TC02735

Appeal number: TC/2012/00228

VALUE ADDED TAX — VATA s 35, Sch 8 Group 5 Note (2) — "do it yourself" builders' scheme — whether relevant conditions met — yes — appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HENRIETTA PEARSON **Appellant**

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

Tribunal: JUDGE COLIN BISHOPP
MR RICHARD THOMAS

Sitting in public in London on 11 October 2012 and 19 April 2013

Mr Ian Wadhams CTA, of Ingenhaag LLP, for the Appellant

Mr Les Bingham, Officer of HMRC, for the Respondents

DECISION

1. The appellant, Lady Henrietta Pearson, is the owner of a property known as Hollowell Lodge Barn, situated in Northamptonshire. At the beginning of the period with which we are concerned, the property was a semi-derelict former farm building consisting of a disused barn with what had probably been an animal shed adjoining it. On 8 January 1997 the local planning authority, Daventry District Council, granted planning permission for the "conversion of barn to provide holiday accommodation". We were told that work started in about 2000, but was not complete and the building was still uninhabitable, when a second application for planning permission was made. That permission was granted on 31 January 2007 and authorised the "[c]hange of use of existing holiday accommodation and conversion of adjoining barn to form one live/work unit". The appellant explained, and we accept, that the reference to an "adjoining barn" was in fact to the animal shed, and that the "existing holiday accommodation" was the barn.

2. The question before us is whether the work, or the greater part of the work, undertaken at the property on the strength of those planning consents is zero-rated, as the appellant contends; or whether some of the statutory requirements are not met with the consequence that the work is standard-rated, as HMRC argue. The matter reaches us by way of an appeal against HMRC's refusal, conveyed by letter of 15 September 2011 and upheld on review, to repay to the appellant the VAT, amounting to £40,233.18, she had incurred on the building costs. No issue is taken about the amount of the claim; the only issue we are required to determine is whether the conditions on which a repayment may be made are satisfied.

3. Those conditions are prescribed by s 35 of the Value Added Tax Act 1994. The purpose of the section, broadly speaking, is to put those undertaking the construction of a new dwelling, or the conversion of an existing building into a dwelling, on the same footing as a commercial builder, who is able to recover most of the VAT incurred in the course of the construction, while incurring no output tax liability as the supply of the completed dwelling is zero-rated.

4. The relevant parts of s 35 provide as follows:

> "(1) Where—
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> (a) a person carries out works to which this section applies,
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> (b) his carrying out of the works is lawful and otherwise than in the course or furtherance of any business, and
>
> (c) VAT is chargeable on the supply, acquisition or importation of any goods used by him for the purposes of the works,
>
> the Commissioners shall, on a claim made in that behalf, refund to that person the amount of VAT so chargeable.
>
> (1A) The works to which this section applies are—
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> …
>
> (c) a residential conversion.
>
> …

(1D) For the purposes of this section works constitute a residential conversion to the extent that they consist in the conversion of a non-residential building, or a non-residential part of a building, into—

(a) a building designed as a dwelling or a number of dwellings; …

(4) The notes to Group 5 of Schedule 8 shall apply for construing this section as they apply for construing that Group…."

5. The Note to Group 5 of Sch 8 on which HMRC relied in refusing the claim, and the only one of any possible relevance here (it being accepted that Note (16), which we do not think it necessary to set out, adds nothing), is Note (2), which reads:

"(2) A building is designed as a dwelling or a number of dwellings where in relation to each dwelling the following conditions are satisfied—

(a) the dwelling consists of self-contained living accommodation;

(b) there is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling;

(c) the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision; and

(d) statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent."

6. We shall return to the statutory provisions later. What is clear even from a cursory reading is that an understanding of precisely what has been done is essential to the application of s 35. The appeal first came before us on 11 October 2012, when we saw various plans and heard some informal evidence from the appellant. However, after we had retired to consider our decision it became apparent that we did not have sufficient information about the work which had been carried out to the building after the first planning consent was granted but before the second consent, and about the further work which had been undertaken since the grant of the second consent, to enable us to reach a conclusion. Accordingly we arranged a second hearing, which took place on 19 April 2013, when additional plans and photographs were provided to us, and we heard further explanations from the appellant.

7. As we have said, before any work started the building was semi-derelict. It consisted of an L-shaped barn, with the disused animal shed at the end of one arm of the L-shape, making the whole into an approximate U-shape. The barn had evidently been used for agricultural storage and the photographs showed clearly that it was uninhabitable: there were holes in the roof, it lacked windows and doors and the interior was open space. The photographs also show that the animal shed consisted of some brick and some timber supports, carrying a corrugated iron roof, that the interior was open to the elements and that it too was uninhabitable.

8. The first planning consent related only to the barn. As is customary, it permitted development "in accordance with the application and plans submitted", but we were not provided with copies of either the application or the approved

plans. We did, however, have contemporary plans which we accept as representative of what was in contemplation at that stage, namely the creation within the barn of three bedrooms, two bathrooms, a kitchen and a living area. We say "in contemplation" because later plans show rather different layouts of the barn accommodation and we are bound to say that the appellant's explanation of the changes of plan and the evolution of the development was in parts rather vague. We do, however, accept that the underlying intention, despite the wording of the first consent, was to provide her and her husband with a country home, and not to create holiday accommodation which, as one of the conditions attached to the first planning consent stipulated, could "not be occupied by any one person for more than 28 days in a calendar year". The reason for that condition was given in the planning consent in these terms "To permit the use of the converted barn as a permanent residential unit would be contrary to the prevailing planning policies for the area which presume against the creation of dwellings in the open countryside". As we understood her evidence, the appellant accepted the condition in the hope that it might later be relaxed.

9. It appears that it was not, however, so much a relaxation as a change of policy which led to the grant of the second planning consent. Again, the development was to be undertaken "in accordance with the application and plans submitted"; on this occasion we did have a copy of the relevant approved plan, though not of the application. The plan shows the barn without any detail of its internal structure; it is simply marked "domestic dwelling previous planning". The detail shown, which is itself somewhat limited, relates entirely to the disused animal shed, and indicates the intended creation of a "domestic service area" and a "work at home area", with various particulars, of no present importance, of the proposed methods of construction. A doorway leading from the "domestic service area" to the barn is marked as "existing door".

10. In fact, as the appellant explained and the photographs produced to us showed, the plans do not accurately reflect what has been done. The bedroom and bathroom accommodation is in approximately the same position as that shown on the 1997 plans, with some changes of layout which do not seem to us to be of any present significance. The area shown on those plans as the space for the kitchen has in fact been made into a living room. The "domestic service area" shown on the 2007 plan was originally intended to house the central heating boiler and a hot water cylinder but they have in fact been located beneath it, in a basement, and the "domestic service area" is occupied by a lavatory and a vestibule. The "work at home area" is occupied in part by the kitchen and in part by an open area which could be, but has not yet been, fitted out for use as a working area. We discovered at the second hearing that there is an upper storey, above only part of the former barn, which contains a bedroom and a study, although the appellant was again rather vague about the use to which those rooms are, or are to be, put. We were left with the impression that, while she and her husband would probably undertake some work in the building, its primary function was intended to, and would, be domestic.

11. Standing back from the detail of the conditions attaching to eligibility for the refund for which s 35(1) provides, it seems to us that what has been done falls

squarely within s 35(1A)(c) and (1D)(a): the appellant started with a non-residential building and has converted it into "a building designed as a dwelling". The question therefore is whether any feature of the work, or of the terms on which it was carried out, renders it ineligible for that refund.

12. HMRC accepted when making their decision that paragraphs (a), (b) and (d) of Note (2) were satisfied; they contended that paragraph (c) was not, and could not be, satisfied because of conditions 9 and 10 to the 2007 planning permission. They were:

> "9. The residential accommodation of the live-work unit hereby permitted shall not be occupied by any persons other than those occupying the work element of the live-work unit.
>
> 10. The live-work unit hereby permitted shall be occupied as a single integrated unit and laid out as shown on the approved drawing and no further subdivision shall take place without the prior written consent of the Local Planning Authority."

13. We interpose for completeness, since we think little or nothing turns on them, that the reasons given for the imposition of those conditions were, respectively, that "The separate use of the accommodation and work unit would result in the creation of [a] new dwelling in the open countryside contrary to policies … which presume against new dwelling in such location unless they are essential for the purposes of agriculture or forestry" and "To safeguard the amenities of those occupying the residential accommodation and to prevent the creation of a separate living Unit."

14. It is apparent from the letters written by HMRC officers, when communicating to the appellant the original decision to refuse to meet the claim and on statutory review of that decision, that although Note (2) was reproduced in full, reliance was placed entirely on paragraph (c). No reference was made to any other provision of the Notes, or to s 35 itself. The question before us, nevertheless, is not simply whether Note (2)(c) is engaged, but whether the provisions of s 35, interpreted in accordance with the relevant Notes, apply to the work. Because the work actually undertaken and the plans differ, we need also to touch on Note (2)(d), and it is convenient to deal with that provision first.

15. That Note imposes two requirements: that planning consent has been obtained; and that it has been complied with. Plainly the first part of the requirement is satisfied; the question is whether the divergence between the approved plans, or at least the second of them, and the finished building offends the second. Quite what is meant by the phrase "in accordance with that consent", in this context, is unclear. At one extreme it could require HMRC and, on appeal, this tribunal to decide whether the consent has been complied with in every detail. At the other it could mean no more than that the consent allows for development broadly equivalent to that undertaken, rather than for something different such as, for example, the conversion of the existing building into a shop.

16. Some help on the point may be derived from the decision of this tribunal in *John and Susan Kear v Revenue and Customs Commissioners* [2013] UKFTT 95 (TC), in which consent was given for the conversion of three adjacent commercial

buildings to a live-work unit, one building forming the working part and the other two the living space. The consent was specific about which parts of the resulting building could be used for each purpose, and a number of other matters. The tribunal determined that there were several breaches of the conditions, particularly of those prescribing the use which could be made of each part, to the extent that the district valuer, when assessing the building for council tax purposes, found that the extent of the commercial use of the building was too small to warrant separate assessment; in essence there was little more than nominal commercial use. The tribunal decided that those breaches were sufficient to engage Note (2)(d), and that the work could not benefit from the provisions of s 35.

17. There is no equivalent provision here about the extent of the working or the living area, beyond what is shown on the approved plan, which is itself very imprecise: the "work at home area" is identified by that text, but its boundaries are not demarcated. The conditions in the planning consent limit the use to be made of the working area to Class B1 in the Schedule to the Town and Country Planning (Use Classes) Order 1987, a class which includes general office work of the kind undertaken by the appellant and her husband, but say nothing about the location or the extent of the area to be so used. Thus this case is rather different from *Kear*.

18. We do not need to decide precisely where in the spectrum we identify in para 15 above the line should be drawn. It is sufficient to say that we have concluded that it is not a necessary requirement that HMRC or the tribunal should be satisfied that any requisite consent has been complied with in every particular. We reach that conclusion from the proposition that it is not the province of HMRC or this tribunal to police the planning rules. Whether the finished building complies with the conditions imposed by the planning authority must be a matter for that authority, and it is not for us to usurp its function. It will be apparent from what has gone before that it is difficult to resist the conclusion that the planning authority in this case has not insisted on strict compliance with the approved plans. But in the absence of any adverse action by it—and there was no evidence of any such action in this case—it is, in our view, proper for the tribunal to proceed on the footing that the work was lawful (as s 35(1)(b) requires) and that there was sufficient compliance with the planning consent to satisfy Note (2)(d). We distinguish this case from *Kear* on the basis that, there, the disregard of the planning consent was almost complete; here, there has been compliance with the spirit, even if not the strict letter, of the consent.

19. We come, then, to the only other relevant provision, the Note (2)(c) exclusion on which HMRC rely. Mr Les Bingham, the officer representing them before us, argued that the point was essentially straightforward: conditions 9 and 10 of the planning permission made it clear that the residential part of the building and the work unit could not be used or disposed of separately and that was enough; Note (2)(c) was in point and it precluded a refund. For the appellant, Mr Ian Wadhams, a chartered tax adviser, argued that if HMRC were right, no live-work unit could ever satisfy the s 35 and Note (2)(c) requirements, since separate occupation of the living and working parts of such a unit is always prohibited.

Indeed, the review letter itself says in terms that a live-work unit cannot satisfy the requirements of s 35.

20. We are not convinced that either Mr Bingham or Mr Wadhams has addressed the correct question. The Note allows for a refund only when "the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision". The question to which that provision gives rise is, "separate from what?". In some cases—an example on which Mr Bingham relied is *Holden and Holden v Revenue and Customs Commissioners* [2012] UKFTT 357 (TC)—the residential and work sections of the live-work unit occupy discrete parts of the building, and in *Holden* there was, moreover, no internal means of access between them. One can well understand the rationale for the imposition of the planning restriction on separate disposal and, in such a case, the answer to the "separate from what?" question is obvious.

21. That is not, however, this case. The residential and working areas of the building do not occupy discrete areas; the working area does not even have a separate room. In reality the finished building does not differ in any material way from any house whose occupant works at home, for example in a study or on the dining room table. Indeed, occupation and use as a "single integrated unit" are what condition 10 of the 2007 consent require. There is nothing from which that "single integrated unit" can be separated, not merely because of the terms of the planning permission, but as a matter of fact; for separate use or disposal mere separation would be insufficient, and subdivision of the whole would be required, and with it the creation of two discrete parts which do not now exist. Note (2)(c) plainly contemplates either two structures or two distinct parts of a single structure which, absent any legal restriction, could be the subject of separate occupation, or could be disposed of individually. It follows, in our view, that if there is nothing from which the dwelling can be separated, as is the case here, any apparent legal restriction is otiose and the Note is not engaged. The reality, as we find, is that the appellant has undertaken a residential conversion within the intended scope of s 35.

22. The appeal must, therefore, be allowed.

23. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

COLIN BISHOPP

TRIBUNAL PRESIDENT

RELEASE DATE: 26 April 2013