

Questions A1/2. from the Occupiers Questionnaire failed to deal adequately with all the potential options for charging VAT on rents. It is clear from the responses that some tenants occupied several properties, on some of which their landlord had opted to tax rents and on some of which they had not. This meant that some respondents answered both questions A3. and A4. whilst it had been envisaged that these questions would be mutually exclusive. The response was not always the same to both questions.

Some difficulties were also encountered with individual questions, particularly those of a matrix format where respondents failed on occasion to comment on every statement they were asked to. The response was therefore incomplete.

Investors Questionnaire, Questions 8/10. and Occupiers Questionnaire, Section B, Questions B6/8. were designed to provide details of the number of times a respondent had incurred a self supply charge or VAT on total development value where part only of a site was developed. One respondent indicated 1% of cases which seems a very small amount. The word 'cases' may also have appeared ambiguous and unrelated. The question might have asked respondents to express 'how many?' by percentage thus continuing the flow of these questions.

One respondent answering the Investors Questionnaire, Question 2. commented that the percentage VAT recovery varied from month to month. This suggests that a view of recovery rate over time was necessary to answer this question.

6.6.4 QUALITY OF RESPONSE

This survey method may be criticised on the grounds of lack of control over who fills out the questionnaire or the environment in which it is completed. Both issues will influence the quality of response.

There is evidence throughout the analysis of the results that some degree of subjective judgement may have been required on the part of respondents to answer

certain questions. This is clearly illustrated in the Occupiers Questionnaire, Question A5. where respondents are asked to indicate the level of additional rent or premium they would pay to secure an unelected building. Similarly, responses to statements based on the reactions of exempt developers/investors must contain a high element of subjectivity, because there were only two fully exempt respondents.

Investors and Developers Question 4. was introduced to provide some assessment of the extent to which the sample was made up of investors and developers so as to determine the extent to which subjective judgements were necessary. It might be argued that subjective responses defeat the object of these questionnaires which was to provide factual evidence. The responses from surveyors are highly subjective and may involve an element of double counting if their clients are also respondents, but it may be argued that these subjective judgements have come from experienced respondents.

A number of problems encountered with the aim one questionnaires were repeated with the aim two questionnaires because the development of these was running consecutively. For example the difficulties experienced with questions such as Surveyors, Investors and Developers Question 3. discussed in section 5.6.3 were not discovered in time for the questions to be amended and they were repeated in the aim two questionnaires. This research would have benefited from being taken one aim at a time the first being completed before the next was commenced.

It is apparent from their response that either tenants found Section A of the Occupiers' Questionnaire too complex or they were unprepared to commit themselves to a subjective judgement. A number ticked boxes in answer to Questions A1/2. but failed to go on to answer Questions A3/4. Others failed to read the directions correctly, a small number who had indicated that they were tenants answering both Sections A and B. This also has repercussions for the quality of response. Perhaps these respondents were unable to follow directions or simply failed to pay insufficient attention to detail. Other respondents failed to appreciate that whilst ticking boxes was required as answers to Questions A1/2, an ordered response was required to Questions A3/4. The change to the requirement for an ordered response without specific directions appeared too subtle for some respondents.

A further indication of difficulties with the quality of response is provided in the results from Questions 1. and 2. of the Occupiers, Investors and Developers Questionnaire. Here the percentage of exempt and fully taxable respondents given in answer to Question 1. does not concur with the responses given to 0% and 100% recovery positions in Question 2. For example a small number of respondents entering themselves as fully taxable in Question 1. then indicated their VAT recovery as 0% in Question 2. This problem had not been experienced with the pilot data because no equivalent of Question 2. was asked.

Errors may also arise because of the respondents' lack of knowledge or poor memory.

6.7.0 CONCLUSION

The second aim of this research was to assess the perceived effects of waiver of exemption on rents in the English commercial property market.

Chapter four, sections 4.3.0 - 4.3.4 developed the conceptual thinking for this second aim. The introduction of the election to waive exemption in the Finance Act 1989 presented a particular problem for part exempt and exempt tenants. The effect of their landlord electing to waive exemption was to increase occupation costs by the amount of irrecoverable VAT charged on rent.

Section 4.3.2. considered in some detail economic price theory and its application to the commercial property market as a possible explanation of the effect of waiver of exemption on rent.

Based on economic price theory it was hypothesised that the effect of waiver of exemption on the commercial property market will be:

- (1) a reduction in the disequilibrium rent, paid by exempt/part exempt tenants, to the equilibrium rent, post tax; and,
- (2) a reduction in the total quantity of commercial property offered to let.

It was decided initially to test whether there was any evidence of a market reaction to waiver of exemption.

Section 6.2.0, in developing this conceptual thinking, further identifies three important issues which this part of the research would need to consider to satisfy its aim.

Questionnaires were developed in section 6.3.0 based on these issues and were amended (section 6.3.5) following the results of the pilot circulation, section 6.3.4.

The results of the main circulation, set out in section 6.5.0 produced results which represent a contribution to knowledge. The results provide evidence in support of economic price theory, that some part exempt/exempt tenants have sought to pay a lower rent on review where VAT is charged on rents.

The results demonstrate that some part exempt/exempt tenants are willing to pay a premium or more rent to secure an unelected building. This suggests that two tier markets have developed in certain commercial centres.

Evidence was also found that some tenants would move to avoid VAT being charged on rent. This might suggest an oversupply of opted buildings, a reaction also predicted by economic price theory, although occupying less space which might also result in surplus space proved to be a less likely option to avoid the extra cost of VAT charged on rent.

Some tenants had adopted other approaches to deal with VAT charged on rent. This suggests that economic price theory may only provide a partial explanation of how some tenants are dealing with the extra cost. Some were able to pass this cost on as higher product prices, others accepted reduced profits and paid the VAT. Others adopted a negotiating stance with their landlord, passed on the VAT or purchased the freehold.

The second hypothesis based on economic price theory as an explanation of the effect of waiver of exemption on rent, was that there would be a reduction in the total quantity of commercial property offered to let. It was concluded that this might first manifest itself as a reduction in the development of new premises.

The results show that some exempt investors and developers have been discouraged from the development of new schemes. There is also evidence that some exempt investors and developers have moved away from new development towards refurbishment, thus avoiding VAT on site costs, but this may not result in a reduction in the total quantity of commercial property offered to let.

It is also evident that VAT is now a significant, and in some instances crucial, factor in the development of new premises. But, the results show development continuing since the changes in VAT introduced in the Finance Act 1989. A possible explanation might be that the impact of VAT has not been as great as initially predicted by commentators. It is apparent from the results that occasions of charge, where significant VAT liability might be incurred, such as self supply

charges, or VAT charged on total site value where only part of a site was developed, are limited. Alternatively the market could take time to react to the changes and research over time will be required.

There is evidence that other methods are being used to continue development and avoid the impact of VAT, such as reducing site bids where VAT cannot be recovered.

There is evidence throughout the results that tax status and the personal circumstances of individual respondents are important issues in determining the effect of waiver of exemption. The result suggests that the exempt sector of the market might be reacting as predicted by economic price theory.

The results also support aim one of the research, confirming a variable take-up of the option to tax with a skew towards a lower level of take-up from this sample. Very limited evidence was found to suggest that overseas investors have been unwilling to invest in the UK as a result of the VAT treatment of UK property.

These results must be qualified on the basis of the critique set out in section 6.6.0. In particular the significant level of unrepresentativeness introduced into these results because of the level of non-response and the reservations expressed about the quality of response must be considered.

In conclusion it is apparent, based on these results, that economic price theory may provide a partial explanation of the effect of waiver of exemption on rents for exempt and to a lesser degree part exempt tenants. However reductions in rent and quantity of accommodation offered to let may not be the only market reactions to this additional tax burden.

Based on these results, further quantitative research into the demand and supply functions for the commercial property market to determine the actual fall in rent levels and quantity of commercial property offered to let are justified.

Appendix seven begins this research by developing a conceptual framework for a model of the commercial property market.

1. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p.26.
2. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p.24.
3. Knight Frank Rutley Research. 1989. The Impact of VAT on the commercial property market, p.11.
4. Knight Frank Rutley Research. 1989. The Impact of VAT on the commercial property market, p.11.
5. Royal Institution of Chartered Surveyors. Geographical Directory 1991 Macmillan.
6. Incorporated Society of Valuers and Auctioneers. List of Members and Organisations 1990/91. HW Glanville.
7. Hedley, C. 18 February 1989. VAT on construction Estates Gazette, p24.
8. Hedley, C. 2 July 1988. The effects of the European Court judgement. Estates Gazette, p26.
9. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p24.

10. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p10.
11. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p22.
12. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p22.
13. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p22.
14. Hedley, C. 2 July 1988. The effects of the European Court judgement. Estates Gazette, p26.
15. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p17.
16. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p17.
17. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p66.

18. Hedley, C. 2 July 1988. The effects of the European court judgement
Estates Gazette, p102.
19. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p66.
20. Moser, C. & Kalton, G. 1979. Survey Methods in Social Investigation. 2nd
Edition, Gower, p.268.
21. Knight Frank Rutley Research 1989. The Impact of VAT on the
Commercial Property Market. pll.
22. Knight Frank Rutley Research 1989. The Impact of VAT on the
Commercial Property Market. pll.
23. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p24.
24. Hedley, C. 2 July 1988. The effects of the European Court judgement
Estates Gazette, p26.
25. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p26.
26. Knight Frank Rutley Research 1989. The Impact of VAT on the
Commercial Property Market, p22.

27. Scammell, M. 19 October 1990. Underpinning the VAT rules. Taxation, p75.
28. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p22.
29. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p16.
30. Hedley, C. 18 February 1989. VAT on Construction. Estates Gazette, p66.
31. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p16.
32. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market. p17.
33. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p66.
34. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p17.
35. Hedley, C. 18 February 1989. VAT on construction. Estates Gazette, p24.

36. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p22.
37. Hedley, C. 2 July 1988. The effects of the European Court judgement. Estates Gazette, p26.
38. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p10.
39. Hedley, C. 2 July 1988. The effects of the European Court judgement. Estates Gazette, p26.
40. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p10.
41. Knight Frank Rutley Research 1989. The Impact of VAT on the Commercial Property Market, p12.
42. Hedley, C. 18 July 1989. VAT on construction. Estates Gazette, p66.
43. Hedley, C. 18 July 1989. VAT on construction. Estates Gazette, p66.

CHAPTER SEVEN

CONCLUSIONS

7.1.0 SUMMARY OF AIMS

The central aim of the research project was to investigate the impact of waiver of exemption on the commercial property market in the UK.

The literature search established that there had been one previous empirical study of property investors' reactions to the option to tax which suggested a limited take-up of this option. This was an important discovery because the Government relied on this mechanism to mitigate the impact of EC judgement (case 416/85) which required the removal of zero-rating provisions from non-domestic construction in the UK.

Commentators around the time of this judgement predicted that it would have a significant impact on the commercial property market in the UK with adverse implications for rents and capital values.

As a result a research project to determine what was actually happening to the commercial property market in the UK following the introduction of waiver of exemption was begun with two parallel and inter-related areas of study, which were:

- (1) To examine the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) in respect of the English commercial property market.
- (2) To assess the perceived effects of waiver of exemption on rents in the English commercial property market.

7.2.0 SUMMARY OF DISCOVERIES

7.2.1 THE DECISION TO ELECT TO WAIVE EXEMPTION

It was postulated that by establishing the take-up rate of waiver of exemption and the absolute and relative importance of the factors which determined whether or not to elect to waive exemption, it would be possible to fulfil the requirements of the first aim.

The results show a variable take-up of waiver of exemption with most respondents opting to tax 1-20% of their commercial property holdings.

The results also establish the absolute and relative importance of the ability to recover input tax as the key factor in making the decision whether or not to elect to waive exemption.

Whilst the initial objectives were satisfied, the link between the key factors determining whether or not to elect, the take-up rate and the amount of input tax recovered has still to be determined if the effectiveness of waiver of exemption in mitigating the effects of the EC judgement (case 416/85) on the commercial property market in the UK is to be established.

However, some evidence was found to suggest that the effectiveness of this mechanism may have been reduced because of legal drafting to prevent an election and a lack of knowledge about the option to tax amongst decision makers.

7.2.2 THE IMPACT ON RENTS AND THE QUANTITY OF COMMERCIAL PROPERTY OFFERED TO LET

Based on economic price theory it was postulated that the impact of waiver of exemption on the UK commercial property market would be a reduction in the disequilibrium rent, paid by part exempt/exempt tenants, to the equilibrium rent, post tax and a reduction in the total quantity of commercial property offered to let.

The results show that some exempt/part exempt tenants have sought to pay lower rents as a result of their landlord opting to tax. Some exempt/part exempt tenants indicated their willingness to pay a premium to secure an unelected building. However, the results show exempt/part exempt tenants adopting a variety of other approaches to deal with this extra tax burden. These include accepting reduced

profits or increasing product prices to compensate. Thus economic price theory may provide only a partial explanation of the impact of waiver of exemption.

It was postulated that the fall in the quantity of commercial property offered to let would be seen as a reduction in new property developments. The results confirm that some part exempt/exempt investors and developers have been discouraged from new development as a result of the VAT changes and establishes the importance of VAT in the decision-making process. However, development was found to be continuing with other options such as reducing site bids being used to offset the additional cost. One possible explanation might be that the market has yet to experience the full impact of the VAT changes introduced in the Finance Act 1989.

The results of this research must be considered in the context of the criticisms made, which have indicated problems with questionnaire design and the quality of response, unrepresentativeness, sampling errors and a misplaced emphasis on preserving anonymity. With the benefit of hindsight these criticisms serve to emphasise the importance of careful choice of sample, data sources and collection methods. In particular the choice of personal interview as an alternative data collection method may have overcome a significant number of the problems encountered.

7.3.0

FURTHER RESEARCH

In undertaking this research a number of areas have been identified which require further research. In some instances further research over time is necessary to investigate the issues more fully. These are considered in detail in this section.

This research has shown a variable take-up of waiver of exemption with most respondents opting to tax 1-20% of their commercial property holdings. The results have also established the importance of input tax recovery as the key factor in making the decision whether or not to elect to waive exemption.

But considering these two issues separately has proved inconclusive in determining the effectiveness of waiver of exemption as a method of mitigation. Further research is required to establish the link between these factors and the amount of input tax actually being recovered. It will then be possible to assess the effectiveness of waiver of exemption in mitigating the effects of EC judgement (case 416/85) by comparing the amount of tax which has actually been recovered with that which would have otherwise been incurred.

The second part of this research has demonstrated in qualitative terms the perceived effects of waiver of exemption on rents in the UK commercial property market. These results justify further quantitative research to model the demand and supply curves for the English commercial property market and thus assess the actual effects on rent of the introduction of waiver of exemption. Appendix seven considers how

this might be approached. It demonstrates the need for a micro, rather than a macro approach to understand how individual processes interact to form the composite market.

The potential impact of the transitional provisions set out in section 3.5.0 has not been investigated as part of this research. Their effect is likely to be limited and temporary. The reference to historic data which would be required ensures that this is likely to be a particularly difficult area to research.

Section 6.5.2.13 highlights the problem that a developer owning a business park on which only one unit is to be developed initially, could incur VAT on the whole. This research establishes that some developers have had to pay VAT on the whole business park in such circumstances. Further research is required to establish the extent of this apparently inequitable situation and the need if appropriate to make reference to Government.

The extent to which overseas investors have been discouraged from investment in UK property as a result of its VAT treatment represents another area where further research is required. It has been acknowledged that the sample may have included a number of respondents who did not have overseas clients and the results are unrepresentative of the overall problem. But the results show the unwillingness of one overseas investors to invest in UK property as a result of its tax treatment. Concentrating on those surveyors with overseas clients would enable further research to be carried out to determine the extent of this potential problem.

Section 5.2.6 highlights the existence of leases which prevent VAT being charged on rent. This may be particularly significant because contracting out of charging VAT on rents removes the opportunity to recover input tax thus frustrating waiver of exemption as a method of mitigating the impact of EC judgement (case 416/85) on the English commercial property market. Further research over time is required to establish whether the number of these leases is increasing and whether this is a potential problem which the Government should be made aware of.

The results of this research suggest that the impact of self supply charges may be limited. But, section 6.7.0 suggests that it may take some time for this tax to impact fully on the English commercial property market. This charge may have a significant impact on the development of new premises. Further research is required to establish whether the incidence of self supply charges is increasing and affecting the development of new premises.

This section has considered those further research issues which have been identified as part of this research. It has highlighted a number of areas of particular concern and suggested that in some instances reference to Government may be required post research to remedy inequitable legislation.

COLLECTED REFERENCES

This collection of references is divided into three parts, books, articles and legislation the latter including European Treaties, law reports, HMCE notices, Parliamentary debates and statutory instruments. More information on the sources used is found in the references which follow each Chapter.

AUTHOR

BOOKS

Arbuthnott, H & Edwards, G. 1979 A Common Man's Guide to the Common Market. Macmillan.

Ball, A. Touche Ross. 1989 VAT and Land. Construction & Property. 2nd Edition CCH Editions Ltd.

Buckett, A. 1989 VAT on Construction, Land & Property. The Tolley Publishing Company.

Charles, S. 1977 Housing Economics. Macmillan.

De Souza, J. & Gillington, R. 1990 The Property Investor and VAT. Sweet & Maxwell.

(Frankfort) - Nachmias, C. & Nachmias, D. 1992 Research Methods in the Social Sciences. 4th Edition. Edward Arnold.

Goy, D & Walters, J. 1989 VAT & Property. Sweet & Maxwell.

Harvey, J. 1992 Urban Land Economics. Macmillan.

Henderson, W. 1962 The Genesis of the Common Market. Frank Case & Co Ltd.

ISVA List of Members & Organisations 1990/91 HW Glanville.

Johnson, T. 1989 VAT on Buildings and Land. 3rd Edition. IBC Financial Books.

MacLennan, D. 1982 Housing Economics. Longman Group Ltd.

Moser, C & Kalton, G. 1979 Survey Methods in Social Investigation. 2nd Edition. Gower.

Pissarides, C. A. 1976 Labour Market Adjustments. Cambridge University Press.

RICS Geographical Directory 1991. Macmillan.

Robinson, R. 1979 Housing Economics and Public Policy. Macmillan.

Scott, H. & McLellan, D. 1989 VAT & Property. Butterworths.

Soares, P.C. 1988 VAT Property Planning after the EEC decision. 2nd Edition.
Longman.

Somerville, I. 1990 VAT planning for property transactions. Woodhead-Faulkner.

Whitehead, C. M. E. 1974 The UK Housing Market: An Econometric Model.
Saxon House/Lexington Books.

ARTICLES

Alm, J. September 1994 Shocks and Valuation in the Rental Housing Market.
Journal of Urban Economics. Academic Press Inc. pps. 117-142.

Anderson, G. S. March 1982 A Linear Programme Model of Housing Market
Equilibrium. Journal of Urban Economics. Academic Press Inc. pps. 159-168.

Benjamin, J.D. Bayle, G.W. & Sirmans, C.F. November 1992 Price Discrimination
in Shopping Centre Leases. Journal of Urban Economics. Academic Press Inc.
pps. 299-317.

Berner, R. F. 2 November 1989 Dropping Into The Black Hole. Taxation, pps.
128-129.

Bibring, M. 16 November 1989 The Tenant's Option to Tax. Taxation, p182.

Bristows, Cooke & Carpmael and Donaldsons 1989 VAT on Property - practical problems answered.

Brodman, M & McLellan, D. 7 November 1987 Decline and fall of the zero rate. Estates Gazette, p.726.

Brogden, C.F. & Cleall, M. 20 January 1990 Office Investment and Development. Estates Gazette, pps.150-152.

Buckett, A. 5 October 1989 when ignorance means risk. Chartered Surveyors Weekly, pps.90 & 92.

Buckett, A. December/January 1989/90 VAT Penalties. National Builder, pps.52-53.

Cadman, D. 17 March 1990 Euphoria or depression? Estates Gazette, pps. 26-28.

Challoner, J. 28 July 1988 EC ruling in a nutshell. Chartered Surveyor Weekly, p.32.

Chase, G. 14 July 1989 Switch to standard rate affects VAT on contracts. Estates Times, p.19.

Cholmeley, F. 24 October 1989 VAT and property: the new rules. Solicitors Journal, p.1323

Clayton, S. Spring 1989 Industrial tops wise investors' shopping list. Estates Times Supplement, pps.13-17.

Coopers & Lybrand & Savills. Undated. European Harmonisation. VAT: Property and Construction

Darlow, C. 20 January 1990 The year at Westminster. Estates Gazette, p.146.

Darlow, C. 19 January 1991 The year at Westminster. Estates Gazette, p.75.

Davis, A. 18 August 1990 VAT for commercial lenders. Estates Gazette, pps. 38-40.

Dick, J. 1 September 1990 VAT and lease surrenders. Estates Gazette, pps.43 & 76.

Duckworth, G. September 1990 Professions prosper in a changing world. Estates Times Supplement, pps. 27-28.

Durkacz, V. 2 September 1988 New VAT Planning Opportunities. Taxation. pps.498-501.

Durkacz, V. 23 February 1989 Side step the penalties on property. Accountancy Age.

Durkacz, V. 10 October 1990 Another Tax on Generosity. Taxation, pps. 154-158.

Ellickson, B. January 1981 An Alternative Test of the Hedonic Theory of Housing Markets. Journal of Urban Economics. Academic Press Inc. pps.56-79.

Fogel, S. & Plumbe, G. 22 April 1989. VAT and rent review clauses. Estates Gazette, pps.76 & 82.

Gilmour, W. 10 November 1990 The Battle for (higher) retail sales. Estates Gazette, p.72.

Goodman, A. C. May 1988 An Econometric Model of Housing Price, Permanent Income, Tenure Choice and Housing Demand. Journal of Urban Economics. Academic Press Inc. pps.327-353.

Grenadier, S. R. January 1995 Local and National Determinants of Office Vacancies. Journal of Urban Economics. Academic Press Inc. pps.57-71.

Gross, D. J. July 1988 Estimating Willingness to Pay for Housing Characteristics: An Application of the Ellickson Bid Rent Model. Journal of Urban Economics. Academic Press Inc. pps.95-112.

Hansuchek, E. A. & Quigley, J. M. January 1979 The Dynamics of the Housing Market: A Stock Adjustment Model of Housing Consumption. Journal of Urban Economics. Academic Press Inc. pps. 90-111.

Harrington, D.E. March 1989 An Intertemporal Model of Housing Demand: Implications for the Price Elasticity. Journal of Urban Economics. Academic Press Inc. pps230-246.

Haurin, D.R. & Lee, K. November 1989 A Structural Model of the Demand for Owner Occupied Housing. Journal of Urban Economics. Academic Press Inc. pps.348-360.

Hannington, R. 18 January 1992 Coping with rising interest. Estates Gazette. pps.62-64.

Hedley, C. 2 July 1988 The effects of the European Court judgement. Estates Gazette, pps.24-26.

Hedley, C. 18 February 1989 VAT on construction. Estates Gazette, pps.24-26.

Hetherington, J. Spring 1989 Record breaking year as boom heads north. Estates Times Supplement, pps.7-10.

Hetherington, J. April 1990 Economic slow-down breaks record rises. Estates Times Supplement, pps. 11-12.

Higson, N. 22 February 1991 Agents try to score tough conversations. Estates Times Industrial Supplement, pps.49-50.

Horowitz, J. L. September 1996 Bidding Models of Housing Markets. Journal of Urban Economics. Academic Press Inc. pps.168-190.

Huyton, D. 1989 What VAT on rents can mean to you. Property Director, Vol. 14, p.73.

Ihlanfeldt, K. R. September 1984 Property Taxation and The Demand for Housing: An Econometric Analysis. Journal of Urban Economics. Academic Press Inc. pps.208-224.

Irvine, T. 20 January 1990 The brakes go on for retailers. Estates Gazette, pps.161-162.

Jenkins, P. 7 July 1990 VAT treatment of land and property. Taxation, pps.264-268.

Jones, H. 22 February 1991 After the feast the famine begins. Estates Times Industrial Supplement, pps.5-6.

Jones Lang Wootton. Spring 1992 Property Index.

Johnson, T. 27 May 1989 VAT on development. Estates Gazette, pps.68 & 88.

Kamecke, U. January 1993 Mean City - A Consistent Approximation of Bid Rent Equilibria. Journal of Urban Economics. Academic Press Inc. pps.48-67.

Kelleher, K. 9 February 1991 Value Added Tax (Buildings and Land) Order 1991. Estates Gazette, pps.102-103.

Kessler, J. 19 January 1989 Forewarned, Forearmed. Taxation, pps. 352-354.

Kinzy, S.A. July 1992 An Analysis of the Supply of Housing Characterised by Builders within the Rosen Framework. Journal of Urban Economics. Academic Press Inc. pps.1-16.

Knight Frank Rutley Research 1989 The Impact of VAT on the Commercial Property Market.

Kowalski, J. G. & Paraskevopoulos, C. C. January 1990 The Impact of Location on Urban Industrial Land Prices. Journal of Urban Economics. Academic Press Inc. pps.16-24.

Lawrence, N. 1990 New VAT financial penalties coming into force. The Estate Agent, 2nd Edition, p.26.

Lawson, D. 18 January 1992 Getting in on the acts. Estates Gazette, p.76.

Maclachlan, J. 20 September 1991 Climbing the slippery slope. Estates Times Review, pps.29-30.

Marshall, T. 18 January 1992 Taking the broader view. Estates Gazette, pps.52-53.

Mass, R. 17 June 1989 VAT on commercial developments. Estates Gazette, pps.84 & 88.

McFarlane, G. 13 October 1989 Property and the new VAT laws. Solicitors Journal, Vol. 133, No. 41, p.1281.

Moore, J. & Lawrence, A. 14 October 1989 To elect or not to elect? Estates Gazette, pps.78 & 81.

Morrell, J. 1 December 1989 Slow growth to come now boom is over. Estates Times Supplement, pps.5-6.

Morgan, M. 14 May 1992 Centres of attention. Chartered Surveyor Weekly, p.44.

Mortished, C. 29 June 1991 Retail squeeze. Estates Gazette, p.77.

Nabarro, R. September 1990 The party's over, time to sober up. Estates Times.
pps.19-20.

12 January 1990 Now office yields rise to. Investors Chronicle, p.22.

Ohkawara, T. November 1985 Urban Residential Land Function: An Alternative
Muth-Mills Model. Journal of Urban Economics. Academic Press Inc. pps.338-
349.

Organ, J. 20 January 1990 Industrial supply stangled - rents sprint. Estates
Gazette, pps.170-171.

Organ, J. 22 February 1991 Provincial cities ride the economic storms. Estates
Times Industrial Supplement, pps. 14-20.

Palmer, C. 18 January 1992 Keeping the engine ticking over. Estates Gazette,
pps.55-56.

Parry-Wingfield, M. 17 February 1990 Tax and the commercial property valuer.
Estates Gazette, pps.20-21.

Patel, K. September 1990 North hits record growth but City slumps. Estates Times Supplement, pps.13-14.

Patel, K. 20 September 1990 The higher they climb. Estates Times Review Office Market, pps. 10-19.

Peacock, C. 18 September 1992 Trapped in a vicious circle. Estates Times Review Office Market, pps.5-10.

RICS 11 May 1989 THE FINANCE BILL VALUE ADDED TAX ON BUILDINGS & LAND CLAUSE 17 SCHEDULE 3. A briefing note for Standing Committee G: Finance Bill. 1989.

Roberts, J. 1 December 1989 Developers begin to feel the squeeze. Estates Times Supplement, pps.17-18.

Roberts, J. April 1990 Slowdown results in a buyers' market. Estates Times Supplement, pps.27-28.

Roberts, J. 20 September 1991 A question of Confidence. Estates Time Review, pps.5-6.

Ross, N. 18 August 1989 VAT flawed by hasty Act. Estates Times, p.7.

Ross, N. 2 December 1989 Making up the profit margins. Estates Times, p.16.

Ross, N. 9 December 1989 Coping with the transition. Estates Times, p.11.

Scammell, M. 22 March 1989 VAT problems for commercial property. Law Society Gazette, pps.26-33.

Scammell, M. 19 October 1990 Underpinning the VAT Rules. Taxation, pps.74-77.

Scammell, M. 20 February 1992 No Option? Taxation, pps.496-500.

Schwab, R. M. March 1983 Real and Nominal Interests Rates and the Demand for Housing. Journal of Urban Economics. Academic Press Inc. pps.181-195.

Scott, H. 16 November 1988 VAT on non-domestic construction. Law Society Gazette, pps.39-43.

Selby, M. 12 July 1989 VAT and property lawyers. Law Society Gazette, pps.14-17 & 27.

Selby, M. 19 July 1989 Advising on VAT and commercial property. Law Society Gazette, pps.19-23.

Shilling, J. D. & Shirmans, C. F. & Corgel, J. B. July 1987 Price Adjustment Process for Rental Office Space, Journal of Urban Economics. Academic Press Inc. pps.90-100.

Soares, P. C. 23 March 1989 VAT On Property. Taxation, pps.622-626.

Tauchen, H. & Witte, A. D. January 1984 Socially Optimal and Equilibrium Distributions of Office Activity: Models with Exogenous and Endogenous Contacts. Journal of Urban Economics. Academic Press Inc. pps.66-86.

Walters, A. & Barber, C. 20 January 1990 Retail - looking for a new beginning. Estates Gazette, pps.164-166.

Watt, D. & Valente, J. 1 December 1989 Moderation follows leaps of the past. Estates Times Supplement, pps.9-15.

Weicher, J. C. & Thibodeau, T. G. January 1988 Filtering & Housing Markets: An Empirical Analysis. Journal of Urban Economics. Academic Press Inc. pps.21-40.

Wheaton, W. C. & Torto, R. G. March 1994 Office Rent Indices and their Behaviour over Time. Journal of Urban Economics. Academic press Inc. pps.121-139

LEGISLATION

- 1972 Finance Act. Chapter 41. HMSO. London. pps.1-36.
- 1973 Treaty of Rome. Treaties Establishing the European Communities. Office for Official publications of the European Communities.
- 1977 Second Directive. Official Journal of the European Communities Special Edition. Article 28(2) Council Directive 77/388/EEC. Office for official publications of the European Communities.
- 1977 Sixth Directive. Official Journal of the European Communities. Vol 20 No. L145 13 June. Office for official publications of the European Communities.
- 1983 Value Added Tax Act. Chapter 55. HMSO. London.
- 1988 Court of Justice of the European Communities, Reports of Cases before the Court part 3. Case 416/85. Commission of the European Communities vvs the United Kingdom of Great Britain and Northern Ireland. Office for official publications of the European Communities.
- 1988 Parliamentary Debates (Hansard) 21 June Sixth series Vol. 135 HMSO.

- 1989 Finance Act. Chapter 26. HMSO. London.
- 1989 HMCE VAT Notice 742 Land & Property 1 April HMSO.
- 1989 Parliamentary Debates (Hansard) 25 April 1989 Sixth Series Volume 151.
HMSO.
- 1989 Parliamentary Debates, House of Commons Official Report, 16-18 May
1989, Standing Committees Session - Finance Bill Vol VII HMSO.
- 1991 SI No. 2569 VAT The Value Added Tax (Buildings & Land) Order.

The Nottingham Trent University
Library & Information Services
SHORT LOAN COLLECTION

| Date | Time | Date | Time |
|-----------------------|----------------|------|------|
| 28 APR 2001 | Per | | |
| 1 XXX XXXX | Per | | |
| 15 MAY 2004 | 1pm | | |

Please return this item to the Issuing Library.
Fines are payable for late return.

THIS ITEM MAY NOT BE RENEWED

**VALUE ADDED TAX -
THE IMPACT OF WAIVER OF EXEMPTION ON THE ENGLISH
COMMERCIAL PROPERTY MARKET**

DAVID N BOOTH

**A thesis submitted in partial fulfilment of the requirements of Nottingham
Trent University for the degree of Master of Philosophy.**

January 1998

**Department of Surveying
Nottingham Trent University**

Volume 2

Bc 4006711836

40-0671186.3



APPENDIX 1

AN ECONOMIC OVERVIEW OF THE UK COMMERCIAL PROPERTY MARKET 1987-1992

This research must be considered in the context of the general economic background persisting at the time and its impact on the commercial property market. This appendix provides a resumé of the major economic and political changes that occurred during the research period and their impact on the commercial property market.

THE BOOM YEARS 1987-1989

Rupert Nabarro writing in the Estates Times Supplement on the office market in September 1990 (1) commented that;

“The period 1987-1989 witnessed the most concentrated and inflated boom that property has ever seen since the war.” and concluded,

“So the party is over and the young and glamorous are lying on the floor after their orgy of selfgratification. A rather more sober market may take some time to emerge.”

With the benefit of hindsight this has proved to be an accurate summary of the commercial property market in the late 1980's and early 1990's.

The first changes resulting from the EC judgement (case 416/85) came into effect on 1 April 1989 at the end of a decade of euphoria in the commercial property market associated with a period of unparalleled rental growth experienced in all sectors of the market.

The office sector peaked in the year to November 1987 at 33.1% per annum rental growth. During the 1980's there had been unprecedented growth in banking, insurance and finance with employment in these sectors growing by more than 50%, increasing the demand for office space. This was accompanied by the increased availability of credit from banks. Land was more readily available following the release of large areas of redundant land by the Government (London Docklands) and planning permission became relatively easy to obtain.

Between 1983 and 1988 consumer spending adjusted for inflation rose by an average of 5% per annum - in part fuelled by the house price explosion, deregulation and tax cuts, that led to consumers being encouraged to turn part of their equity in houses into spending. Companies assumed these rates were normal and were prepared to borrow substantial sums as interest rates declined.

Rental growth for industrial space rose in 1988 and 1989 with the biggest jump in the Midlands and North. Interest from developers had been revived. They could now make schemes financially viable. A ripple effect in industrial development

took place outwards from the South-East due to improved roads and cheaper land prices. Investors were attracted to industrials as the prospects for short-term growth improved in this sector of the market.

Industrial and rental growth was fuelled by service and distribution companies. Strong competition from developers to develop out-of-town industrial sites caused a shortage of standard sheds.

Shop rents across the UK rose on average by 19% during 1987/88. However, indicators showed that retail rental growth was slowing by December 1989 reflecting increasing uncertainty regarding the retail market. Falling gross domestic product, growth and rising inflation combined with high interest rates lie behind the transformation of the retail market during 1989. The rise in disposable income had slowed resulting in falls in consumer expenditure.

The harsher trading environment coupled with spiralling costs (occupancy rates and wages) curtailed expansion plans and the demand for space. During the boom increased turnover and retail profitability were largely achieved by ambitious expansion programmes aimed at country-wide representation. Increased demand for retail space was coupled with a shortage of supply. The retail market during 1989 underwent a rapid transformation from a persistent period of boom to a situation characterised by moderate rises in expenditure and retail sales as well as profitability - factors which traditionally underpin the prospects for rental growth.

In 1989 funds moved out of retail given a record amount of available space as the prospects for short term rental growth receded. Concerns were expressed as to the possibility of survival for niche retailers who expanded rapidly during the boom such as Tie Rack and Sock Shop. Investment in food retailing was more stable.

Changing demographic trends into the next decade were also being assessed. There had been a fall in the 15-19 year old population in England and Wales from 3.7 million in 1988 to 3.2 million in 1996 and the composition of spending was set to change dramatically.

By the end of the decade the government had been forced to raise interest rates to penal levels and maintain them in an attempt to curb inflation. John Major replaced Nigel Lawson as Chancellor of the Exchequer and the Treasury forecast for 1990 was pessimistic.

THE DOWNTURN - 1990

In January 1990 the Investors Chronicle (2) reported shop yields were continuing to rise, office yields starting to rise and industrials were generally unchanged. By September 1990 the rate of rental growth had slowed dramatically to 6.4% (annualised) for the six months April-September 1990. The impact on returns and values was dramatic.

The first falls in office rents in the City of London since 1976 were experienced. The continuing office construction boom, predicted to continue to 1992, the fall in demand for space following the stock market crash of 1987 and the ensuing rise in floorspace availability were all factors contributing to the downward pressure on rental growth.

Tenants and investors alike were holding off taking space in the hope of agreeing more favourable terms. Many sectors of the UK economy were beginning to reflect a downturn in business. Companies also began to appraise the likely impact of joining the Exchange Rate Mechanism (ERM) and the moves towards monetary union. With the general election due shortly the Government's economic policy would be based on its wish to win. Premiums had begun to drop rapidly and rent-free periods were being offered as rental incentives.

As 1990 progressed the scene on high streets and retail parks became increasingly pessimistic as a result of constrained consumer spending. The Uniform Business Rate came into effect on 1 April 1990, increasing retailer's costs, reducing profits by an estimated 5-6%. All of this led to a "rapid slow down in the retail property market" as reported by W. Gilmour (3).

Healey and Baker's comments in the Estates Times Supplement for February 1991 (4) indicated prime yields for mixed business space were 8.5% reflecting location and strength of covenant rather than perceived rental growth. Healey and Baker's March 1991 Quarterly Investment Report (5) put these yields at only 7.75%. Jane Roberts writing in the Estates Times Supplement of April 1990 (6) indicated that funds were still buying industrials but were being extremely selective wanting good modern buildings in the best locations.

Agents reported a fall in the number of sales and lettings in the last third of 1990 with terms struck being considerably less favourable to the seller. Viewings were falling away and conversions of sales were almost impossible. Interest rates at the beginning of 1990 were high and sites bought and built out for a yield of 7.5% were attractive when borrowing was around 10% but the situation became unsustainable when borrowing was at 16% or 17%.

However, the provinces continued to register strong rental growth peaking in the Midland and Northern regions in the year to November 1989 as the effects of the boom rippling out from London and the South-East continued. Deregulation of the financial sector, privatisation of the nationalised industries and a steady proliferation of mergers and takeovers were factors identified as maintaining a healthy demand for office space throughout the country. A number of major companies were still rationalising their operations and devolving their business away from London, e.g. Lloyds move to Bristol and Barclays take-up of a large amount of space in Coventry. Localised areas of shortage continued to see rental growth.

Some areas of the market were still active in 1990, such as the business park market. Major multi-nationals who were only partly affected by the recession were able to take a longer-term view than smaller local companies. Disposals of second-

hand warehouses and industrial buildings were also taking place where these could be acquired at prices considerably below those of new buildings. Some commentators even predicted a mini-boom in 1991 due to a slow down in construction, pre-completion of speculative build and the take-up of existing stock. But with the benefit of hindsight the reality was that capital values slipped sharply during 1990, corporate failures shocked the market and institutions had effectively withdrawn as buyers.

THE BOTTOM OF THE TROUGH - 1991

J Organ commenting in the Estates Times Industrial Supplement of February 1991 (7) indicated that;

“We are at the bottom of the economic trough and market sentiment is weak.....but commercial property is like an oil tanker. It can take two miles to stop so that oversupply is bound to occur”.

On 28 November, Margaret Thatcher resigned as Prime Minister and was replaced by John Major. The Budget was a neutral affair. Inflation was running at around 10% at the time of the Governments autumn statement when it declared its continued aim to conquer it. The decision was taken for sterling to join the ERM accompanied by a 1% cut in base rates to 14%.

January and February 1991 remained inordinately depressed with interest rates at very high levels despite increased evidence of recession. Iraq invaded Kuwait at the beginning of August. The Gulf war produced headlines predicting economic catastrophe. Activity in property investment was minimal.

The atmosphere changed in mid-March as gloom laden predictions were unfounded and interest rates began to fall. Deals were progressed and institutions began to show renewed interest. During the summer interest rates continued to fall and competition for good stock developed. Provincial property yields began to harden.

However by the autumn firm evidence of economic recovery had failed to emerge, the Stock Market had slipped and the Chancellor of the Exchequer had little scope for further interest rate reductions due to the ERM. Political uncertainty also had its effect with the possibility of a Labour victory in the forthcoming general election.

The situation had worsened perceptibly by September 1991, Jane Roberts in a review of confidence in property in the Estates Times (8) indicated that “business confidence is declining sharply”. This review also indicated that employment was expected to fall dramatically with the loss of 43,000 jobs. Many more firms expected to vacate space due to a contraction of business. The report also suggested that a commitment to investing in new space would lag any general rise in business confidence. The boom conditions in the late 1980's resulted in many inappropriate industrial facilities being built to justify land values. The small freehold business

space market was hardest hit by interest rate rises and low general economic confidence.

The Jones Lang Wootton Index for Spring 1992 (9) showed annual rental growth for offices in the period March 1991 - March 1992 of minus 19.7% making offices the least favourable of all sectors. Office yields continued to rise standing at a record high of 9.3%. The impact on returns and values was again severe. Office capital values decreased by 24% and the total return was minus 17.5% in the year to May 1991 - the worst figure recorded since data collection began. Office floorspace availability levels had been rising rapidly in central London standing at 13.3% of total stock compared to 3.3% in 1987. However, the northern regions were still recording positive rental growth in the office sector.

The retail sector continued to be affected by the UBR, the Government's spending squeeze in the form of higher interest rates, the Poll Tax and increased VAT. Agents were bullish but hopes of an early recovery seemed slim. With the volume of sales down retailers were desperate to keep costs under control. Rents, wage costs and rates were all rising at the point in the cycle when they should have been falling. The expansion programmes of the 1980's were beginning to cause problems. Richard Ellis (10) were reporting virtually no growth in rental values and Hillier Parker (11) gave strong evidence that a number of shopping centre schemes were being mothballed. Any real improvement would depend on a boost in demand and more favourable costs structures.

Demand remained generally low with the exception of one or two niche schemes. The supply of stock increased dramatically as a result of company failures, reorganisations and a reluctance to conclude deals. In 1991 there were hard and substantial falls in industrial freehold and leasehold values. In most areas rent free periods and incentives were increasingly offered by desperate landlords and developers. Most major schemes were for food retailers such as Tesco. Infrastructure projects such as the A1/M1 link and the Channel Tunnel caused some localised market activity as account of these improvements was taken.

Since the early 1980's the insured funds have decreased their assets in direct property from 20% to 10-15% and pension funds from 15% to 5-10%, triggered by the outstanding performance of the UK and overseas equity markets and the focus on short-term performance. Economic recession, high interest rates, the Gulf war and an oversupply of offices contributed to this fall. Total institutional investment in property in 1991 was running at an estimated £1 billion per annum about half the sum invested in the early 1980's.

Funds were showing a more positive stance to property as reported in the Estates Times Review of September 1991 (12) as a result of falling interest rates, the prospects for reduced inflation and the potential for real growth in property. However, their interest was more selective in an attempt to spread risk, located in provincial centres such as Bristol, Manchester and Leeds in good quality buildings.

THE ECONOMIC RECESSION - 1992

In 1992 the commercial property market was characterised by oversupply particularly in the south-east coupled with economic recession with reduced letting activity and itself added to the level of vacant space. The impact on rental growth led to significant changes in letting terms such as shorter leases and break clauses.

The retail sector was expected to be the first to benefit from any upturn with the return of consumer confidence being translated into sales. Mark Morgan in an article in the Chartered Surveyor Weekly (13), suggested that the Conservative election victory had reduced uncertainty and investor interest was returning, to shopping centres at least. Evidence was limited but prime shopping centre yields stood at 8-8.5% comparing favourably with average equity yields.

Olympia and York's flagship development, Canary Wharf, was put into liquidation in May 1992 and the Mountleigh Group went into receivership. Banks continued their withdrawal from funding commercial property in an attempt to reduce their exposure to this market.

The industrial market continued to mark time as a result of the Government's economic policy. Property values continued to fall and there remained a stubbornly high level of vacant space. Nevertheless this gloomy overview disguised significant variations in performance both geographically and by building type. A closer examination of the fall in industrial rental values during 1992 shows a higher rate of decline in London and the South-East with the South, Midlands and Northern regions remaining fairly stable. Similarly the amount of new stock continued to decline whilst there was a rise in the amount of previously used floorspace.

European changes in the form of the Single Market and the Channel Tunnel had some localised impact. The regional centres could be significantly enhanced by the improved accessibility of the UK which the Tunnel would bring. However, comment was premature as uncertainties regarding the completion of the project continued.

The Chancellor of the Exchequer introduced a budget 'for jobs', raising industrial plant and machinery allowances. In September the UK dropped out of the ERM and by November base rates were down to 7%.

This period is then essentially one of a commercial property market post boom, characterised by oversupply, rising yields, falling rents and values. The downturn began in the retail sector at the end of the last decade and spread rapidly to offices with industrials affected to a lesser extent. Not all types of property or indeed all parts of the country were affected to the same extent and generalisations are difficult.

The period ends with commentators still sceptical that economic recovery was imminent, a precondition to any improvement in market conditions. On the basis

that the economy would start to grow in 1993 commentators indicated that letting activity would also start to lift as a result of parallel growth in business confidence.

1. Nabarro, R. September 1990. The party's over. time to sober up, Estates Times Supplement, pp. 19-20.
2. 12 January 1990. Now office yields rise too, Investors Chronicle, p. 22.
3. Gilmour, W. 10 November 1990. The Battle for (higher) retail sales, Estates Gazette, p. 72.
4. Organ, J. 22 February 1991. Provincial cities ride the economic storms, Estates Times Industrial Supplement, p. 14.
5. Roberts, J. April 1990. Slowdown results in a buyer's market, Estates Times Supplement, p. 6
6. Roberts, J. April 1990. Slowdown results in a buyer's market, Estates Times Supplement, p. 5.
7. Organ, J. 22 February 1991. Provincial cities ride the economic storms, Estates Times Industrial Supplement, pp. 14-16.
8. Roberts, J. 20 September 1991. A question of Confidence, Estates Times Review - Offices, pp. 5-6.
9. Jones Lang Wootton. Spring 1992. Property Index.
10. Mortished, C. 29 June 1991. Retail squeeze, Estates Gazette, p. 77.
11. Mortished, C. 29 June 1991. Retail squeeze, Estates Gazette, p. 77.
12. Maclachlan, J. 20 September 1991. Climbing the slippery slope. Estates Times Review - Offices, p. 30.
13. Morgan, M. 14 May 1992. Centres of attention, Chartered Surveyor Weekly, p. 44.

APPENDIX 2

EXTRACT FROM THE FINANCE BILL 1989, SCHEDULE 6A

5 "Refund of tax to persons constructing certain buildings" 21.—(1) Subject to subsection (2) below, where tax is chargeable on the supply of goods to, or the importation of goods by, a person constructing a building lawfully and otherwise than in the course or furtherance of any business, and—

(a) the goods are incorporated in the building or its site, and

10 (b) the supply of the goods would have been zero-rated by virtue of item 3 of Group 8 of Schedule 5 to this Act if they had been supplied by a supplier making to the same person supplies within item 2 of that Group of services including their use or installation, and any required certificate had been given,

15 the Commissioners shall, on a claim made in that behalf, refund to the person the amount of the tax so chargeable.

2 (2) The Commissioners shall not be required to entertain a claim for a refund of tax under this section unless the claim—

(a) is made within such time and in such form and manner,

(b) contains such information, and

20 (c) is accompanied by such documents, whether by way of evidence or otherwise,

as the Commissioners may by regulations prescribe."

6.—(1) The following section shall be inserted in the Value Added Tax Act 1983 after section 35— 1983 c. 55.

25 "Buildings and land. 35A. Schedule 6A to this Act shall have effect with respect to buildings and land."

(2) The following Schedule shall be inserted in the Value Added Tax Act 1983 after Schedule 6—

"SCHEDULE 6A

1983 c. 55.

30 BUILDINGS AND LAND

Residential and charitable buildings: change of use etc.

1.—(1) In this paragraph "relevant zero-rated supply" means a grant or other supply taking place on or after 1st April 1989 which—

35 (a) relates to a building intended for use solely for a relevant residential purpose or a relevant charitable purpose or part of such a building; and

(b) is zero-rated, in whole or in part, by virtue of Group 8 of Schedule 5 to this Act.

(2) Sub-paragraph (3) below applies where—

40 (a) one or more relevant zero-rated supplies relating to a building (or part of a building) have been made to any person;

45 (b) within the period of ten years beginning with the day on which the building is completed, the person grants an interest in, right over or licence to occupy the building or any part of it (or the building or any part of it including, consisting of or forming part of the part to which the relevant zero-rated supply or supplies related); and

50 (c) after the grant the whole or any part of the building, or of the part to which the grant relates, (or the whole of the building or of the part to which the grant relates, or any part of it including, consisting of or forming part of the part to which the relevant

Sch. 3

zero-rated supply or supplies related) is not intended for use solely for a relevant residential purpose or a relevant charitable purpose.

(3) Where this sub-paragraph applies, to the extent that the grant relates to so much of the building as—

(a) by reason of its intended use gave rise to the relevant zero-rated supply or supplies; and

(b) is not intended for use solely for a relevant residential purpose or a relevant charitable purpose after the grant,

it shall be taken to be a taxable supply in the course or furtherance of a business which is not zero-rated by virtue of Group 8 of Schedule 5 to this Act (if it would not otherwise be such a supply).

(4) Sub-paragraph (5) below applies where—

(a) one or more relevant zero-rated supplies relating to a building (or part of a building) have been made to any person; and

(b) within the period of ten years beginning with the day on which the building is completed, the person uses the building or any part of it (or the building or any part of it including, consisting of or forming part of the part to which the relevant zero-rated supply or supplies related) for a purpose which is neither a relevant residential purpose nor a relevant charitable purpose.

(5) Where this sub-paragraph applies, his interest in, right over or licence to occupy so much of the building as—

(a) by reason of its intended use gave rise to the relevant zero-rated supply or supplies; and

(b) is used otherwise than for a relevant residential purpose or a relevant charitable purpose,

shall be treated for the purposes of this Act as supplied to him for the purpose of a business carried on by him and supplied by him in the course or furtherance of the business when he first uses it for a purpose which is neither a relevant residential purpose nor a relevant charitable purpose.

(6) Where sub-paragraph (5) above applies—

(a) the supply shall be taken to be a taxable supply which is not zero-rated by virtue of Group 8 of Schedule 5 to this Act (if it would not otherwise be such a supply); and

(b) the value of the supply shall be such that the amount of tax chargeable on it is equal to the amount of the tax which would have been chargeable on the relevant zero-rated supply (or, where there was more than one such supply, the aggregate amount which would have been chargeable on them) had so much of the building as is mentioned in sub-paragraph (5) above not been intended for use solely for a relevant residential purpose or a relevant charitable purpose.

Election to waive exemption

2.—(1) Subject to sub-paragraph (2) below, where an election has been made under this paragraph in relation to any building or land, if and to the extent that any grant made in relation to it at a time when the election has effect by the person who made the election, or where that person is a body corporate by that person or a relevant associate, would (apart from this sub-paragraph) fall within Group 1 of Schedule 6 to this Act, the grant shall not fall within that Group.

(2) Sub-paragraph (1) above shall not apply in relation to a grant if the grant is made in relation to—

- 5
- (a) a building or part of a building intended for use as a dwelling or number of dwellings or solely for a relevant residential purpose; or
 - (b) a building or part of a building intended for use solely for a relevant charitable purpose, other than as an office.

10

(3) Subject to the following provisions of this paragraph, no input tax on any supply or importation which, apart from this sub-paragraph, would be allowable by virtue of the operation of this paragraph shall be allowed if the supply or importation took place before the first day for which the election in question has effect.

(4) Subject to sub-paragraph (5) below, sub-paragraph (3) above shall not apply where the person by whom the election was made—

- 15
- (a) has not, before the first day for which the election has effect, made in relation to the land or building to which the election relates any grant falling within Group 1 of Schedule 6 to this Act; or
 - (b) has before that day made in relation to that land or building a grant or grants so falling but the grant, or all the grants,—
20
 - (i) were made in the period beginning with 1st April 1989 and ending with 31st July 1989; and
 - (ii) would have been taxable supplies but for the amendments made by Schedule 3 to the Finance Act 1989.

25

(5) Sub-paragraph (4) above does not make allowable any input tax on supplies or importations taking place before 1st August 1989 unless—

- (a) it is attributable by or under regulations to grants made by the person on or after 1st April 1989 which would have been taxable supplies but for the amendments made by Schedule 3 to the Finance Act 1989; and
- 30 (b) the election has effect from 1st August 1989.

(6) Sub-paragraph (3) above shall not apply in relation to input tax on grants or other supplies which are made in the period beginning with 1st April 1989 and ending with 31st July 1989 if—

- 35
- (a) they would have been zero-rated by virtue of item 1 or 2 of Group 8 of Schedule 5 to this Act or exempt by virtue of item 1 of Group 1 of Schedule 6 to this Act but for the amendments made by Schedule 3 to the Finance Act 1989; and
 - (b) the election has effect from 1st August 1989.

3.—(1) An election under paragraph 2 above shall have effect—

- 40
- (a) from the beginning of the day on which the election is made or of any later day specified in the election; or
 - (b) where the election is made before 1st November 1989, from the beginning of 1st August 1989 or of any later day so specified.

(2) An election under paragraph 2 above may be made in relation to—

- 45
- (a) any building (or planned building) specified, or of a description specified, in the election, other than one on agricultural land;
 - (b) all agricultural land (including the buildings on such land) in which the person making the election has (or after the election obtains) an interest, over which he has (or obtains) a right or
50 which he has (or obtains) a licence to occupy; or

SCH. 3

(c) any land (not being land on which a building has been or is being constructed or agricultural land) specified, or of a description specified, in the election;

and for the purposes of paragraph (a) of this sub-paragraph buildings linked internally or by a covered walkway, and parades, precincts and complexes divided into separate units, shall be taken to be a single building (if they otherwise would not be).

(3) An election under paragraph 2 above shall be irrevocable and, except where it is an election of a description specified in a notice published by the Commissioners, notification of the election shall be given to the Commissioners together with such information as the Commissioners may require.

(4) Except where the Commissioners otherwise allow, a notification required under sub-paragraph (3) above shall be given not later than the end of the period of thirty days beginning with the day on which the election is made.

(5) In paragraph 2 above "relevant associate", in relation to a body corporate by which an election under that paragraph has been made in relation to any building or land, means a body corporate which under section 29 of this Act—

(a) was treated as a member of the same group as the body corporate by which the election was made at the time when the election first had effect;

(b) has been so treated at any later time when the body corporate by which the election was made had an interest in, right over or licence to occupy the building or land (or any part of it); or

(c) has been treated as a member of the same group as a body corporate within paragraph (a) or (b) above or this paragraph at a time when that body corporate had an interest in, right over or licence to occupy the building or land (or any part of it).

4.—(1) This paragraph has effect where rent is payable in consideration of the grant of an interest in, right over, or licence to occupy any building or land to which an election under paragraph 2 above relates (or any part of any such building or land).

(2) If—

(a) the rent relates to a period beginning before and ending on or after the first day for which the election has effect; and

(b) the grant for which the rent is consideration would, apart from this sub-paragraph, take place before that day,

the grant shall be treated as taking place on that day to the extent that it is made for rent relating to the part of the period falling on or after that day.

(3) If—

(a) the rent relates to a period beginning on or after the first day for which the election has effect; and

(b) the grant for which the rent is consideration would, apart from this sub-paragraph, take place before that day,

the grant shall be treated as taking place on the first day of the period to which the rent relates.

(4) If—

(a) the rent relates to a period beginning before the first day for which the election has effect; and

- (b) the grant for which the rent is consideration takes place on or after that day,
- tax shall not be chargeable on the grant by virtue of paragraph 2 above to the extent that it is made for rent relating to any time before that day.
- 5 (5) Where the rent is payable by a person in relation to a period when he is in occupation of a building completed before 1st August 1989 (or part of such a building) or land of which he was in occupation immediately before that date, any tax which would be chargeable by virtue of paragraph 2 above on the grant for which the rent is consideration—
- 10 (a) except in the case of a charity, shall be chargeable as if the consideration were reduced by 50 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1989 and ending on 31st July 1990; and
- (b) in the case of a charity—
- 15 (i) shall be chargeable as if the consideration were reduced by 80 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1989 and ending on 31st July 1990;
- 20 (ii) shall be chargeable as if the consideration were reduced by 60 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1990 and ending on 31st July 1991;
- (iii) shall be chargeable as if the consideration were reduced by 40 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1991 and ending on 31st July 1992; and
- 25 (iv) shall be chargeable as if the consideration were reduced by 20 per cent. if and to the extent that the rent relates to or to any part of the year beginning on 1st August 1992 and ending on 31st July 1993.
- 30

Developers of certain non-residential buildings etc.

- 5.—(1) Paragraph 6 below shall apply on the first occasion during the period of ten years beginning with the completion of a building or work within sub-paragraph (2) below on which a person who is a developer in relation to the building or work—
- 35 (a) grants an interest in, right over or licence to occupy the building or work (or any part of it) which is an exempt supply; or
- (b) is in occupation of the building, or uses the work, (or any part of it) when not a fully taxable person (or, if a person treated under section 29 of this Act as a member of a group, when the representative member is not a fully taxable person).
- 40 (2) Subject to sub-paragraph (3) below, the buildings and works within this sub-paragraph are—
- 45 (a) any building neither designed as a dwelling or number of dwellings nor intended for use solely for a relevant residential purpose or a relevant charitable purpose; and
- (b) any civil engineering work, other than a work necessary for the development of a permanent park for residential caravans.
- (3) A building or work is not within sub-paragraph (2) above if—
- 50 (a) construction of it was commenced before 1st August 1989; or
- (b) a grant of the fee simple in it which falls within paragraph (a) (ii) or (iv) of item 1 of Group 1 of Schedule 6 to this Act has been made before the occasion concerned.

SCH. 3

(4) For the purposes of this paragraph a taxable person is, in relation to any building or work, a fully taxable person throughout a prescribed accounting period if—

- (a) at the end of that period he is entitled to credit for input tax on all supplies to, and importations by, him in the period (apart from any on which input tax is excluded from credit by virtue of section 14(10) of this Act); or 5
- (b) all the supplies made by him during that period in the course or furtherance of the business or businesses any part of which is carried on by him during that period at the building or work are supplies within section 15(2) of this Act. 10

(5) Subject to sub-paragraph (6) below, in this paragraph and paragraphs 6 and 7 below “developer”, in relation to a building or work, means any person who—

- (a) constructed it; 15
- (b) ordered it to be constructed; or
- (c) financed its construction,

with a view to granting an interest in, right over or licence to occupy it (or any part of it) or to occupying or using it (or any part of it) for his own purposes. 20

(6) Where—

- (a) a body corporate treated under section 29 of this Act as a member of a group is a developer in relation to a building or work; and
- (b) it grants an interest in, right over or licence to occupy the building or work (or any part of it) to another body corporate which is treated under that section as a member of the group, 25

then, for the purposes of this paragraph and paragraphs 6 and 7 below, as from the time of the grant any body corporate such as is mentioned in sub-paragraph (7) below shall be treated as also being a developer in relation to the building or work. 30

(7) The bodies corporate referred to in sub-paragraph (6) above are any which under section 29 of this Act—

- (a) was treated as a member of the same group as the body corporate making the grant at the time of the grant;
- (b) has been so treated at any later time when the body corporate by which the grant was made had an interest in, right over or licence to occupy the building or land (or any part of it); or 35
- (c) has been treated as a member of the same group as a body corporate within paragraph (a) or (b) above or this paragraph at a time when that body corporate had an interest in, right over or licence to occupy the building or work (or any part of it). 40

6.—(1) Where this paragraph applies—

- (a) the fee simple in the building or work concerned shall be treated for the purposes of this Act as supplied to the developer for the purpose of a business carried on by him and supplied by him in the course or furtherance of the business on the last day of the prescribed accounting period during which it applies; 45
- (b) the supply shall be taken to be a taxable supply; and
- (c) subject to sub-paragraph (2) below, the value of the supply shall be the open market value of an actual supply of the fee simple on the day on which the building or work is first ready for occupation or use. 50

(2) Where, apart from this sub-paragraph, the value of the supply would be less than £100,000 it shall be treated as nil.

(3) For the purposes of this paragraph and paragraph 7 below a building or work shall be treated as ready for occupation or use if at least 90 per cent. of it is actually so ready.

7.—(1) Subject to sub-paragraphs (2) and (3) below, paragraphs 5 and 6 above shall apply in relation to the reconstruction, enlargement or extension of, or the provision of an annex to, an existing building which increases the total floor area of the building by at least 10 per cent. as they apply to the construction of a building.

(2) Sub-paragraph (1) above does not apply where the developer has held an interest in the land on which the whole of the reconstructed, enlarged or extended building, or of the building with the annex, stands throughout the period of ten years ending with the day on which the reconstructed, enlarged or extended building, or the building with the annex, is first ready for occupation.

(3) In their application by virtue of sub-paragraph (1) above paragraphs 5 and 6 above shall have effect as if—

(a) subject to paragraph (b) below, references to the building were references to the reconstructed, enlarged or extended building, or the building with the annex; and

(b) the reference in paragraph 6(1)(c) to the open market value of an actual supply of the fee simple on the day on which the building is first ready for occupation were a reference to the difference between—

(i) the open market value of an actual supply of the fee simple of the reconstructed, enlarged or extended building, or of the building with the annex; and

(ii) what would have been the open market value of the fee simple of the existing building, on the day on which the reconstructed, enlarged or extended building, or the building with the annex, is first ready for occupation.

General

8. The Notes to Group 8 of Schedule 5 to this Act and Group 1 of Schedule 6 to this Act apply in relation to this Schedule as they apply in relation to their respective Groups but subject to any appropriate modifications.

9. The Treasury may by order make such amendments of this Schedule as are necessary or expedient in consequence of the making of an order under this Act varying Schedule 5 or 6 to this Act."

7. In section 42 (adjustment of consideration on changes in tax) of the Value Added Tax Act 1983—

Section 35A.

(a) the following subsection shall be inserted after subsection (1)—

"(1A) Subsection (1) above shall apply in relation to a tenancy or lease as it applies in relation to a contract."; and

(b) in subsection (2), the words "(including a change attributable to the making of an election under paragraph 2 of Schedule 6A to this Act)" shall be added at the end.

8. In section 48 (interpretation) of the Value Added Tax Act 1983, after the definition of "Commissioners" there shall be inserted—

""fee simple"—

APPENDIX 3

**EXTRACT FROM THE VALUE ADDED TAX
(BUILDINGS AND LAND) ORDER 1991**

- (b) the expected total value of grants relating to the relevant land that would be taxable if the election were to have effect; and
- (c) the total amount of input tax which has been incurred on or after 1st August 1989 or is likely to be incurred in relation to the relevant land.

that there would be secured a fair and reasonable attribution of the input tax mentioned in paragraph (c) above to grants in relation to the relevant land which, if the election were to have effect, would be taxable.”.

5. Paragraph 5 of Schedule 6A to the Value Added Tax Act 1983 shall be amended by adding the following sub-paragraphs after sub-paragraph (7)–

“(8) Subject to sub-paragraph (10) below, sub-paragraphs (1) and (2) and sub-paragraphs (4) to (7) above shall apply in relation to any of the following reconstructions, enlargements or extensions–

- (a) a reconstruction, enlargement or extension of an existing building which is commenced on or after 1st January 1992 and–
 - (i) which is carried out wholly or partly on land (hereafter referred to as new building land) adjoining the curtilage of the existing building, or
 - (ii) as a result of which the gross external floor area of the reconstructed, enlarged or extended building (excluding any floor area on new building land) exceeds the gross external floor area of the existing building by not less than 20 per cent of the gross external floor area of the existing building;
- (b) a reconstruction of an existing building which is commenced on or after 1st January 1992 and in the course of which at least 80 per cent of the area of the floor structures of the existing building are removed;
- (c) a reconstruction, enlargement or extension of a civil engineering work which is commenced on or after 1st January 1992 and which is carried out wholly or partly on land (hereafter referred to as new land) adjoining the land on or in which the existing work is situated,

as if references to the building or work were references to the reconstructed, enlarged or extended building or work and as if references to construction were references to reconstruction, enlargement or extension.

(9) For the purposes of sub-paragraph (8)(a) above, extensions to an existing building shall include the provision of any annex having internal access to the existing building.

(10) Sub-paragraphs (1) and (2) and sub-paragraphs (4) to (7) above shall not apply to a reconstruction, enlargement or extension–

- (a) falling within sub-paragraph (8)(a)(i), (ii) or (c) above where the developer has held an interest in at least 75 per cent of all of the land on which the reconstructed, enlarged or extended building or work stands, or is constructed, throughout the period of ten years ending with the last day of the prescribed accounting period during which the reconstructed, enlarged or extended building or work becomes substantially ready for occupation or use; or
- (b) to the extent that it falls within sub-paragraph (8)(a)(ii) above or falling within sub-paragraph (8)(b) above, where the interest in, right over or licence to occupy the building concerned (or any part of it) has already been treated as supplied to and by the developer under paragraph 6(1) below.”.

6. Paragraph 6 of Schedule 6A to the Value Added Tax Act 1983 shall be amended as follows–

- (a) for paragraph (a) of sub-paragraph (2) there shall be substituted the following–
 - “(a) the value of grants relating to the land on which the building or work is constructed, made or to be made to the developer, but excluding, in a case where construction of the building or work in question commenced before 1st January 1992, the value of any grants to be made for consideration in the form of rent the amount of which cannot be ascertained by the developer when the supply is treated as made,

and in any other case excluding the value of any—

- (i) grants made before the relevant day to the extent that consideration for such grants was in the form of rent, and to the extent that such rent was properly attributable to a building which has been demolished,
- (ii) grants made before the relevant day in respect of a building which has been reconstructed, enlarged or extended so that the reconstruction, enlargement or extension falls within paragraph 5(8)(a)(ii) above, and does not fall also within paragraph 5(8)(b) above, to the extent that consideration for such grants was in the form of rent, and to the extent that such rent was properly attributable to the building as it existed before the commencement of the reconstruction, enlargement or extension,
- (iii) grants made before the relevant day in respect of a building which has been so reconstructed that the reconstruction falls within paragraph 5(8)(b) above, to the extent that consideration for such grants was in the form of rent, and to the extent that such rent was properly attributable to the building before the reconstruction commenced,
- (iv) grants falling within paragraph (aa) of item 1 of Group 1 of Schedule 6 to this Act; and”;

(b) there shall be inserted after sub-paragraph (2) the following sub-paragraphs—

“(2A) Where the rate of tax (the lower rate) chargeable on a supply (the construction supply) falling within sub-paragraph (2)(b) above, the value of which is included in the value of a supply (the self-supply) treated as made by sub-paragraph (1) above, is lower than the rate of tax (the current rate) chargeable on that self-supply, then tax on the self-supply shall be charged—

- (a) on so much of its value as is comprised of the relevant part of the value of the construction supply, at the lower rate; and
- (b) on the remainder of its value at the current rate.

(2B) For the purposes of sub-paragraph (2A)(a) above, the relevant part of the value of the construction supply means—

- (a) where the construction supply is a supply of goods, the value of such of those goods as have actually been delivered by the supplier;
- (b) where the construction supply is a supply of services, the value of such of those services as have actually been performed by the supplier,

on or before the last day upon which the lower rate is in force.”;

(c) there shall be added after sub-paragraph (3) the following sub-paragraphs—

“(4) For the purposes of sub-paragraph (2)(a)(i) above, the relevant day is the day on which the demolition of the building in question commenced and, for the purposes of sub-paragraph (2)(a)(ii) and (iii) above, the relevant day is the day on which the reconstruction, enlargement or extension in question commenced.

(5) In the application of sub-paragraphs (1) to (4) above to a reconstruction, enlargement or extension to which sub-paragraphs (1) and (2) and sub-paragraphs (4) to (7) of paragraph 5 above apply by virtue of paragraph 5(8) above—

- (a) references to the building or work shall be construed as references to the reconstructed, enlarged or extended building or work, and references to construction shall be construed as references to reconstruction, enlargement or extension;
- (b) the reference in paragraph (a) of sub-paragraph (2) to the value of grants relating to the land on which the building or work is constructed shall be construed as a reference—
 - (i) in relation to a reconstruction, enlargement or extension of an existing building to the extent that it falls within paragraph

5(8)(a)(i) above and does not fall also within paragraph 5(8)(b) above, to the value of grants relating to the new building land;

(ii) in relation to a reconstruction, enlargement or extension of an existing building, to the extent that it falls within paragraph 5(8)(a)(ii) above and does not fall also within paragraph 5(8)(b) above, to the value of grants relating to the land on which the existing building stands multiplied by the appropriate fraction;

(iii) in relation to a reconstruction, enlargement or extension to a work falling within paragraph 5(8)(c) above, to the value of grants relating to the new land.

(6) For the purposes of sub-paragraph (5)(b)(ii) above the appropriate fraction shall be calculated by dividing the additional gross external floor area resulting from the reconstruction, enlargement or extension (excluding any floor area on new building land) by the gross external floor area of the reconstructed, enlarged or extended building (excluding any floor area on new building land)."

7. After paragraph 6 of Schedule 6A to the Value Added Tax Act 1983 there shall be inserted the following paragraph—

"6A.—(1) Where a developer is a tenant, lessee or licensee and becomes liable to a charge to tax under paragraph 6(1) above in respect of his tenancy, lease or licence he shall notify forthwith in writing his landlord, lessor or licensor (as the case may be)—

(a) of the date from which the tenancy, lease or licence becomes a developmental tenancy, developmental lease or developmental licence for the purposes of paragraph (aa) of item 1 of Group 1 of Schedule 6 to this Act;

(b) in a case falling within paragraph 5(8)(a)(ii) above, of the appropriate fraction determined in accordance with paragraph 6(6) above.

(2) Where the appropriate fraction has been notified in accordance with sub-paragraph (1)(b) above, any supply made pursuant to the tenancy, lease or licence in question shall be treated as made pursuant to a developmental tenancy, developmental lease or developmental licence (a developmental supply) as if, and only to the extent that, the consideration for the developmental supply is for an amount equal to the whole of the consideration for the supply made pursuant to the tenancy, lease or licence, multiplied by the appropriate fraction."

8. Paragraph 8 of Schedule 6A to the Value Added Tax Act 1983 shall be amended by substituting for the words "The Notes to Group 8 of Schedule 5 to this Act and" the words "Notes (1) to (6) and Note (10) to Group 8 of Schedule 5 to this Act and Notes (1) and (2) to".

13th November 1991

Sydney Chapman
Irvine Patnick
Two of the Lords Commissioners of
Her Majesty's Treasury

APPENDIX 4
EARLY RESEARCH

Value Added Tax

To elect or not to elect?

by John Moore and Amanda Lawrence

On August 1, a new element was introduced into the twilight world of VAT on property, an element novel to any tax system — the taxpayer was actually given a choice of whether or not to pay tax. This is a disturbing development; property people have not had to think much about VAT until now, but as taxpayers they are used to facing new taxes with fortitude, taking advice on legitimate avoidance tactics and otherwise accepting the inevitable. They are not used to having a choice in the matter. In the case of VAT, however, the Government has apparently put the ball in the taxpayer's court. A choice faces all those who make VAT-exempt supplies of commercial property, a choice which could have a considerable impact on their whole VAT status. It is, moreover, a choice which needs to be made before October 31 to get the maximum benefit. This article considers how you should go about making the choice, what is actually happening in the market — and how much of a choice is it anyway?

The right to elect for taxation on supplies of land (alias "the option to tax" or, more properly, the right to waive exemption) was a kind of *quid pro quo* for the forced abolition of zero-rating on commercial property. Zero-rating was a useful benefit which allowed the supplier to offset input tax against outputs to which he did not actually have to add VAT. After April 1, as the property world now knows, all supplies of commercial property became either standard-rated or exempt. VAT was imposed on some transactions that had not previously suffered it, while others became non-taxable and therefore ineligible for the supplier to reclaim his input tax in relation to them. However, with the changes in VAT status came the option to tax, which enables the VAT-registered supplier to turn an exempt supply into a standard-rated one. He then has to account to Customs & Excise for the 15% of the price, but he can pass this cost on to the recipient of the supply and he can now reclaim any input tax which relates to the supply. The right to elect became operative on August 1, and for the election to be deemed effective from that date it must be exercised by October 31.

It is important to make the right choice about the option to tax. What are the questions the property investor should be asking himself?

(1) Does the option to tax apply to this transaction?

The option to tax applies to transactions which are exempt supplies of land for VAT purposes. As from April 1, most grants of an interest in, right over or licence to occupy land are exempt. This includes, most importantly, the grant of a new lease, payments of rent on an existing lease, the freehold sale of a building completed before April 1 or one completed subsequently when it is more than three years old, and the freehold or leasehold sale of building land. It also includes the grant of a specific right of way or similar right, and the grant of a licence to occupy.

There are some important exceptions. *Not* included are the freehold sale of a building completed after April 1 while it is less than three years old, the surrender of a lease, or any one of a number of specific exceptions listed in Group 1 of schedule 6 of the Value Added Tax Act 1983, all of which are standard-rated. The specific exceptions include hotel accommodation, caravan sites, parking rights, sports facilities and the like. The other important exception is residential property, which remains zero-rated and therefore ineligible for the option to tax. This includes any *part* of a building which is used for residential purposes, even if the building is principally used for business purposes.

Clearly, owners of buildings which are already let, as well as those who plan to grant leases or sell land or buildings, may want to elect to add VAT to rents or sale prices.

(2) Am I the person who has the right to opt to tax?

The option is exercisable by any person with an interest in the building in respect of which he makes supplies for VAT purposes. Therefore, if

the building is owned by freeholder A, let to headlessee B, and sublet to sublessee C, A and B have separate rights to opt to tax the headlease and underlease respectively.

(3) If I do opt to tax, how will the election operate?

The election is personal and irrevocable. For example, once the owner of a particular building has opted to tax a lease of the building, he *must* tax every lease or other supply made in relation to that building during his period of ownership. However, if he assigns the reversion of the building, the new owner can make his own election. Only if the existing building is completely demolished and a new building erected on the site is the owner released from his election on the previous building.

The election can be exercised in several different ways. The owner can make a separate election for each building or plot owned, except where agricultural land is concerned. Alternatively, he can elect for all buildings or land of a specified description. Or he can elect for all land and buildings owned. If he owns agricultural land, he *must* make one election for all the land, except where different farms are separated by non-agricultural land or land in different ownership. In that case, he has a separate right of election for each individual unit.

One other rule affects the basis of election: this is the notorious "covered walkway" rule. Buildings linked internally or by covered walkways, parades, precincts and complexes split into separate units are treated as one unit for which the owner has only one right of election.

(4) What are the advantages of opting to tax?

This and the next question are the most important for the property investor. Normally there *will* be an advantage in opting to tax, but this is not always the case.

The principal advantage of exercising the option is that it increases recovery of input tax. Any input tax referable to that building or land can be recovered. If the owner has already incurred, or will incur, a significant amount of VAT, he will benefit from opting to tax. This will arise where, for example, a refurbishment has been carried out, or where significant repair or improvement bills are envisaged for the future.

Furthermore, a business which is otherwise wholly or partially exempt can improve its overall VAT position by, for example, opting to tax the rent on all buildings it owns. Broadly speaking, a business which makes exempt supplies can recover only so much of its input tax as is equivalent to the proportion of taxable supplies it makes overall. Consequently, the more taxable supplies the business makes, the higher the proportion of its overall input tax that can be recovered.

The business may be able to secure a cashflow advantage if its VAT accounting period can be so arranged that it does not have to account to Customs & Excise for the VAT until after the taxed payment has been recovered.



John E Moore is a partner and Amanda Lawrence is a solicitor with Macfarlanes, of London ECA.

Another reason for exercising the election is if the developer of a new building, or the investor funding it, plans to grant leases of the building rather than sell it. In this case, opting to tax the lease is essential to avoid the self-supply charge which applies as soon as an exempt supply or exempt occupation of the building takes place. The developer/investor will need to weigh up the disadvantages (if any) of exercising the election against the likely VAT bill if the self-supply charge operates.

(5) What, then, are the possible disadvantages?

The owner of land or buildings can opt to tax supplies of the land or buildings without consulting the person to whom the supplies are to be made, and to whom he will obviously be passing on the tax burden. In particular, a landlord need not consult his tenants before opting to tax their leases. For the tenants, no difficulty will arise provided they are themselves fully taxable for VAT purposes and can recover the extra charge as input tax. If, however, a tenant is exempt or partly exempt, he will not be able to recover the tax. This does not stop the landlord from exercising the option — but remember that once the option has been exercised it is irrevocable. If the situation of the building or its particular design make it likely to attract only exempt or partly exempt tenants (for example, a building designed as a banking hall in an area traditionally dominated by financial institutions) then the effect of opting to tax may be to depress the rental value. Likewise, opting to tax building land could depress its sale value.

Since the election must be exercised for a whole building, it is not possible to make an exception for one or two exempt tenants where the others are all fully taxable. However, there are some possible alternatives. In return for not opting to tax, the landlord could agree a higher rental with the tenant, or some other form of compensation, to offset the landlord's irrecoverable input tax.

From a practical point of view, therefore, it is important to know the VAT status of your tenant/purchaser (or whoever), and that of any likely future tenants before exercising the option.

As the answers to questions 4 and 5 show, the decision whether to opt to tax is something of a balancing act between several different considerations. While there is an inherent risk in generalising, the most significant factors are summarised in the following checklist:

- (1) If you opt to tax, you will be entitled to recover any VAT paid by you in relation to the building.
- (2) Once an election has been made, it is irrevocable while the property remains in your ownership, and will affect all leases granted by you within that building.
- (3) If you elect, any subsequent sale of the property will be standard-rated.
- (4) Remember that, on a sale of a standard-rated

building, stamp duty will be payable by your purchaser on the price of land plus the amount of the VAT.

- (5) If you are constructing a new building you will need to make an election by the time of the grant of the lease or occupation of the building if you are to avoid the self-supply charge.
- (6) Are you likely to incur significant amounts of VAT on improvements, general management, legal fees or repairs, which you wish to be able to recover?
- (7) Can your tenant recover the VAT he will have to pay?
- (8) What effect, if any, will an election have on the rent review, or on the investment value of your building?
- (9) If you are partially exempt — for example, if you are an insurance company — an election will improve your overall ability to recover VAT. However, you should bear in mind that though this might help the company, it should not be at the expense of the policy holders.

(6) Do I really have a choice?

From the foregoing, it will be obvious that in many cases the choice to elect will be dictated by financial and other circumstances. Consider, for example, our building owned by A, let to B and sublet to C. A needs to elect to tax B's rent because he is the developer of the building and will otherwise incur a large self-supply charge. B is fully taxable, but C is partially-exempt. B has no choice but to elect to tax C's sublease because he needs to pass on the VAT imposed on him by A.

In the majority of cases, the best course will be to make the election. This, of course, is what is intended by the Government! The choice is not so much of a choice as all that.

(7) When should I elect?

The simple answer to that is "as soon as possible". The election is not retrospective. In general, VAT cannot be added to a transaction until the election has been made, and no input tax incurred before the first day for which the election has effect can be reclaimed. However, between August 1 and October 31 a period of grace has been decreed. Elections made within this period can take effect from August 1. If input tax incurred in the transitional period between April 1 and August 1 is to be recovered, it is vital that an election having effect from August 1 is in place. As the election must be notified to Customs & Excise within 30 days, in practice property owners have until November 30 to notify Customs that an election has been made with effect from August 1.

(8) How do I make the election?

The practicalities of making the election are quite straightforward. Having decided on what basis he is going to elect (building-by-building, specified land or all land/buildings owned) the person making the election must notify Customs & Excise in writing within 30 days, unless the total consideration for all supplies for the build-

ings/land for which the election has been exercised is expected to be less than £20,000 in the next 12 months.

There is no standard form for notifying Customs of the election. All that is required is a letter to the local VAT office giving the following: name and address.

VAT registration number, specifying the land or buildings, or the description of land or buildings, for which the election is being exercised.

It is easy enough for bystanders to talk about how the decision to elect *should* be made. But what is actually happening in the market-place? A survey of 151 property investors, comprising banks, pension funds, insurance companies and property investment companies reveals some interesting trends. Those who took part were asked about their intentions as regards opting to tax their portfolios.

- (1) Of those who have or will be electing, 90% are doing so building by building, and by no means across the board. Many have elected on some properties already but are keeping their options open on others.
 - (2) Only slightly more investors have already elected than those who have not, and those who have not are evenly divided between those who do plan to do so in the future and those who do not. The result is that by the end of October a majority of investors are likely to have elected on at least part of their portfolio.
 - (3) Although the majority of investors will have elected by the end of October there is no sign of a general rush to do so across the board. As one respondent put it: "It would make commercial sense [to elect before October 31] but we may prefer to keep the option."
 - (4) Most of those who are or will be electing are obviously thinking carefully about the basis on which they will elect, and only doing so where there is a clear financial advantage. Several say they will elect where money has been spent (on new development or on refurb) the VAT on which can be reclaimed, ie, the general trend is to make the decision on an individual basis, after consideration.
 - (5) Agricultural landowners do not appear to be keen to exercise the election for their agricultural land. Specific comments made in replies about the basis of election were:
 - "where new build/refurb"
 - "only if financially worthwhile"
 - "on recently developed portfolios where VAT on building costs can be recovered and cashflow advantage obtained"
 - "where money spent on refurb and premiums"
 - "on the whole retail/industrial portfolio and a few office buildings where there is a clear benefit"
 - "probably on developments only"
 - "new build or substantial refurb"
- Therefore, opting to tax future supplies of the property is most likely to be beneficial, although it may also present problems. Either way, it is not a decision you can ignore.

APPENDIX 5

APPENDIX 5.1

PILOT QUESTIONNAIRE PROPERTY OWNERS

Please tick box as appropriate

Q1. Do you know that you can charge VAT on the rents of non-domestic property?

| | |
|-----|----|
| YES | NO |
| | |

If NO return questionnaire. If YES go to Q2.

Q2. On what proportion of properties do you charge VAT on rents?

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. Did you seek professional advice before making the decision to charge VAT on rents?

| | |
|-----|----|
| YES | NO |
| | |

If NO go to Q5. If YES go to Q4.

Q4. Who advised you?

| Managing Agent | Solicitor | Accountant | Other (specify) |
|----------------|-----------|------------|-----------------|
| | | | |

Q5. Do you have any leases which contain a covenant preventing you from charging VAT on rents?

| | |
|-----|----|
| YES | NO |
| | |

Rank the following statements in order of importance in making your decision to charge/not charge VAT on rents, (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)

- a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc.
- b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.
- c. VAT will have to be paid on the sale price when the property is sold if you charge VAT on rents.
- d. Charging VAT on rents will limit the options of a future owner of the property.
- e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.

Some other criteria (please specify and rank)

- f.
- g.
- h.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.2 COVERING LETTER

Dear

VALUE ADDED TAX (VAT)

I am a research student pursuing a higher degree award by part-time study at Nottingham Polytechnic and a practising Chartered Surveyor based in south Lincolnshire.

My purpose in writing to you is to seek your assistance in determining the impact of value added tax on the commercial property market.

As a result of a recent judgement by the European Court the Government of the United Kingdom was required to remove the zero-rating treatment of certain non-domestic property for value added tax purposes. In 1989 the Government enacted the most far reaching changes to value added tax as it affects commercial property since its introduction in 1972.

As part of the new legislation the Government introduced the concept of waiver of exemption (more commonly known as the option to tax) which permits tax payers, from 1st August 1989, to elect to make taxable what would otherwise be exempt supplies of certain commercial interests.

The Government believed that this option would largely alleviate the additional tax burden which the removal of zero-rating would create. Early research has indicated that this may not be the case and there is a possibility that the additional tax burden may significantly affect rents and capital values in certain sectors of the commercial property market.

The purpose of this questionnaire is therefore to determine how successful the Government has been in alleviating the tax burden by the use of the option to tax and to assess the impact which this has had on the commercial property market.

I would appreciate you returning the questionnaire attached to this letter in the envelope provided whether or not you are prepared to participate. All replies will be treated in the strictest confidence and information from individual responses will be lost in the aggregation and summary process.

I would not expect you to contribute to this study without return and a summary of the results will therefore be sent to all participants.

I very much look forward to receiving your response and if you require any further information please contact my research supervisor, Professor John Moohan on Nottingham 418418 Ext. 2513.

Please return your response to the questionnaire in the envelope provided by Friday 25th October 1991.

Yours sincerely

APPENDIX 5.3

PILOT QUESTIONNAIRE IN-HOUSE SURVEYORS

Q1. On what percentage of your company's property portfolio has the option to tax been exercised?

Please tick box as appropriate

| | | | | | | |
|---|---------|----------|----------|----------|----------|------|
| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
| | | | | | | |

Q2. Was this decision made on an individual property by property basis?

| | |
|-----|----|
| YES | NO |
| | |

Q3. Has the option to tax only been exercised where there is a clear financial advantage to do so?

| | |
|-----|----|
| YES | NO |
| | |

Q4. Is your company prevented from charging VAT on rents by a covenant in any of its leases?

| | |
|-----|----|
| YES | NO |
| | |

Q5. Rank the following statements in order of importance in your company's decision to opt/not opt to tax; (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

- a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc.
- b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.
- c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents.
- d. Charging VAT on rents will limit the options of a future owner of the property.
- e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.
- Some other criteria (please specify and rank)
- f.
- g.
- h.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.4

PILOT QUESTIONNAIRE PROFESSIONAL ADVISORS

Q1. On what percentage of your clients' property portfolio have they opted to tax rents?

Please tick box as appropriate

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q2. Are you aware of any clients who are prevented from charging VAT on rent by a covenant in a lease?

| YES | NO |
|-----|----|
| | |

Q3. Rank the following statements in order of importance to your clients in their decision to opt/not opt to tax;

(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

- a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc.
- b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.
- c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents.
- d. Charging VAT on rents will limit the options of a future owner of the property.
- e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.

Some other criteria (please specify and rank)

- f.
- g.
- h.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.5

RESPONSES TO PILOT QUESTIONNAIRES

Descriptive statistics for each questionnaire have been produced from aggregate data based on a total count of respondents and the percentage of responses.

5.5.1 Property Owners Questionnaire Question 1

“Do you know that you can charge VAT on the rents of non-domestic property?”

Response:

| | YES | NO |
|---------------------------------------|--------------|--------------|
| Number/ percentage of responses | 5 (83.3%) | 1 (16.6%) |

5.5.2 Property Owners Questionnaire Question 2

“Q2. On what proportion of properties do you charge VAT on rents?”

In-House Surveyors Questionnaire Question 1

“Q1. On what percentage of your company’s property portfolio has the option to tax been exercised?”

Professional Advisors Questionnaire Question 1

“Q1. On what percentage of your clients’ property portfolio have they opted to tax rents?”

Response:

| % | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|-------------|---------------|-------------|------------|-------------|-------------|--------------|
| Number/ percentage of responses | 4 (9.5%) | 17 (40.5%) | 1 (2.4%) | 8 (19%) | 2 (4.7%) | 4 (9.5%) | 6 (14.3%) |

5.5.3 Property Owners Questionnaire Question 3

“Q3. Did you seek professional advise before making the decision to charge VAT on rents?”

Response:

| | Yes | No |
|---------------------------------------|-------------|-----------|
| Number/ percentage of responses | 5 (100%) | 0 (0%) |

5.5.4 Property Owners Questionnaire Question 4

“Q4. Who advised you?”

Response:

| | Managing Agent | Solicitor | Accountant | Other |
|--------------------------------------|----------------|------------|------------|------------|
| Number percentage of responses | 1 (10%) | 3 (30%) | 4 (40%) | 2 (20%) |

5.5.5 Property Owners Questionnaire Question 5

“Q5. Do you have any leases which contain a covenant preventing you from charging VAT on rents?”

In-house surveyors Questionnaire Question 4

“Q4. Is your company prevented from charging VAT on rents by a covenant in any of its leases?”

Professional Advisors Questionnaire Question 2

“Q2. Are you aware of any clients who are prevented from charging VAT on rent by a covenant in a lease?”

Response:

| | Yes | No |
|---------------------------------------|-------------|---------------|
| Number/ percentage of responses | 2 (4.8%) | 40 (95.2%) |

5.5.6 In-house Surveyors Questionnaire Question 2

“Q2. Was this decision made on an individual property by property basis?”

Response:

| | Yes | No |
|---------------------------------------|------------|------------|
| Number/ percentage of responses | 4 (80%) | 1 (20%) |

5.5.7 In-house Surveyors Questionnaire Question 3

“Q3. Has the option to tax only been exercised where there is a clear financial advantage to do so?”

Response:

| | Yes | No |
|---------------------------------------|-------------|-----------|
| Number/ percentage of responses | 5 (100%) | 0 (0%) |

5.5.8 Property Owners Questionnaire Question 6

“Q6. Rank the following statements in order of importance in making your decision to charge/not charge VAT on rents; (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)”

In-house Surveyors Questionnaire Question 5

“Q5. Rank the following statements in order of importance in your company’s decision to opt/not opt to tax; (4 = crucial)”

Professional Advisors Questionnaire Question 3

“Q3. Rank the following statements in order of importance to your clients in their decision to opt/not opt to tax; (4 = crucial)”

Response:

| | <u>Crucial</u> | <u>very significant</u> | <u>significant</u> | <u>slightly significant</u> | <u>no significance</u> |
|---|----------------|-------------------------|--------------------|-----------------------------|------------------------|
| a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees etc. | 18 (43.9%) | 14 (34.1%) | 6 (14.6%) | 2 (4.9%) | 1 (2.4%) |
| b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc. | 1 (2.5%) | 2 (5%) | 11 (27.5%) | 17 (42.5%) | 9 (22.5%) |
| c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents. | 6 (15%) | 12 (30%) | 8 (20%) | 11 (27.5%) | 3 (7.5%) |
| d. Charging VAT on rents will limit the options of a future owner of the property. | 1 (2.6%) | 8 (21%) | 11 (28.9%) | 10 (26.3%) | 8 (21%) |
| e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review. | 3 (7.5%) | 9 (22.5%) | 13 (32.5%) | 9 (22.5%) | 6 (15%) |

APPENDIX 5.6

QUESTIONNAIRE MAIN CIRCULATION PROPERTY OWNERS

Please tick box as appropriate

Q1. Do you know that you can charge VAT on the rents of non-domestic property?

| | |
|-----|----|
| YES | NO |
| | |

If NO return questionnaire. If YES go to Q2.

Q2. On what proportion of properties do you charge VAT on rents?

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. Did you seek professional advice before making the decision to charge VAT on rents?

| | |
|-----|----|
| YES | NO |
| | |

If NO go to Q5. If YES go to Q4.

Q4. Who advised you?

| Managing Agent | Solicitor | Accountant | Other (specify) |
|----------------|-----------|------------|-----------------|
| | | | |

Q5. What percentage of your commercial property holdings are for:

| Investment | Development | Other (specify) |
|------------|-------------|-----------------|
| | | |

Q6. Do you have any leases which contain a covenant preventing you from charging VAT on rents?

| | |
|-----|----|
| YES | NO |
| | |

Q7. How significant are the following factors in making your decision to charge/not charge VAT on rents?

(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)

- a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc.
- b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.
- c. VAT will have to be paid on the sale price when the property is sold if you charge VAT on rents.
- d. Charging VAT on rents will limit the options of a future owner of the property.
- e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Some other criteria (please specify and rank)

- f. f.
- g. g.
- h. h.

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.7

QUESTIONNAIRE MAIN CIRCULATION IN-HOUSE SURVEYORS

Q1. On what percentage of your company's property portfolio has the option to tax been exercised?

Please tick box as appropriate

| | | | | | | |
|---|---------|----------|----------|----------|----------|------|
| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
| | | | | | | |

Q2. Was this decision made on an individual property by property basis?

| | |
|-----|----|
| YES | NO |
| | |

Q3. Has the option to tax only been exercised where there is a clear financial advantage to do so?

| | |
|-----|----|
| YES | NO |
| | |

Q4. Is your company prevented from charging VAT on rents by a covenant in any of its leases?

| | |
|-----|----|
| YES | NO |
| | |

Q5. What percentage of your commercial property holdings are for:

| | | |
|------------|-------------|-----------------|
| Investment | Development | Other (specify) |
| | | |

Q6. How significant are the following factors in your company's decision to opt/not opt to tax?

(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc.

a.

b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc.

b.

c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents.

c.

d. Charging VAT on rents will limit the options of a future owner of the property.

d.

e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review.

e.

Some other criteria (please specify and rank)

f.

f.

g.

g.

h.

h.

| | | | | | |
|----|---|---|---|---|---|
| | 4 | 3 | 2 | 1 | 0 |
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.8

QUESTIONNAIRE MAIN CIRCULATION PROFESSIONAL ADVISORS

Q1. On what percentage of your clients' property portfolio have they opted to tax rents?

Please tick box as appropriate

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q2. Are you aware of any clients who are prevented from charging VAT on rent by a covenant in a lease?

| YES | NO |
|-----|----|
| | |

Q3. What percentage of your commercial property holdings are for:

| Investment | Development | Other (specify) |
|------------|-------------|-----------------|
| | | |

Q4. Are you aware of any overseas investors who have been unwilling to invest in the UK as a result of the VAT treatment of UK property?

| YES | NO |
|-----|----|
| | |

Q5. How significant are the following factors in your clients' decision to opt/not opt to tax?

(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

- a. Charging VAT on rents enables the recovery of VAT on landlords' repairs, construction costs, service charges, managing agents' fees, etc. a.
- b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc. b.
- c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents. c.
- d. Charging VAT on rents will limit the options of a future owner of the property. d.
- e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover VAT he may want to pay a lower rent on review. e.
- Some other criteria (please specify and rank)
- f. f.
- g. g.
- h. h.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |

Please feel free to make additional comments on a separate sheet.
THANK YOU FOR ASSISTING WITH THIS QUESTIONNAIRE

APPENDIX 5.9

RESULTS OF THE MAIN CIRCULATION

5.9.1 Property Owners Questionnaire Question 1

“Do you know that you can charge VAT on the rents of non-domestic property?”

Response:

| | Yes | No |
|---------------------------------------|---------------|-------------|
| Number/ percentage of responses | 41 (91.1%) | 4 (8.9%) |

5.9.2 Property Owners Questionnaire Question 2

“Q2. On what proportion of properties do you charge VAT on rents?”

In-house Surveyors Questionnaire Question 1

“Q1. On what percentage of your company’s property portfolio has the option to tax been exercised?”

Professional Advisors Questionnaire Question 1

“Q1. On what percentage of your clients’ property portfolio have they opted to tax rents?”

Response:

| | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|
| Number/ percentage of responses | 20 (16.1%) | 37 (29.8%) | 17 (13.7%) | 14 (11.3%) | 13 (10.5%) | 11 (8.9%) | 12 (9.7%) |

5.9.3 **Property Owners Questionnaire Question 3**

“Q3. Did you seek professional advice before making the decision to charge VAT on rents?”

Response:

| | YES | NO |
|---------------------------------------|---------------|---------------|
| Number/ percentage of responses | 31 (75.6%) | 10 (24.4%) |

5.9.4 **Property Owners Questionnaire Question 4**

“Q4. Who advised you?”

Response:

| | Managing Agent | Solicitor | Accountant | Other |
|---------------------------------------|----------------|--------------|---------------|-------------|
| Number/ percentage of responses | 7 (18%) | 6 (15.4%) | 24 (61.5%) | 2 (5.1%) |

5.9.5 **Property Owners Questionnaire Question 5,
In-house Surveyors Questionnaire Question 5,
and Professional Advisors Questionnaire Question 3,**

“Q5/3. What percentage of your commercial property holdings are for Investment Development Other”

Response:

| | Investment | Development | Other |
|----------------------------|------------|-------------|-------|
| Percentage of responses | 55.1% | 25.7% | 14.5% |

5.9.6 **Property Owners Questionnaire Question 6**

“Q6. Do you have any leases which contain a covenant preventing you from charging VAT on rents?”

In-house Surveyors Questionnaire Question 4

“Q4. Is your company prevented from charging VAT on rents by a covenant in any of its leases?”

Professional Advisors Questionnaire Question 2

“Q2. Are you aware of any clients who are prevented from charging VAT on rent by a covenant in a lease?”

Response:

| | YES | NO |
|----------------------------|---------|---------|
| Number | 17 | 115 |
| percentage of responses | (12.9%) | (87.1%) |

5.9.7 In-house Surveyors Questionnaire Question 2

“Q2. Was this decision made on an individual property by property basis?”

Response:

| | YES | NO |
|--|------------|------------|
| Numbers/ percentage of responses | 9 (75%) | 3 (25%) |

5.9.8 In-house Surveyors Questionnaire Question 3

“Q3. Has the option to tax only been exercised where there is a clear financial advantage to do so?”

Response:

| | YES | NO |
|--|---------------|--------------|
| Numbers/ percentage of responses | 10 (83.3%) | 2 (16.7%) |

5.9.9 Professional Advisors Questionnaire Question 4

“Q4. Are you aware of any overseas investors who have been unwilling to invest in the UK as a result of the VAT treatment of UK property?”

Response:

| | YES | NO |
|--|-------------|---------------|
| Numbers/ percentage of responses | 2 (2.6%) | 75 (97.4%) |

5.9.10 **Property Owners Questionnaire Question 7**

“Q7. How significant are the following factors in making your decision to charge/not charge VAT on rents? (4 = crucial, 3 = ...)”

In-house Surveyors Questionnaire Question 6

“Q6. How significant are the following factors in your company’s decision to opt/not opt to tax? (4 = crucial, 3 = ...)”

Professional Advisors Questionnaire Question 5

“Q5. How significant are the following factors in your clients’ decision to opt/not opt to tax? (4 = crucial, 3 = ...)”

Response:

| | crucial | very significant | significant | slightly significant | no significance |
|---|---------------|------------------|---------------|----------------------|-----------------|
| a. Charging VAT on rents enables the recovery of VAT on landlords’ repairs, construction costs, service charges, managing agents’ fees, etc | 52 (38.8%) | 40 (29.8%) | 21 (15.6%) | 13 (9.7%) | 8 (6%) |
| b. Charging VAT on rents will increase management costs, ie customs control visits, issuing tax invoices etc. | 8 (6%) | 12 (8.9%) | 26 (19.4%) | 58 (43.3%) | 30 (22.4%) |
| c. VAT will have to be paid on the sale price when the property is sold if VAT is charged on rents. | 37 (27.8%) | 30 (22.6%) | 37 (27.8%) | 18 (13.5%) | 11 (8.3%) |
| d. Charging VAT on rents will limit the options of a future owner of property. | 19 (14.2%) | 22 (16.4%) | 36 (26.9%) | 36 (26.9%) | 21 (15.6%) |
| e. The effect on the tenants of charging VAT on rents, ie if the tenant cannot recover the VAT he may want to pay a lower rent on review | 20 (14.9%) | 22 (16.4%) | 46 (34.3%) | 36 (26.9%) | 10 (7.5%) |

APPENDIX 6

APPENDIX 6.1

OCCUPIERS PILOT QUESTIONNAIRE

Q1. Are you exempt part exempt or, fully taxable for VAT?

If fully taxable, return questionnaire. If part exempt/exempt, go on.

Q2. Are you?

| Owner Occupier | Tenant |
|----------------|--------|
| | |

If tenant answer Section A only. If owner answer Section B only.

SECTION A

A1. Do you pay VAT on rent?

| YES | NO |
|-----|----|
| | |

 If yes go to A3. If no go to A2.

A2. Have you ever paid VAT on rent?

| YES | NO |
|-----|----|
| | |

 If yes go to A3. If no go to A4.

A3. Rank the following options based on your strategy to avoid this extra cost, (4 = most likely and 0 = least likely).

- | | | 4 | 3 | 2 | 1 | 0 |
|--|----|---|---|---|---|---|
| a. Move to a building where no VAT is charged on rent. | a. | | | | | |
| b. Secure a lower rent on rent review. | b. | | | | | |
| c. Occupy less floor space. | c. | | | | | |
| d. Pass on as higher product prices. | d. | | | | | |
| e. Accept reduced profits and pay the VAT. | e. | | | | | |
| f. Other (specify)..... | f. | | | | | |

Go to A5.

A4. If your landlord were to opt to tax your rent rank the following options based on your strategy to avoid this extra cost, (4 = most likely, and 0 = least likely).

- | | | 4 | 3 | 2 | 1 | 0 |
|--|----|---|---|---|---|---|
| a. Move to a building where no VAT is charged on rent. | a. | | | | | |
| b. Secure a lower rent on rent review. | b. | | | | | |
| c. Occupy less floor space. | c. | | | | | |
| d. Pass on as higher product prices. | d. | | | | | |
| e. Accept reduced profits and pay the VAT. | e. | | | | | |
| f. Other (specify)..... | f. | | | | | |

Go to A5.

A5. If you ranked A3a/A4a as "most likely" above:

a. Have or would you be prepared to pay a premium or more rent to secure a building where no VAT is charged on rent?

| | |
|-----|----|
| YES | NO |
| | |

b. How much more: (i) rent as a % of rent paid?

| | | | |
|------|-------|--------|----------|
| 1-5% | 6-10% | 11-15% | Over 15% |
| | | | |

OR (ii) premium as a % of rent paid?

| |
|--|
| |
|--|

SECTION B

B1. Do you hold land for the development of new premises?

| | |
|-----|----|
| YES | NO |
| | |

B2. Have you developed new premises since 1.8.89?

| | |
|-----|----|
| YES | NO |
| | |

B3. Do you intend to develop new premises?

| | |
|-----|----|
| YES | NO |
| | |

B4. To what extent has the introduction of VAT on development influenced your attitude towards the development of new premises (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

| | | | | |
|---|---|---|---|---|
| 4 | 3 | 2 | 1 | 0 |
| | | | | |

B5. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?

| | |
|-----|----|
| YES | NO |
| | |

B6. If yes on what percentage of cases?

| |
|--|
| |
|--|

B7. Have you had to pay VAT on total site value where only part of the site has been developed?

| | |
|-----|----|
| YES | NO |
| | |

B8. If yes on what percentage of cases?

| |
|--|
| |
|--|

APPENDIX 6.2

COVERING LETTER

Dear

IS VAT PLACING A BURDEN ON YOUR BUSINESS?

SHOULD YOU BE TAKING PROFESSIONAL ADVICE?

I am a research student pursuing a higher degree award by part-time study at Nottingham Polytechnic and a practising Chartered Surveyor based in South Lincolnshire.

My purpose in writing to you is to seek your assistance in determining the impact of value added tax on the commercial property market.

Early research has shown that the imposition of VAT may lead to significant fluctuations in rent and property values. The enclosed questionnaire seeks to determine the extent of the problem and in assisting with its completion you will be contributing evidence which may require that the Government consider amending the present legislation.

I would appreciate you returning the attached questionnaire in the envelope provided whether or not you are prepared to participate. All replies will be treated in the strictest confidence and information from individual responses will be lost in the aggregation process. The questionnaire is coded to identify the category of respondent only.

I would not expect you to contribute to this study without return and a summary of the results will therefore be sent to all participants.

I very much look forward to receiving your response and if you require any further information please contact my research supervisor, Professor John Moohan on Nottingham, 418418 Ext. 6439.

Please return your responses to the questionnaire in the envelope provided by Monday 13th April 1992.

Yours faithfully

APPENDIX 6.3

INVESTORS PILOT QUESTIONNAIRE

1. Are you

| |
|---------|
| exempt, |
| |

| |
|-------------|
| part exempt |
| |

 or,

| |
|---------------|
| fully taxable |
| |

 for VAT

Q2. On what percentage of properties do you charge VAT on rents?

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. What percentage of your commercial property portfolio is held for:

| Investment | Development | Other |
|------------|-------------|-------|
| | | |

Q4. Assess the following statements based on your own experience:
 (4 = always true, 3 = mostly true, 2 = sometimes true,
 1 = little truth, 0 = never true).

| | 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|---|
| a. Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents. | | | | | |
| b. Site bids will be reduced when VAT cannot be recovered. | | | | | |
| c. Investors favour unelected buildings. | | | | | |
| d. Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. | | | | | |
| e. Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. | | | | | |
| f. Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. | | | | | |
| g. Tenants who cannot recover VAT paid on rent want to pay a lower rent. | | | | | |

Q4. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed.
 (4 = crucial, 3 = very significant, 2 = significant,
 1 = slightly significant, 0 = no significance)

| 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|
| | | | | |

APPENDIX 6.4

DEVELOPERS PILOT QUESTIONNAIRE

Q1. Are you

| |
|---------|
| exempt, |
| |

 or,

| |
|-------------|
| part exempt |
| |

 or,

| |
|---------------|
| fully taxable |
| |

 for VAT?

Q2. On what percentage of properties do you charge VAT on rents?

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. What percentage of your commercial property portfolio is held for:

| Investment | Development | Other |
|------------|-------------|-------|
| | | |

Q4. Assess the following statements based on your own experience:
(4 = always true, 3 = mostly true, 2 = sometimes true, 1 = little truth, 0 = never true).

- a. Developers will opt to tax every new freehold commercial building to ensure the recovery of VAT on construction costs and site purchase. a.
- b. Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. b.
- c. Site bids will be reduced where VAT cannot be recovered. c.
- d. Investors favour unelected buildings. d.
- e. Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. e.
- f. Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. f.
- g. Tenants who cannot recover VAT paid on rent want to pay a lower rent. g.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |

Q5. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed.
(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)

| 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|
| | | | | |

Q6. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?

| YES | NO |
|-----|----|
| | |

Q7. If yes, on what percentage of cases?

Q8. Have you had to pay VAT on total site value where only part of the site has been developed?

| YES | NO |
|-----|----|
| | |

Q9. If yes, on what percentage of cases?

APPENDIX 6.5

SURVEYORS PILOT QUESTIONNAIRE

APPENDIX 6.6

RESULTS OF PILOT QUESTIONNAIRES CIRCULATION

6.6.1 Occupiers Pilot Questionnaire, Question 1

“Q1. Are you exempt, part exempt or fully taxable for VAT?”

| Response: | <u>Exempt</u> | <u>Part Exempt</u> | <u>Fully Taxable</u> |
|---------------------------------------|---------------|--------------------|----------------------|
| Number/ percentage of responses | 1 (6.2%) | 3 (18.8%) | 12 (75%) |

6.6.2 Occupiers Pilot Questionnaire, Question 2

“Q2. Are you? Owner Occupier or Tenant?”

| Response: | <u>Owner Occupier</u> | <u>Tenant</u> |
|---------------------------------------|-----------------------|---------------|
| Number/ percentage of responses | 1 (50%) | 1 (50%) |

6.6.3 Occupiers Pilot Questionnaire, Section A, Question A1

“A1. Do you pay VAT on rent?”

| Response: | <u>YES</u> | <u>NO</u> |
|---------------------------------------|-------------|-----------|
| Number/ percentage of responses | 1 (100%) | 0 (0%) |

6.6.4 Occupiers Pilot Questionnaire, Section A, Question A2

“A2. Have you ever paid VAT on rent?”

| Response: | <u>YES</u> | <u>NO</u> |
|---------------------------------------|-------------|-----------|
| Number/ percentage of responses | 1 (100%) | 0 (0%) |

6.6.5 Occupiers Pilot Questionnaire, Section A, Question A3

“A3. Rank the following options based on your strategy to avoid this extra cost, (4 = most likely and 0 = least likely).”

| Response: | 4 | 3 | 2 | 1 | 0 |
|--|-------------|-----------|-----------|-----------|-------------|
| a. Move to a building where no VAT is charged on rent. | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) | 1 (100%) |
| b. Secure a lower rent on rent review. | 1 (100%) | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) |
| c. Occupy less floor space. | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) | 1 (100%) |
| d. Pass on as higher product prices. | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) | 1 (100%) |
| e. Accept reduced profits and pay the VAT. | 1 (100%) | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) |

6.6.6 Occupiers Pilot Questionnaire, Section A, Question A4

No response as respondent paying VAT on rent.

6.6.7 Occupiers Pilot Questionnaire, Section A, Question A5

“A5. If you ranked A3a/A4a as “most likely” above:

- a. Have or would you be prepared to pay a premium or more rent to secure a building where no VAT is charged on rent?”

Response:

| | YES | NO |
|---------------------------------------|-------------|-----------|
| Number/ percentage of responses | 1 (100%) | 0 (0%) |

“b. How much more

- (i) rent as a percentage of rent paid?”

| Response: | 1-5% | 6-10% | 11-15% | over 15% |
|---------------------------------------|-----------|-------------|-----------|-----------|
| Number/ percentage of responses | 0 (0%) | 1 (100%) | 0 (0%) | 0 (0%) |

“(ii) premium as a percentage of rent paid?” - no response (only one respondent)

As an owner occupier as well as a tenant this respondent went on to complete section B of the occupiers questionnaire.

6.6.8 Occupiers Pilot Questionnaire, Section B, Question B1

“B1. Do you hold land for the development of new premises?”

| Response: | YES | NO |
|---------------------------------------|-----------|-------------|
| Number/ percentage of responses | 0 (0%) | 1 (100%) |

6.6.9 Occupiers Pilot Questionnaire, Section B, Question B2

“B2. Have you developed any new premises since 1.8.89?”

| Response | YES | NO |
|---------------------------------------|-----------|-------------|
| Number/ percentage of responses | 0 (0%) | 1 (100%) |

6.6.10 Occupiers Pilot Questionnaire, Section B, Question B3

“B3. Do you intend to develop new premises?”

| Response: | YES | NO |
|---------------------------------------|-----------|-------------|
| Number/ percentage of responses | 0 (0%) | 1 (100%) |

6.6.11 Occupiers Pilot Questionnaire, Section B, Question B4

“B4. To what extent has the introduction of VAT on development influenced your attitude towards the development of new premises? (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).”

| Response: | 4 | 3 | 2 | 1 | 0 |
|---------------------------------------|-----------|-----------|-----------|-------------|-----------|
| Number/ percentage of responses | 0 (0%) | 0 (0%) | 0 (0%) | 1 (100%) | 0 (0%) |

6.6.12 Occupiers Pilot Questionnaire, Section B, Question B5

“B5. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?”

| | | |
|---------------------------------------|------------------|--------------------|
| Response: | YES | NO |
| Number/ percentage of responses | <u>0</u> (0%) | <u>1</u> (100%) |

6.6.13 Occupiers Pilot Questionnaire, Section B, Question B6

This was not answered as the response to question B5. was no.

6.6.14 Occupiers Pilot Questionnaire, Section B, Question B7

“B7. Have you had to pay VAT on total site value where only part of the site has been developed?”

| | | |
|---------------------------------------|------------------|--------------------|
| Response: | YES | NO |
| Number/ percentage of responses | <u>0</u> (0%) | <u>1</u> (100%) |

6.6.15 Occupiers Pilot Questionnaire, Section B, Question B8

This was not answered as the response to question B7. was no.

6.6.16 Investors and Developers Pilot Questionnaires, Question 1

“Q1. Are you exempt, part exempt or fully taxable for VAT?”

| | | | |
|---------------------------------------|---------------|--------------------|----------------------|
| Response: | <u>Exempt</u> | <u>Part Exempt</u> | <u>Fully Taxable</u> |
| Number/ percentage of responses | 1 (16.6%) | 2 (33.3%) | 3 (50%) |

**6.6.17 Investors and Developers Pilot Questionnaires, Question 2,
Surveyors Pilot Questionnaire, Question 1**

“Q2. On what percentage of properties do you charge VAT on rents?”

“Q1. On what percentage of your clients’ property portfolio have they opted to tax rents?”

| | | | | | | | |
|---------------------------------------|--------------|--------------|--------------|-----------|-----------|-----------|--------------|
| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
| Number/ percentage of responses | 2 (28.6%) | 1 (14.3%) | 1 (14.3%) | 0 (0%) | 0 (0%) | 0 (0%) | 3 (42.8%) |

**6.6.18 Investors and Developers Pilot Questionnaires, Question 3
Surveyors Pilot Questionnaire Question 2**

“Q3. What percentage of your commercial property portfolio is held for:”

“Q2 What percentage of your clients property portfolio is held for:”

| | | | |
|----------------------------|------------|-------------|-------|
| Response: | Investment | Development | Other |
| Percentage of responses | 47.2% | 33.4% | 19.4% |

6.6.19 Surveyors Pilot Questionnaire, Question 3

“Q3. Are you aware of any overseas investors who have been unwilling to invest in the UK as a result of the VAT treatment of UK property?”

| | | |
|---------------------------------------|-----------|-------------|
| Response: | YES | NO |
| Number/ percentage of responses | 0 (0%) | 1 (100%) |

**6.6.20 Investors, Developers and Surveyors Pilot Questionnaires,
Question 4**

“Q4. Assess the following statements based on your own experience:

(4 = always true, 3 = mostly true, 2 = sometimes true, 1 = little truth, 0 = never true).”

| Response: | Always true | Mostly true | Sometimes true | Little truth | Never true |
|--|--------------|--------------|----------------|--------------|--------------|
| Developers will opt to tax every new freehold commercial building to ensure the recover of VAT on construction costs and site purchase. | 0 (0%) | 3 (50%) | 2 (33.3%) | 0 (0%) | 1 (16.7%) |
| Site bids will be reduced where VAT cannot be recovered. | 1 (12.5%) | 3 (37.5%) | 2 (25%) | 1 (12.5%) | 1 (12.5%) |
| Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. | 0 (0%) | 0 (0%) | 2 (28.6%) | 5 (71.4%) | 0 (0%) |
| Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. | 0 (0%) | 0 (0%) | 1 (25%) | 3 (75%) | 0 (0%) |
| Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. | 0 (0%) | 1 (16.6%) | 1 (16.6%) | 2 (33.3%) | 2 (33.3%) |
| Investors favour unelected buildings. | 0 (0%) | 0 (0%) | 3 (60%) | 2 (40%) | 0 (0%) |
| Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents. | 2 (50%) | 1 (25%) | 1 (25%) | 0 (0%) | 0 (0%) |
| Tenants who cannot recover VAT paid on rent want to pay a lower rent. | 2 (25%) | 2 (25%) | 2 (25%) | 1 (12.5%) | 1 (12.5%) |
| Tenants will take less floor space to offset irrecoverable VAT. | 0 (0%) | 0 (0%) | 0 (0%) | 2 (100%) | 0 (0%) |
| Tenants will pay a premium or more rent to secure an unelected building. | 0 (0%) | 0 (0%) | 0 (0%) | 2 (100%) | 0 (0%) |

| Response: | Always true | Mostly true | Sometimes true | Little truth | Never true |
|---|-------------|-------------|----------------|--------------|------------|
| Tenants will move to avoid having to pay VAT on rent. | 0 (0%) | 0 (0%) | 1 (50%) | 1 (50%) | 0 (0%) |
| A two tier rental market has developed in certain commercial areas. | 1 (50%) | 0 (0%) | 1 (50%) | 0 (0%) | 0 (0%) |

**6.6.21 Investors Pilot Questionnaire, Question 4,
Developers Pilot Questionnaire, Question 5**

“Q4/5. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed. (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)”

| Response: | 4 | 3 | 2 | 1 | 0 |
|---------------------------------------|-----------|--------------|------------|--------------|--------------|
| Number/ percentage of responses | 0 (0%) | 1 (16.6%) | 3 (50%) | 1 (16.6%) | 1 (16.6%) |

6.6.22 Developers Pilot Questionnaire, Question 6

“Q6. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?”

| Response: | YES | NO |
|---------------------------------------|-----------|-------------|
| Number/ percentage of responses | 0 (0%) | 4 (100%) |

6.6.23 Developers Pilot Questionnaire, Question 7

“Q7. If yes, on what percentage of cases?”

Response: (0%)

6.6.24 Developers Pilot Questionnaire, Question 8

“Q8. Have you had to pay VAT on total site value where only part of the site has been developed?”

| Response: | YES | NO |
|---------------------------------------|-----------|-------------|
| Number/ percentage of responses | 0 (0%) | 4 (100%) |

6.6.25 Developers Pilot Questionnaire, Question 9

“Q9. If yes, on what percentage of cases?”

Response: 0%

APPENDIX 6.7

OCCUPIERS MAIN QUESTIONNAIRE CIRCULATION

Q1. Are you

| | | |
|---------|-------------|---------------------------|
| exempt, | part exempt | or fully taxable for VAT? |
| | | |

If fully taxable, return questionnaire. If part exempt/exempt, go on.

Q2. What percentage of VAT are you able to recover?

| 0% | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|----|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. Are you?

| Owner Occupier | Tenant | Both |
|----------------|--------|------|
| | | |

If tenant answer Section A only. If owner answer Section B only. If both answers Sections A and B.

SECTION A

A1. Do you pay VAT on rent?

If yes go to A3. If no go to A2.

| YES | NO |
|-----|----|
| | |

A2. Have you ever paid VAT on rent?

If yes go to A3. If no go to A4.

| YES | NO |
|-----|----|
| | |

A3. Order the following options based on your strategy to avoid this extra cost, (1 = most likely and 6 = least likely).

- a. Move to a building where no VAT is charged on rent.
- b. Secure a lower rent on rent review.
- c. Occupy less floor space.
- d. Pass on as higher product prices.
- e. Accept reduced profits and pay the VAT.
- f. Other (specify).....

| | |
|----|--|
| a. | |
| b. | |
| c. | |
| d. | |
| e. | |
| f. | |

Go to A5

A4. If your landlord were to opt to tax your rent order the following options based on your strategy to avoid this extra cost, (1 = most likely, and 6 = least likely).

- a. Move to a building where no VAT is charged on rent.
- b. Secure a lower rent on rent review.

| | |
|----|--|
| a. | |
| b. | |

/contd.

A4./contd.

- c. Occupy less floor space.
- d. Pass on as higher product prices.
- e. Accept reduced profits and pay the VAT.
- f. Other (specify).....

| | |
|----|--|
| c. | |
| d. | |
| e. | |
| f. | |

Go on to

A5. If you ranked A3a/A4a as "most likely" above:

- a. Have or would you be prepared to pay a premium or more rent to secure a building where no VAT is charged on rent?

| | |
|-----|----|
| YES | NO |
| | |

- b. How much more: (i) rent as a % of rent paid?

| | | | |
|------|-------|--------|----------|
| 1-5% | 6-10% | 11-15% | Over 15% |
| | | | |

Or (ii) premium?%
(as a percentage of current rent)

SECTION B

- B1. Do you hold land for the development of new premises?

| | |
|-----|----|
| YES | NO |
| | |

- B2. Have you developed new premises since 1.8.89?

| | |
|-----|----|
| YES | NO |
| | |

- B3. Do you intend to develop new premises?

| | |
|-----|----|
| YES | NO |
| | |

- B4. To what extent has the introduction of VAT on development influenced your attitude towards the development of new premises?
(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).

| | | | | |
|---|---|---|---|---|
| 4 | 3 | 2 | 1 | 0 |
| | | | | |

- B5. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?

| | |
|-----|----|
| YES | NO |
| | |

- B6. If yes on what percentage of cases?

.....%

- B7. Have you had to pay VAT on total site value where only part of the site has been developed?

| | |
|-----|----|
| YES | NO |
| | |

- B8. If yes on what percentage of cases?

.....%

APPENDIX 6.8

INVESTORS MAIN QUESTIONNAIRE CIRCULATION

| | | | |
|-------------|---------|-------------|---------------------------|
| Q1. Are you | exempt. | part exempt | or fully taxable for VAT? |
| | | | |

Q2. What percentage of VAT are you able to recover?

| | | | | | | |
|----|---------|----------|----------|----------|----------|------|
| 0% | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
| | | | | | | |

Q3. On what percentage of properties do you charge VAT on rents?

| | | | | | | |
|----|---------|----------|----------|----------|----------|------|
| 0% | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
| | | | | | | |

Q4. What percentage of your commercial property portfolio is held for:

| | | |
|-----------------|------------------|----------------------|
| Investment % | Development % | Other (specify) % |
| | | |

Q5. Assess the following statements based on your own experience:
(4 = always true, 3 = mostly true, 2 = sometimes true,
1 = little truth, 0 = never true).

- a. Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents. a.
- b. Site bids will be reduced when VAT cannot be recovered. b.
- c. Investors who cannot recover VAT favour unelected buildings to retain flexibility in tax treatment. c.
- d. Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. d.
- e. Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. e.
- f. Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. f.
- g. Tenants who cannot recover VAT paid on rent want to pay a lower rent. g.

| | | | | | |
|----|---|---|---|---|---|
| | 4 | 3 | 2 | 1 | 0 |
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |

Q6. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed.

(4 = crucial, 3 = very significant, 2 = significant,
1 = slightly significant, 0 = no significance)

| | | | | |
|---|---|---|---|---|
| 4 | 3 | 2 | 1 | 0 |
| | | | | |

APPENDIX 6.9

DEVELOPERS MAIN QUESTIONNAIRE CIRCULATION

Q1. Are you

| | | |
|---------|-------------|---------------------------|
| exempt, | part exempt | or fully taxable for VAT? |
| | | |

Q2. What percentage of VAT are you able to recover?

| 0% | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|----|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q3. On what percentage of properties do you charge VAT on rents?

| 0% | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|----|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q4. What percentage of your commercial property portfolio is held for:

| Investment % | Development % | Other (specify) % |
|-----------------|------------------|----------------------|
| | | |

Q5. Assess the following statements based on your own experience:
(4 = always true, 3 = mostly true, 2 = sometimes true, 1 = little truth, 0 = never true).

- a. Developers will opt to tax every new freehold commercial building to ensure the recovery of VAT on construction costs and site purchase. a.
- b. Developers who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. b.
- c. Site bids will be reduced where VAT cannot be recovered. c.
- d. Tenants who cannot recover VAT paid on rent want to pay a lower rent. d.
- e. Developers who cannot recover VAT will be discouraged from the development of new sites. e.

| 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

Q6. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed.
(4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)

| 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|
| | | | | |

Q7. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course or furtherance of a business)?

| YES | NO |
|-----|----|
| | |

Q8. If yes, on what percentage of cases?%

Q9. Have you had to pay VAT on total site value where only part of the site has been developed?

| YES | NO |
|-----|----|
| | |

Q10. If yes, on what percentage of cases?%

APPENDIX 6.10

SURVEYORS MAIN QUESTIONNAIRE CIRCULATION

Q1. On what percentage of your clients' property portfolio have they opted to tax rents?

| 0 | 1 - 20% | 21 - 40% | 41 - 60% | 61 - 80% | 81 - 99% | 100% |
|---|---------|----------|----------|----------|----------|------|
| | | | | | | |

Q2. What percentage of your clients' property portfolio is held for:

| Investment | Development | Other (specify) |
|------------|-------------|-----------------|
| % | % | % |

Q3. Are you aware of any overseas investors who have been unwilling to invest in the UK as a result of the VAT treatment of UK property?

| YES | NO |
|-----|----|
| | |

Q4. Assess the following statements based on your own experience: (4 = always true, 3 = mostly true, 2 = sometimes true, 1 = little truth, 0 = never true).

- a. Developers will opt to tax every new freehold commercial building to ensure the recovery of VAT on construction costs and site purchase. a.
- b. Developers who cannot recover VAT will be discouraged from the development of new sites. b.
- c. Site bids will be reduced where VAT cannot be recovered. c.
- d. Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. d.
- e. Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. e.
- f. Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. f.
- g. Investors who cannot recover VAT favour unelected buildings to retain flexibility in tax treatment. g.
- h. Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents. h.
- i. Tenants who cannot recover VAT paid on rent want to pay a lower rent. i.

| | 4 | 3 | 2 | 1 | 0 |
|----|---|---|---|---|---|
| a. | | | | | |
| b. | | | | | |
| c. | | | | | |
| d. | | | | | |
| e. | | | | | |
| f. | | | | | |
| g. | | | | | |
| h. | | | | | |
| i. | | | | | |

j. Tenants who cannot recover VAT will take less floor space to offset irrecoverable VAT.

k. Tenants who cannot recover VAT will pay a premium or more rent to secure an unelected building.

l. Tenants who cannot recover VAT will move to avoid having to pay VAT on rent.

m. A two tier rental market has developed in certain commercial areas.

j.

k.

l.

m.

| 4 | 3 | 2 | 1 | 0 |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

APPENDIX 6.11

DATA SOURCES MAIN QUESTIONNAIRE CIRCULATION

OCCUPIERS - EC2/3

- source - British Insurance Companies - City Directory 10th Edition, pps.86 - 100.
- sample - EC2/3

- source - Building Societies - City Directory 10th Edition, pps.128 - 131
- sample - every other entry

- source - Merchant Banks and Securities Houses - City Directory 10th Edition, pps.2-4
- sample - EC2/3

- source - Clearing Banks - City Directory 10th Edition p1
- sample - EC2/3

- source - Property Owners listing - Yellow Pages Directory London Central 1991/92 British Telecommunications Plc, p.1521
- sample - EC2/3

- source - Commercial Concerns - RICS Geographical Directory 1991 Macmillan pps.16-18.
- sample - EC2/3

- **BRISTOL BS1**

- source - Property Owners listing - Yellow Pages Directory 1991/2 Bristol. British Telecommunications Plc. p.1071.
- sample - Bristol STD code

- source - Commercial Concerns - RICS Geographical Directory 1991 Macmillan. pps.225-226.
- sample - Bristol (Avon)

INVESTORS - EC2/3

- source - Property Investment listing - Yellow Pages Directory London Central 1991/2 British Telecommunications Plc. p1603-1604.
- sample - EC2/3

- source - Investors - Directory of Property Developers, Investment & Financiers 1988/89 Building Economic Bureau.
- sample - EC2/3
- source - Property Unit Trusts - City Directory 10th Edition, pps.85-86.
- sample - EC2/3
- source - Pension Funds - Directory of Property Developers, Investment and Financiers 1988/89. Building Economic Bureau.
- sample - Bristol

- **BRISTOL BSI**

- source - Property Investment listing - Yellow Pages Directory Bristol 1991/2. British Telecommunications Plc. p.1069.
- sample - Bristol STD
- source - Investors - Directory of Property Developers, Investment & Financiers 1988/89 Building Economic Bureau.
- sample - Bristol
- source - Pension Funds - Directory of Property Developers, Investment and Financiers 1988/89. Building Economic Bureau.
- sample - Bristol

DEVELOPERS - EC2/3

- source - Major Property Development & Investment Companies in the London Area - City Directory 10th Edition, pps.212-219.
- sample - every second entry
- source - Property Developers - Directory of Property Developers, Investment and Financiers 1988/89. Building Economic Bureau.
- sample - EC2/3
- source - Property Development listing - Yellow Pages Directory Central London 1991/92 British Telecommunications Plc. pps.1600-1603.
- sample - EC2/3

- **BRISTOL BS1**

- source - Property Development listing - Yellow Pages Directory Bristol 1991/2. British Telecommunications Plc. pps.1068-1069.
- sample - Bristol STD

SURVEYORS - EC2/3

- source - RICS Geographical Directory 1991 Macmillan, pps.15-19 & 20-21.
- sample - EC2/3. Fields of practice and nature of service: Commercial Property

- **BRISTOL BS1**

- source - RICS Geographical Directory 1991 Macmillan, p 242.
- sample - Bristol (Avon). Fields of practice and nature of service: Commercial Property

APPENDIX 6.12

RESULTS MAIN QUESTIONNAIRE CIRCULATION

6.12.1 Occupiers, Investors and Developers Questionnaires, Question 1

“Q1. Are you exempt, part exempt or fully taxable for VAT?”

| Response: | <u>Exempt</u> | <u>Part Exempt</u> | <u>Fully Taxable</u> |
|---------------------------------------|---------------|--------------------|----------------------|
| Number/ percentage of responses | 8 (11.7%) | 44 (64.7%) | 16 (23.6%) |

6.12.2.1 Occupiers Investors and Developers Questionnaires, Question 2

“Q2. What percentage of VAT are you able to recover?”

Aggregate

| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|-------------|-------------|-----------|--------------|--------------|-------------|-------------|
| Number/ percentage of responses | 11 (14%) | 22 (28%) | 3 (4%) | 9 (11.5%) | 8 (10.5%) | 11 (14%) | 14 (18%) |

6.12.2.2 Occupiers, Investors & Developers Questionnaires, Question 2 (Analysed by Category)

Occupiers

| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|------------|---------------|-------------|------------|--------------|-------------|-------------|
| Number/ percentage of responses | 8 (19%) | 15 (35.7%) | 2 (4.8%) | 8 (19%) | 5 (11.9%) | 2 (4.8%) | 2 (4.8%) |

Investors

| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|------------|------------|-----------|--------------|-----------|-----------|--------------|
| Number/ percentage of responses | 2 (25%) | 2 (25%) | 0 (0%) | 1 (12.5%) | 0 (0%) | 0 (0%) | 3 (37.5%) |

Developers

| | | | | | | | |
|---------------------------------------|-------------|--------------|-------------|-------------|-------------|------------|---------------|
| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
| Number/ percentage of responses | 2 (6.5%) | 5 (16.2%) | 1 (3.2%) | 1 (3.2%) | 3 (9.7%) | 9 (29%) | 10 (32.2%) |

6.12.3 Occupiers Questionnaire, Question 3

“Q3. Are you occupier, tenant or both?”

| | | | |
|---------------------------------------|-----------------|---------------|-------------|
| Response: | <u>Occupier</u> | <u>Tenant</u> | <u>Both</u> |
| Number/ percentage of responses | 5 (12%) | 17 (40%) | 20 (48%) |

6.12.4 Occupiers Questionnaire, Section A, Question A1

“A1. Do you pay VAT on rent?”

| | | |
|---------------------------------------|-------------|-------------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ percentage of responses | 12 (30%) | 28 (70%) |

6.12.5 Occupiers Questionnaire, Section A, Question A2

“A2. Have you ever paid VAT on rent?”

| | | |
|---------------------------------------|---------------|--------------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ percentage of responses | 21 (87.5%) | 3 (12.5%) |

6.12.6 Occupiers Questionnaire, Section A, Questions A3/A4

“A3. Order the following options based on your likely strategy to avoid this extra cost,

(1 = most likely and 6 = least likely).....”

“A4. If your landlord were to opt to tax your rent order the following options based on your strategy to avoid this extra cost.....”

| Response: | 6 Least Likely | 5 | 4 | 3 | 2 | 1 Most Likely |
|--|-------------------|--------------|--------------|---------------|-------------|------------------|
| a. Move to a building where no VAT is charged on rent. | 2 (13%) | 2 (13%) | 3 (20%) | 1 (7%) | 6 (40%) | 1 (7%) |
| b. Secure a lower rent on review | 0 (0%) | 0 (0%) | 0 (0%) | 1 (4%) | 11 (48%) | 11 (48%) |
| c. Occupy less floor space | 2 (8.5%) | 9 (39%) | 7 (30%) | 4 (17.5%) | 0 (0%) | 1 (4.5%) |
| d. Pass on as higher product prices | 2 (14.3%) | 4 (28.6%) | 4 (21.4%) | 2 (14.3%) | 1 (7.1%) | 2 (14.3%) |
| e. Accept reduced profits and pay the VAT | 2 (8.5%) | 4 (17.5%) | 3 (13.5%) | 10 (43.5%) | 2 (8.5%) | 2 (8.5%) |

6.12.7 Occupiers Questionnaire, Section A, Question A5

“A5. If you ranked A3a/A4a as “most likely” above

- a. Have or would you be prepared to pay a premium or more rent to secure a building where no VAT is charged on rent?”

| Response: | YES | NO |
|--------------------------------|-------------|---------------|
| Number/percentage of responses | 4 (8.9%) | 41 (91.1%) |

- “b. How much more: (i) rent as a % of rent paid? or”

| Response: | 1-5% | 6-10% | 11-15% | Over 15% |
|--------------------------------|------------|------------|-----------|-----------|
| Number/percentage of responses | 1 (25%) | 3 (75%) | 0 (0%) | 0 (0%) |

“(ii) premium?%
(as a percentage of current rent)”

| Response: | 1-5% | 6-10% | over 10% |
|--------------------------------|-----------|-------------|-----------|
| Number/percentage of responses | 0 (0%) | 1 (100%) | 0 (0%) |

6.12.8 Occupiers Questionnaire, Section B, Question B1

“B1. Do you hold land for the development of new premises?”

| | | |
|--------------|------------|-----------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ | 12 | 12 |
| percentage | (50%) | (50%) |
| of responses | | |

6.12.9 Occupiers Questionnaire, Section B, Question B2

“B2. Have you developed new premises since 1.8.89?”

| | | |
|--------------|------------|-----------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ | 16 | 7 |
| percentage | (69.5%) | (30.5%) |
| of responses | | |

6.12.10 Occupiers Questionnaire, Section B, Question B3

“B3. Do you intend to develop new premises?”

| | | |
|--------------|------------|-----------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ | 14 | 9 |
| percentage | (61%) | (39%) |
| of responses | | |

6.12.11 Occupiers Questionnaire, Section B, Question B4

“B4. To what extent has the introduction of VAT on development influenced your attitude towards the development of new premises? (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance)”

| | | | | | |
|--------------|----------------|-------------------------|--------------------|-----------------------------|------------------------|
| Response: | <u>Crucial</u> | <u>very significant</u> | <u>significant</u> | <u>slightly significant</u> | <u>no significance</u> |
| Number/ | 3 | 2 | 11 | 7 | 6 |
| Percentage | (10.3%) | (6.9%) | (37.9%) | (24.2%) | (20.7%) |
| of responses | | | | | |

6.12.12 Occupiers Questionnaire, Section B, Question B5, Developers Questionnaire, Question 7

“B5/Q7. Have you incurred a self supply charge, (making a taxable supply for a deemed consideration to yourself in the course of furtherance of a business)?”

| | | |
|---------------------------------------|-------------|---------------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ percentage of responses | 4 (7.5%) | 49 (92.5%) |

**6.12.13 Occupiers Questionnaire, Section B, Question B6,
Developers Questionnaire, Question 8**

“B6/Q8. If yes, on what percentage of cases?”

| | | | | | |
|---------------------------------------|------------|-----------|-------------------|------------|-------------|
| Response: | <u>1%</u> | <u>2%</u> | <u>3%.....98%</u> | <u>99%</u> | <u>100%</u> |
| Number/ percentage of responses | 1 (25%) | | | 3 (75%) | |

**6.12.14 Occupiers Questionnaire, Section B, Question B7,
Developers Questionnaire, Question 9**

“B7/Q9. Have you had to pay VAT on total site value where only part of the site has been developed?”

| | | |
|---------------------------------------|------------|-------------|
| Response: | <u>YES</u> | <u>NO</u> |
| Number/ percentage of responses | 3 (6%) | 49 (94%) |

**6.12.15 Occupiers Questionnaire, Section B, Question B8,
Developers Questionnaire, Question 10**

“B8/Q10. If yes, on what percentage of cases?”

| | | | | | | | |
|--------------------------------------|--------------|-----------|-------------------|--------------|--------------------|------------|--------------|
| Response: | <u>1%</u> | <u>2%</u> | <u>3%.....49%</u> | <u>50%</u> | <u>51%.....98%</u> | <u>99%</u> | <u>100%</u> |
| Number Percentage of responses | 1 (33.3%) | | | 1 (33.3%) | | | 1 (33.3%) |

6.12.16 Investors and Developers Questionnaires, Question 3

“Q3. On what percentage of properties do you charge VAT on rents?”

Surveyors questionnaire, Question 1

“Q1. On what percentage of your clients’ property portfolio have they opted to tax rents?”

| Response: | 0% | 1-20% | 21-40% | 41-60% | 61-80% | 81-99% | 100% |
|---------------------------------------|--------------|---------------|-----------|-------------|-------------|--------------|------------|
| Number/ percentage of responses | 8 (14.5%) | 22 (40.5%) | 5 (9%) | 2 (3.5%) | 3 (5.5%) | 9 (16.5%) | 6 (11%) |

6.12.17 Investors and Developers Questionnaires, Question 4

“Q4. What percentage of your commercial property portfolio is held for:”

Surveyors Questionnaire, Question 2

“Q2. What percentage of your clients’ property portfolio is held for:”

| Response: percentage responses | <u>Investment</u> | <u>Development</u> | <u>Other (Specify)</u> |
|--------------------------------------|-------------------|--------------------|------------------------|
| | 67% | 28% | 5% |

6.12.18 Surveyors Questionnaire, Question 3

“Q3. Are you aware of any overseas investors who have been unwilling to invest in the UK as a result of the VAT treatment of UK property?”

| Response: | <u>YES</u> | <u>NO</u> |
|---------------------------------------|-------------|---------------|
| Number/ percentage of responses | 1 (6.6%) | 14 (93.3%) |

6.12.19 Investors and Developers Questionnaires, Question 5, Surveyors Questionnaire, Question 4

“Q4/5. Assess the following statements based on your own experience: (4 = always true, 3 = mostly true, 2 = sometimes true, 1 = little truth, 0 = never true).”

| Response: | <u>Always True</u> | <u>Mostly True</u> | <u>Sometimes True</u> | <u>Little Truth</u> | <u>Never True</u> |
|---|--------------------|--------------------|-----------------------|---------------------|-------------------|
| Investors will continue to opt to tax rents after purchasing a let commercial building where VAT is already being charged on rents. | 13 (52%) | 9 (36%) | 3 (12%) | 0 (0%) | 0 (0%) |

| Response: | Always True | Mostly True | Sometimes True | Little Truth | Never True |
|--|---------------|---------------|----------------|---------------|-------------|
| Site bids will be reduced when VAT cannot be recovered. | 14 (27%) | 17 (33%) | 12 (23%) | 6 (11.5%) | 3 (5.5%) |
| Investors who cannot recover VAT favour unelected buildings to retain flexibility in tax treatment. | 7 (29%) | 9 (37.5%) | 6 (25%) | 2 (8.5%) | 0 (0%) |
| Investors who cannot recover VAT are unwilling to fund new freehold commercial schemes. | 1 (4.5%) | 7 (30.5%) | 9 (39%) | 6 (26%) | 0 (0%) |
| Investors who cannot recover VAT prefer to take a long lease of a new commercial building with an option to purchase the freehold after three years. | 2 (11.8%) | 5 (29.4%) | 5 (29.4%) | 5 (29.4%) | 0 (0%) |
| Investors who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. | 2 (9%) | 4 (18%) | 7 (32%) | 9 (41%) | 0 (0%) |
| Tenants who cannot recover VAT paid on rent want to pay a lower rent. | 16 (31.5%) | 18 (35.5%) | 10 (19.5%) | 6 (11.5%) | 1 (2%) |
| Developers will opt to tax every new freehold commercial building to ensure the recovery of VAT on construction costs and site purchase. | 11 (24.2%) | 25 (55%) | 5 (11%) | 1 (2.2%) | 3 (6.6%) |
| Developers who cannot recover VAT favour refurbishment as there is no VAT on site costs to pay. | 1 (4%) | 3 (12.5%) | 11 (46%) | 4 (16.5%) | 5 (21%) |
| Developers who cannot recover VAT will be discouraged from the development of new sites. | 2 (4.5%) | 21 (48%) | 12 (27%) | 7 (16%) | 2 (4.5%) |
| Tenants who cannot recover VAT will take less floor space to offset irrecoverable VAT. | 0 (0%) | 0 (0%) | 2 (13.3%) | 10 (66.6%) | 3 (20%) |
| Tenants who cannot recover VAT will pay a premium or more rent to secure an unelected building | 0 (0%) | 3 (20%) | 6 (40%) | 5 (33%) | 1 (7%) |
| Tenants who cannot recover VAT will move to avoid having to pay VAT on rent | 1 (7%) | 0 (0%) | 3 (21.5%) | 10 (71.5%) | 0 (0%) |
| A two tier rental market has developed in certain commercial areas. | 0 (0%) | 3 (20%) | 6 (40%) | 6 (40%) | 0 (0%) |

6.12.20 Investors and Developers Questionnaires, Question 6

“Q6. Based on your own experience, indicate to what extent the VAT position will affect whether a scheme will proceed. (4 = crucial, 3 = very significant, 2 = significant, 1 = slightly significant, 0 = no significance).”

| Response: | crucial | very significant | significant | slightly significant | no significance |
|---------------------------------------|-------------|------------------|---------------|----------------------|-----------------|
| Number/ percentage of responses | 2 (5.5%) | 9 (25%) | 15 (41.7%) | 8 (22.3%) | 2 (5.5%) |

APPENDIX 7

TOWARDS A CONCEPTUAL FRAMEWORK FOR A MODEL OF THE COMMERCIAL PROPERTY MARKET

Chapter 4 considered economic price theory as a possible explanation of the impact of waiver of exemption on the commercial property market. It was shown that in applying this theory, which predicts the effect of taxes on the demand and supply of a commodity, to the commercial property market, that rents would be lower post-tax and there would be a fall in the quantity supplied.

It was concluded that to further this research a quantitative analysis would be required to derive the demand and supply curves for the commercial property market and that this was beyond the scope of this research. This appendix begins to consider how this quantitative analysis might be approached.

An initial literature review of housing market models was carried out in an attempt to find a model which might be adapted for the commercial property market.

This appendix begins by considering some significant characteristics of the commercial property market and then focuses on MacLennan's approach to housing market models as a basis for developing a conceptual framework for a model of the commercial property market. This framework is critically discussed towards the end of this appendix.

Finally issues including data/resource requirements and collaboration are considered and the appendix concludes with an analysis as to how this research might proceed.

CHARACTERISTICS OF THE COMMERCIAL PROPERTY MARKET

Property is generally recognised as a multi-dimensional commodity embodying a variable mix of characteristics, from which consumers demand a flow of services. The commercial property market comprises a series of complex mechanisms.

There are several features of this market and its mechanisms which suggest that it will not conform to the simple assumptions associated with other models such as those of the housing market.

For example individuals will transact in the market infrequently. Whilst they may obtain some general market information from sources such as the media, this will not be of sufficient detail to base specific choice decisions.

The nature of the market which experiences constantly changing property characteristics, prices and vacancy rates ensures that information once obtained will quickly become obsolete. Potential movers are thus faced with a situation of imperfect information.

Purchasers will generally wish to evaluate each property in some detail as an acquisition which is less than satisfactory may involve a considerable loss and may be difficult to reverse in the short term.

The complexity of commercial property further exacerbates the problem of evaluation and may mean that individuals are open to influence by property market professionals who shape their tastes and choices.

The dispersed spatial nature of property will add time, travel and psychic costs to the search process.

The general system of renting commercial property does not conform to the assumptions of housing market models which relate to the single transaction of house purchase.

There are a number of factors associated with the commercial property market such as lags in the supply of new completions, fixity of the second-hand stock and reliance on institutional finance which result in an almost constant disequilibrium within the market.

The following section goes on to consider MacLennan's (1) approach to modelling the housing market which may overcome some of the problems discussed in this section associated with modelling the commercial property market.

MACLENNAN'S ALTERNATIVE APPROACH

Housing market models may represent a satisfactory explanation of parts of the housing market. For example, MacLennan suggests that;

“...the filtering model was evaluated as being a series of specific, inductively based hypotheses which may have applicability in some locations and periods...” (2)

The essential problem is that these models cannot serve as general models of urban housing demand or housing market dynamics.

MacLennan (3) goes on to suggest an alternative approach to housing market models, which is equally applicable to the commercial property market. This continues to apply economic principles within a structure of concepts and assumptions.

MacLennan suggests a series of detailed analyses of the urban economy which will build up a general and relevant level of understanding which may exceed the understandings derived from general equilibrium models which start with a series of overgeneralised assumptions. In essence the approach suggested represents an aggregation of a series of individual studies of constituent parts of the market to provide a representative explanation of the whole.

The remainder of this section outlines a possible framework for the economic analysis of the commercial property market based broadly on Maclennan's alternative approach.

A POSSIBLE FRAMEWORK FOR THE ECONOMIC ANALYSIS OF THE COMMERCIAL PROPERTY MARKET

The Concept of Equilibrium

Maclennan argues that it is essential to develop a broader concept of equilibrium which is more appropriate to the property market. Presenting the case for a change in the traditional methods of equilibrium analysis, Maclennan uses the case against the assumption of a state of long-run competitive equilibrium in the access-space model, presented by Whitehead and Odling-Smee;

“The concept of equilibrium in the conventional sense is particularly inappropriate in the urban housing market because such factors as transaction costs are of more than usual importance.” (4)

Maclennan then proceeds to argue that alternative concepts of equilibrium can be developed which do not imply the existence of perfect economic order and the absence of frictions such as that presented by Hahn who argues that it is;

“...reasonable to require of our equilibrium notion that it should reflect the sequential character of our actual economies, (and that) this in turn requires that information processes and costs, transactions and transaction costs and also expectations and uncertainty be explicitly and essentially included in the equilibrium notion.” (5)

Maclennan argues that even at an aggregate level and over a period of comparable episodes Hahn's state of equilibrium would hold in a set of structurally stable equations describing successive periods.

Housing Choice and Demand

Maclennan then proceeds to develop a research framework for analysing the process of housing choice and demand, drawing on models of mobility and spatial search behaviour developed in urban geography by Moore/Clark and the information and adjustment models of Phelps and Pissarides (6)

Maclennan's framework of housing choice and demand is an extension and formalisation of the mover-stayer model used in the analysis of population migration, shopping behaviour and labour market analysis. Maclennan's analysis focuses on the household or in the case of commercial property the individual or individuals responsible for making the decision to move, ie the decision taker(s).

The model framework proposed does not assume a specific market structure nor that a neoclassical equilibrium is a necessary component of conceptual organisation.

The conceptual framework does make some broad assumptions about the structure of what in this case would be the commercial property choice decision. The direct linkages between individuals and market institutions are identified.

To make the framework operational and measurable certain additional conceptual boxes are introduced, eg pre-search aspirations. The framework does not make a priori assumptions regarding the objects of process or choice. No prior assumption is made regarding the behavioural assumptions by which the stages of the choice decision are linked.

Maclennan initially assumes that the household is receiving a given utility or satisfaction from their present dwelling. This assumption may be extended to commercial property where the occupier can be assumed to be receiving a given level of satisfaction from their present property.

Each occupier has a series of activities, requiring inputs of time and resources which are related to the characteristics of the property, location and neighbourhood. Decision taker(s) may not be equally satisfied or dissatisfied with their property provision.

For a move to occur the decision taker(s) must perceive a minimum threshold of dissatisfaction. The impetus to move may occur over time as this may be necessary to recognise dissatisfaction.

Maclennan identifies a series of "triggers" (7) which determine when the household will actively enter the housing market. These include long term events such as increasing income, family size and others which are well defined in established models such as filtering. An important area of research will be to establish what triggers the decision taker(s) into action.

It is possible to identify a number of triggers in the commercial property market which may initiate the decision to actively enter the market. For example, the general state of the economy may trigger expansion or contraction of a firms operation requiring more or less commercial property.

Changes in population structure may influence the demand for firms products and hence their space requirement. A sudden increase in the availability of credit or a reduction in interest rates may allow firms the opportunity for expansion. Changes in infrastructure such as a new road or rail link may provide an opportunity to reduce costs by moving to another location which has become more accessible.

Changes in technology may trigger a requirement for new premises. For example computerisation may require a building with improved floor loading. Changes in government regulations such as hygiene may produce a situation where it is more cost effective to move to alternative premises than to upgrade existing.

The Process of Evaluation

The next step will be for the decision taker(s) to evaluate alternative premises. This process of evaluation is complex for the commercial property market. It may be assumed that the decision taker(s) will have some form of utility function for commercial property the precise details of which cannot be known or assessed a priori by the researcher. The particular form of this utility function is an important research issue. This should not be assumed or initially imposed.

Maclennan suggests that a possible approach based on a research survey strategy may be appropriate. This would ask respondents to attach an importance or rank to the characteristics of property which influence their choice.

Such an approach could be adapted in the context of commercial property. A number of characteristics which might influence choice are immediately apparent such as government intervention, costs of occupation, nature of the built environment and location.

Governments may influence the choice of commercial property by either taxation or allowances. An example of the latter would be enterprise zones or freeports. Government intervention may also have an indirect influence, for example, security of tenure legislation.

Costs of occupation often represent a commercial occupiers main outgoing. These include rent, rates, heat, light power, insurance and repairs. The opportunity to reduce the costs of occupation may often be a compelling reason to move.

The nature of the built environment will also influence the choice of commercial property. This may be subdivided into a number of factors which include the building's size; normally occupiers would be unwilling to rent more than they require as this may add to costs. Age will also be an important characteristic. Older obsolete buildings may add to repair costs but may be available at lower rents.

High standards of design and specification may be an important characteristic for companies seeking a prestigious headquarters building. The availability of suitable buildings may restrict the decision takers choice of commercial property.

The increasing use of the car as a principal means of transport has led to the increasing need for car parking on site or close by. For some occupiers this may be a particularly important factor in their choice of commercial property.

Location continues to play an important role in the income generating capacity of land and buildings. Kowalski and Paraskevopoulos (8) in a recent paper on the impact of location on urban industrial land prices allude to its importance. They conclude that location close to communication links and within industrial park themselves have positive impacts on unit prices.

Access to good transport facilities may be a particularly important requirement for some occupiers such as those who require raw materials and products to be transported by road. Access to the labour market may be an important requirement for labour intensive industries. The quality of environment may be important to office users.

MacLennan suggested that uncertainty with regard to income, the pattern and level of excess demand and search costs may also influence property evaluation.

The Search Process

The decision taker(s) will next move to the active search process which MacLennan identified as comprising three distinct phases. Prior to the active search phase the decision taker(s) will form aspirations or targets, on a limited number of targets which they can obtain, eg rent, size and location. During this phase the decision taker(s) will receive information from a number of indirect sources such as local press or casual acquaintances.

The second phase is denoted by a careful scrutiny of different alternatives. In this phase random search is abandoned in favour of an ordered pattern of search in relation to broadly defined initial aspirations and perceived constraints.

The third phase is characterised by a detailed evaluation of specific properties. This phase would include obtaining detailed information such as surveys or schedules of dilapidation. Costs will be incurred in obtaining this information and visiting potential properties. Details of the costs of moving will be established in terms of a number of factors including social aspects such as the impact on their existing labour force as well as the actual cost of the physical move.

The Bid Formation Process

Having evaluated the alternatives, the decision taker(s) moves into a bid formation process which may be heavily influenced by the institutions in the commercial property market.

This is an area where significant research will be required to establish the market mechanism linking the bid formation process with the utility function, for example, how decision taker(s) relate characteristics such as the built environment to rent bids.

Horowitz's research (9) into bidding models of the housing market may assist in research into the bid formation process.

The nature of the firm may be an important consideration in the bid formation process. Major international companies such as ICI may adopt a different approach to regional or local companies.

The tax status of the occupier may also be an important influence. KFR (10) suggest that exempt occupiers will be attracted to unelected buildings and the requirement to pay VAT might influence exempt companies rent bids.

Closely linked to the bid to rent commercial property will be the terms of occupation. These may influence the nature of the bid. For example the rent review patterns may influence the level of rent. A tenant may be prepared to offer a higher initial rent for a lease with a longer review period.

The repairing liability under the lease may also affect the rent bid. An occupier with an internal repairing lease may be prepared to pay more rent because his repairing liability is likely to be less than an occupier taking a full repairing lease.

Leases which adversely affect the occupiers ability to assign or sub-let his interest may affect the rent bid. For example an occupier who needs to move regularly may be prepared to pay more rent for a short term lease.

The user clause in a lease may also be an important factor when considering the rent bid. Tenants may benefit from an open user which may ensure an easier disposal of their interest. However landlords may require a higher rent for an open user clause.

The formation of a bid-price, particularly the negotiations which take place between landlord, tenant and their professional advisers, is clearly another important area of research. It would be incorrect to make a priori assumptions regarding this at this stage.

Maclennan suggests that in forming a bid-price which is considered acceptable, the decision taker(s) form a direct link with the supply side of the property market. The supply side of the model will be examined in the following section.

Supply

It is proposed that the supply side of the model will be treated in an essentially similar manner to the demand side of the model discussed above.

Whitehead suggests that;

“the supply of accommodation in the UK is made up of the stock of existing housing + the supply of new private dwellings (completions) + conversions less demolitions.” (11)

A similar statement can be made about the supply of commercial property in the UK, which is made up of the stock of existing commercial property + new commercial property (including conversions) less demolitions.

Maclennan suggests that;

“.....in examining the supply side of the housing system, the focus of interest rests upon how the flow of housing services supplied in the market will vary with house price changes.” (12)

This suggests that a model of the supply side of the commercial property market should focus on how the flow of commercial services supplied varies with changes in price/rental levels. The next two sections consider firstly the supply of existing commercial stock and then the supply of new commercial property.

The Supply of the Existing Commercial Stock

The supply of existing commercial property will either be from owners or tenants wishing to dispose of their interest.

Occupiers may be assumed to derive a given level of utility from occupying commercial property. It may therefore be possible to derive a utility function for occupiers, identifying and ranking those characteristics of commercial property which are important to this group.

Landlords willingness to hold a desired inventory of vacant space is considered by Shilling, Sirmans and Corgel (13) in their paper on the price adjustment process for rental office space. Research by Steven Grenadier (14) into local and national determinants of office vacancies may also prove useful in researching this part of the model.

A number of potential characteristics are immediately apparent and these are considered below.

An important motivation in holding commercial property is as a means of storing wealth and generating income. Its ability to maintain and improve on both these factors will affect its attractiveness.

Investment in commercial property may be only one of the investment opportunities open to companies and individuals. The return from other methods of investment will also be an important consideration. For example investing in stocks may yield a better return without the problems of managing rented property causing investors to switch. This represents an important link between the commercial property and investment markets which will be an important area of research.

In many cases the purchase of investment property will be funded with borrowed money. Interest rates and the availability of sources of funding may be important factors in the supply of commercial property. Funding for commercial property may be restricted to the major international banks. This represents an important link between the commercial property, government interest rate policy and the financial markets which once again will form an important area of research.

Landlords willingness to supply property to let may also be influenced by government through taxation, at a local level in the form of rates and at a national level through capital taxes, ie empty rates. Central government may also influence the willingness of investors to make available commercial property to rent through legislation such as security of tenure.

Another source of supply of existing commercial stock is from tenants wishing to assign their leases. It is possible to identify a number of factors which trigger disposals, for example, companies contracting in a recession or needing to relocate.

Tenants may want to move but may have difficulty in assigning their lease. Factors such as the form of assignment clauses within leases and the general state of the economy may be important influences on the supply of existing stock from tenants.

Thus it may be possible to identify the market mechanisms which underpin the supply of existing commercial property. The following sections goes on to consider the supply of new commercial property.

The Supply of New Commercial Property

The supply of new commercial property for rent is provided by construction firms building for owner occupiers and investors who may retain the freehold and let to tenants.

It is possible to recognise three distinct phases in the development of new commercial stock; a demand assessment phase, where the objectives of the development are set out and the production decision is made; the project planning phase, linking the supply of commercial property to the land and capital markets; and the construction phase, linking the supply of commercial property to the labour and materials markets. Each phase and its linkages with other markets will be considered briefly below.

The Demand Assessment Phase

Before embarking on a scheme to develop new commercial property the instigator will almost certainly undertake an assessment process to establish the market for the completed property.

This will include an assessment of needs, requirements and some basic indication of the cost of the scheme. For investors this may also include an assessment of the state of the commercial property market, other markets and the anticipated income from the completed project.

An important part of the research will be to establish what investment criteria investors seek from commercial property market, other markets and the anticipated income from the completed project.

The investment criteria might include the likely rent, size and style requirements of potential occupiers, locations available/favoured, demand from potential occupiers, rental/capital growth and vacancies. This research might include shopping surveys, the assessment of risk and the possibility of pre-lets.

The income generating capacity of the completed property will be a particularly important factor to any investor involved in commercial property development. This will include not only its ability to generate income but to sustain this and grow in real terms. Acceptable rates of return may vary between investors.

The decision to build is likely to be based as much on future expectations of rental levels as on existing. It might be at this point that an assessment of how the supply will vary dependent on rental levels will be made.

Government policy may influence the decision to construct a new commercial building in a particular location, for example incentive schemes designed to regenerate depressed areas.

Having made the decision to develop a new commercial building the next phase of the supply of new commercial stock is reached.

The Project Planning Phase

In this phase the detailed planning of the project begins.

Most new development is funded on borrowed money. Interest rates and the availability of credit will be important influences on the supply of new housing stock. Rising interest rates may have a significant impact on the cost and viability of any scheme. This represents an important link between the supply of new commercial stock and the capital markets.

The costs of the scheme will represent a major influence on the supply of new commercial property. For example in periods of high cost inflation the project may no longer be viable and the scheme aborted. Costs will include professional fees (architects, planning) in addition to the building costs of the project. Design costs may be influenced by new innovations for example system building.

Land costs often represent a significant percentage of the total costs of any scheme. This represents an important link with the land market. Land banking has become an important feature of modern property development. This involves the buying and holding of land for development now in the expectation of future development and increase in land costs.

Land may be held with planning permission and designs available to reduce the reaction period. This represents an important link between the supply of new commercial stock and the planning process which will be another important area of research.

Having completed the planning phase construction of the project may be commenced.

The Construction Phase

This phase involves the construction of the new commercial building which may take several years. The supply of new commercial property may also be influenced by those engaged to complete the development and by the structure of the construction industry. The industry is characterised by a large number of small firms and low productivity.

A large number of small firms suggests an industry which is highly competitive. But in certain circumstances, for example, where the project is specialised only a limited number of companies would be able to provide the necessary skills to complete the process and the market is much less perfect. The industry is highly labour intensive having strong links with the labour market and wage rates. Sustained periods of high wage inflation may be a particular problem for costs. The requirement for large scale project management and control of some developments may add significantly to costs.

There is likely to be a time lag between commencement and completion of the project. This may have a significant impact on the variables within the scheme, which may change over time. Climatic factors may also influence the completion date often causing delays during winter months.

Investors may be forced to revise their assessment as variables change over time. For example the demand for the completed development may change before completion. Thus the influence of time on the supply side of the market will be of considerable significance and an important area of research.

The development costs of any scheme will be closely linked to the market for materials. Maclennan (15) suggests that forty percent of the value of contractors output is materials and these are very important in the overall process.

At some point, usually after the planning phase or even on completion of the construction of the commercial project the process moves to the active search phase which is examined below.

The Active Search Phase

Once the commercial property is available either as new or existing stock the person responsible for the disposal of that property enters an active search phase to find a suitable occupier.

This process will often involve property professionals and will represent an important area of research. Costs will be involved as commercial property agents are likely to be instructed to dispose of the property. Active marketing may be undertaken with expenditure on promotion.

The process ends by identifying a suitable occupier linking the demand and supply sides of the model through the bid-acceptance process. This process involves agreement of terms and the conclusion of the deal.

In conclusion, MacLennan suggests that;

“A behavioural approach has much to commend it.” (16),

enabling market imperfections, uncertainties surrounding the development decision and the objectives of the developer to be clearly stated. Such an approach also enables important links between the supply of commercial property, the land, capital, labour and material markets to be fully investigated.

But MacLennan is under no misapprehension that;

“The housing supply curve is as difficult to identify, measure and interpret as housing demand.” (17)

CONCLUSIONS

This conceptual framework for a model of the commercial property market follows the approach suggested by MacLennan to analyse consumer urban housing choice and demand. The approach is based on the aggregation of detailed individual studies to provide a model of the whole market.

Demand is assessed on the basis that decision taker(s) derive a given level of satisfaction from occupying commercial property. Triggers can be identified which initiate a requirement to move and an evaluation process begins. The decision taker(s) will then formulate a bid.

At this point the link with the supply side of the model is established. The processes which underpin supplying new and existing commercial property can be identified. Once the production or disposal decision has been made the process may then enter an active search phase to find a suitable occupier sometimes in conjunction with the detailed planning and construction processes. The process ends with bid-acceptance linking with the demand side of the model.

This approach is more detailed, less disaggregated and less hypothetical than neoclassical models of the housing market. Its usefulness has yet to be established but a number of arguments can be advanced in its favour;

- (1) This approach lays stress on identifying through a detailed study of those involved in the decision process how commercial property choice is made.
- (2) The model takes into account the market mechanisms and processes, allowing for their adjustments.

- (3) The role of the property professional is allowed for.
- (4) The framework allows for the quite obvious links between demand and supply which are not treated in isolation.
- (5) The model enables the use of earlier neoclassical/other models where appropriate and useful.

The preceding sections begin to develop a conceptual framework for a model of the commercial property market. It is apparent that the market is highly complex and considerable further research into the various market mechanisms will be required. MacLennan summarises the research required by stating that;

“it is only by embarking on a long series of widespread and systematic studies of the housing choice processes that richer insights for theory and policy will be gleaned.” (18)

The following section goes on to consider the data/resource requirements and the possibility of collaboration in the context of developing model of the commercial property market.

DATA REQUIREMENTS, COLLABORATION AND RESOURCE REQUIREMENTS

Wheaton and Torto summarise the essential difficulty for researchers of commercial property, thus;

“Research about commercial property markets has been hampered by the general absence of information on rental rates. Without systematic data about rents and prices, much of the research done on housing has yet to be duplicated in the commercial space market” (19)

It is difficult at this conceptual stage to identify precisely the data requirements. However, these fall into three broad areas based on the framework developed in the preceding section;

- (1) information about property characteristics such as rent, occupation costs and lease terms;
- (2) economic data, including information on financial markets, interest rates, credit and the general state of the economy; and,
- (3) miscellaneous data shown to be connected with the operation of the commercial property market, such as population data, information about the labour and materials markets.

Economic and miscellaneous data is available through such mediums as the Census, Bank of England Bulletins and Central Statistical Office Financial Statistics. But, as

Wheaton and Torto suggest, commercial property data is scarce. Some of the larger commercial property agents have their own research departments which produce data on commercial property. But this is often specific to a particular area or type of property (eg Knight Frank Rutley Quarterly Report on Central London) and do not provide the detailed information which would be necessary in modelling the whole commercial property market.

It may therefore be necessary to collect the data required from source and this has implications for both resource requirements and collaboration. It is obvious that to attempt to model the commercial property market is a considerable undertaking because of the markets complexity. It would be impossible to attempt to produce a model of the commercial property market without the assistance of a collaborating organisation to provide the resource requirements necessary in terms of accessing raw data.

An organisation is unlikely to be interested in collaboration without return and MacLennan alludes to the benefits of further research into housing supply thus;

“A more precise understanding of the housing supply system would contribute to housing theory, the development of housing policy, the overall modelling of the urban economy, and interpretation of the macro-economic role, both in relation to output and inflation of the housing system.” (20)

The incentive, is then the same for those involved in commercial property, that by extending research into this area the operation of the market and possibly the potential for increased profits will be improved by increased knowledge.

It is possible to identify those who have an interest in commercial property and might represent potential collaborating organisations. It is now recognised that commercial property is an important part of the overall economy and the Government may be interested in research which might further develop that sector of the economy.

Those directly involved in the operation of the market itself may represent potential collaborating organisations with the required resources and good access to raw data. These might include those involved in investment, such as pension funds; those involved in development, such as the national developers, Wimpey, Laing, Costain, etc; and those involved as commercial property agents, such as the research departments of Richard Ellis, Jones Lang Wooton, etc.

Finally those already undertaking research in this and associated areas may represent potential collaborating organisations. These might include university departments both in the UK and overseas.

Having established the data, resource requirements and the potential for collaboration at this early conceptual stage, the following section goes on to provide a critique of this conceptual framework for a model of the commercial property market.

CRITIQUE OF THE CONCEPTUAL FRAMEWORK FOR A MODEL OF THE COMMERCIAL PROPERTY MARKET

This section provides a critical analysis of the conceptual framework for a model of the commercial property market discussed in the preceding sections. The principal areas of criticism are that the model framework lacks rigour; that there are problems with specification, linkages and data availability.

It is apparent based on the foregoing analysis that the commercial property market, like the housing market, is extremely complex. The conceptual framework discussed in the preceding sections may be criticised on the basis that it does not represent a rigorous appraisal. The above framework does not represent a set of well defined and accepted concepts and research techniques which form a basis for hypothesis derivation and testing. However, it is not possible to provide a rigorous appraisal at this early conceptual stage because the model will evolve as the research progresses.

It may also be argued that the model framework in its present form represents a set of empty boxes which will remain unfilled because of the expense of observing the market. The lack of suitable data presents a particular problem. MacLennan (21) points out that the absence of a wide base of empirical research presents problems in making generalisations, for example, about the characteristics of the search process. His suggested approach is only a "tentative outline" which relies on limited empirical backing. It is recognised that there are few empirical estimates of either demand or supply side parameters available for discussion, factors which make model specification particularly difficult at this conceptual stage.

The framework may be criticised as loose and the specification of some parts of the model is extremely limited. But this is necessary because there should be no a priori assumptions which restrict the model. To illustrate, it is recognised that the property function is complex and there is little empirical evidence that property attributes actually satisfy wants. Rather than imposing a particular form of utility function a priori it should be an important research question to establish which attributes are important and further how such sources of satisfaction vary across different groups. It is vital that the importance of attributes is identified by research rather than inferred from ex-post market data. Particular care is required to avoid oversimplification and assumptions which are devoid of reality, the pitfalls of many earlier models of the housing market.

Both Whitehead and MacLennan, the latter by reference to research into the labour market (22), highlighted the problem that to produce meaningful research this must be undertaken over several years. MacLennan suggests over twenty. This would present practical difficulties, not only in terms of how to observe the market over such a long time period, but also in collaboration with many years research being required before any return could be achieved.

Whilst it may be possible to study market mechanisms and processes at a micro-economic level, there may be particular problems in the aggregation processes to

form a model of the whole market. The very diversity of the market itself, for example, office, industrial, retail - primary, secondary, tertiary, shopping centres, parades, kiosks, etc. may present particular problems in the aggregation process.

In carrying out research into waiver of exemption it is necessary to consider changes in rent. This requires the exclusion of the owner occupied sector of the market. There may be difficulties in isolating this part of the market.

Chapter four established that the impact of waiver of exemption is specific to a particular sector of the commercial property market, exempt occupiers. The model fails to specify how the impact of waiver of exemption on a small sector of the market will be isolated and researched. There may also be difficulties in isolating waiver of exemption from the other tax changes including those introduced as part of the Finance Act 1989.

It is also recognised that there are a limited number of fully exempt tenants on which to base any research and this may present particular problems in producing a representative sample.

Hahn's equilibrium assumes rational plans and feasible reactions are instantly reconciled. MacLennan suggests that equilibrium will occur when the behaviour of economic agents becomes repetitive. But is equilibrium in the commercial property market ever achieved? Will it be possible to examine the commercial property market in the terms of economic price theory? These are questions which can only be answered by further research and the following section examines how this research might proceed.

HOW FURTHER RESEARCH MIGHT BE APPROACHED

A conceptual framework for a model of the commercial property market has been developed on the basis of an alternative approach to the housing market model suggested by MacLennan in this appendix.

This conceptual framework was criticised in terms of rigour, specification and data availability. It will be necessary to overcome these criticisms of the conceptual framework as the research progresses.

The next step will be to undertake a comprehensive literature review. This may not only assist in identifying a suitable collaborating organisation or individual which will be necessary before data collection could begin, but may also assist in refining the existing model framework and developing the research methodology.

Only when these issues have been addressed satisfactorily will it be possible to begin the process of data collection to test the hypotheses which have been developed. This data collection will almost certainly begin at a micro-economic level with aspects such as the composition of the utility function or identifying triggers.

The task is complex but this in itself is not considered sufficient reason to abort the research because it is only by research that a deeper knowledge of the operation of the commercial property market will be gained.

- (1) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.59.
- (2) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.59-75.
- (3) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.62-63.
- (4) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.62-63.
- (5) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.63.
- (6) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.65.
- (7) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.67.
- (8) Kowalski, J. G. and Paraskevopoulos, C. C. January 1990, The impact of Location on Industrial Land Prices, Journal of Urban Economics, vol. 27, No. 1 Academic Press Inc, pp.16-24.
- (9) Horowitz, J. L. September 1986, Bidding Models of Housing Markets. Journal of Urban Economics, vol. 20, No. 2, Academic Press Inc, pp.168-190.
- (10) Knight Frank Rutley Research, 1989, The Impact of VAT on the commercial property market, p.10.
- (11) Whitehead, C. M. E. 1974, The UK Housing Market: An Econometrical Model. Saxon House/Lexington Books, p.105.
- (12) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.94.
- (13) Shilling, J. D, Sirmans, C. F, and Corgel, J. B. July 1987, Price Adjustment Process for Rental Office Space, Journal of Urban Economics, vol. 22, No. 1 pp.90-100.
- (14) Grenadier, S. R. January 1995, Local and National Determinants of Office Vacancies, Journal of Urban Economics, vol. 37, No. 1, pp.57-71.
- (15) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.94.
- (16) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.110.
- (17) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p. 110.
- (18) MacLennan, D. 1982, Housing Economics, Longman Group Ltd, p.75.
- (19) Wheaton, W. C. and Torto, R. G. March 1994, Office Rent Indices and their behaviour over time, Journal of Urban Economics, vol. 35, No. 2, Academic Press Inc, pp.121-139.

- (20) Maclennan, D. 1982, Housing Economics, Longman Group Ltd, p.110.
- (21) Maclennan, D. 1982, Housing Economics, Longman Group Ltd, p.71.
- (22) Maclennan, D. 1982, Housing Economics, Longman Group Ltd, p.65.