[2016] UKFTT 694 (TC)

TC05426

Appeal number: TC/2015/06620

VAT – option to tax – apportionment – disused public house and flat - Schedule 10 to the Value Added Tax Act 1994 – Notice 700/57 – appeal against an apportionment of 90% to commercial and 10% to residential – appeal allowed – substitute apportionment of two thirds commercial and one third residential

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) DAVID JOHN MATTHEWS **Appellants**
(2) PAMELA ELLA MATTHEWS

- and -

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

TRIBUNAL: JUDGE RICHARD CHAPMAN
MR RICHARD CROSLAND

Sitting in public at Alexandra House, 14-22 The Parsonage, Manchester, M3 2JA on 1 June 2016.

Mr Matthews appeared in person on behalf of both of the Appellants.

Mrs Lisa Fletcher, Presenting Officer, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This is an appeal against an assessment charging output tax in the sum of £7,634 for the VAT period 11/12 arising out of the sale of a property. A default surcharge in the sum of £768 was also applied which is not formally part of the appeal. However, the parties helpfully agreed that the outcome of the appeal against the assessment would be determinative of the need for any amendment to the surcharge and so we do not deal with the surcharge any further in this decision.

The Factual Background

2. The broad factual background was not in dispute. On 2 June 2011, Mr and Mrs Matthews purchased the long leasehold of a property at auction named "The Dog and Partridge" ("the Property"). It was sold with the benefit of a five year lease which had commenced on 10 August 2011. As one might expect from the name, the tenant was at that time carrying on business from the Property as a public house.

3. On 10 June 2011, Mr and Mrs Matthews completed and sent to HMRC a standard form notification of an option to tax. The notification treated the effective date of the option to tax as 9 June 2011. By a letter dated 4 July 2011, HMRC acknowledged and accepted the option to tax. This letter included the following:

> "Your option to tax will not have an effect on all land/property, for example, property intended for use as a dwelling or for relevant residential or charitable purposes. Please refer to Public Notice 7742A, section 3 for further details."

4. It is important to note at this stage that the Property as purchased did include a residential element. The Property is a double-fronted, modestly sized building constructed in 1777. At ground floor level, there was (at the time of Mr and Mrs Matthews' purchase of it) a bar area, two open plan rooms and a toilet. There was also a further toilet in the outhouse. The commercial areas of the Property (together, "the Public House") also included a beer cellar and a beer garden. At first floor level, there was a residential flat with three rooms, a kitchen and a bathroom ("the Flat"). The sole access to the Flat was through a staircase in the main bar and so there was no independent access (although there was potential for creating an external access if the toilets were reconfigured). The roof space was also accessed via the Flat, although this had not been converted into accommodation and could only be used for storage. At the time of purchase, the Flat was being used by the manager of the Public House.

5. Mr and Mrs Matthews then encountered difficulties. The tenant failed to make rental payments and vacated the Property relatively soon after their purchase. Mr and Mrs Matthews were unable to rent out the Property, whether in whole or in part. They then investigated alternative uses for the Property, including conversion of the whole of it into residential accommodation. Although detailed plans were drawn up for such a conversion, planning permission was not obtained. In the event, Mr and Mrs

Matthews decided to cut their losses and sold the Property on 17 September 2012 for the sum of £52,500. The purchaser of the Property ("the Purchaser") intended to (and, it seems, did) convert the Property into a restaurant.

6. Mr and Mrs Matthews did not file any VAT returns in the period 11/12, wrongly assuming that there was no need to as (on their case) no output tax was payable and no input tax was being claimed. This was highlighted following a visit to Mr and Mrs Matthews by HMRC, which resulted in returns eventually being filed. There appears to be agreement that nothing was due in respect of rent after applying bad debt relief. Correspondence then passed as to what the appropriate output tax payable should be following the sale of the Property.

7. In essence, Mr and Mrs Matthews argued that no VAT was payable as the Flat represented the whole of the value of the Property and so the residential percentage should be set at 100%. HMRC disagreed and took the view that the ratio should be 90% commercial and 10% residential in accordance with HMRC's established approach to public houses with residential service accommodation.

8. HMRC notified Mr and Mrs Matthews of their intention to assess on the basis of a 90% commercial and 10% residential division in a letter dated 11 May 2015 and, following further representations, confirmed this in a letter dated 24 July 2015. Mr and Mrs Matthews requested a review, which took place and upheld the original decision by way of a letter dated 6 October 2015.

The Grounds for Appeal

9. Mr and Mrs Matthews appealed the assessment by a notice of appeal dated 6 November 2015. It is not clear when the notice of appeal was received by the Tribunal but HMRC did not take any issue with whether or not it was in time and have treated it as such throughout. Insofar as it was not received within time, we grant permission to bring the appeal out of time. We will give a separate decision containing our reasons for this if either party requests us to do so.

10. The grounds for appeal are as follows:

> "The 'rule' that residential property is only worth 10% of the value of a combined residential commercial is wrong and resulted in a property eligible for Local Housing Benefit of £5,940 per annum being 'valued' at £5,250. The evidence I submitted was ignored.
>
> The review acknowledged that commercial property values have dropped (and by implication, residential values have increased) in the years since the ration was adopted but then said it was correct to be used.
>
> It was said that the values could be proportioned on a floor by floor basis but that would be 'unhelpful'. I asked for details of this but this was ignored.

It was stated several times that the flat was 'small' as part of the justification of the tiny valuation. When I proved that the flat was 'large' and asked how this affected the value I was ignored.

5 The review stated that the value of the flat was not supported by the facts. The facts I submitted did support a realistic value for the flat. This was ignored and no facts were put forward to support the VAT valuation.

10 The standard industry apportionment of 10% does not exist in the property industry and seems to be just an out dated ratio used by the VAT, its title suggests a wider validity and is misleading.'

The Legal Framework

11. The option to tax is dealt with in Schedule 10 to the Value Added Tax Act 1994 ("Schedule 10" and "VATA 1994" respectively). Paragraphs 1, 2 and 5 of Schedule 10 provide as follows:

15 '*Overview of the option to tax*

1

(1) This Part of the Schedule makes provision for a person to opt to tax any land.

20 (2) The effect of the option to tax is dealt with in paragraph 2 (exempt supplies become taxable), as read with paragraph 3.

(3) Grants are excluded from the effect of paragraph 2 by—

(a) paragraph 5 (dwellings designed or adapted, and intended for use, as dwelling etc),

(b) paragraph 6 (conversion of buildings for use as dwelling etc),

25 (c) paragraph 7 (charities),

(d) paragraph 8 (residential caravans),

(e) paragraph 9 (residential houseboats),

(f) paragraph 10 (relevant housing associations), and

(g) paragraph 11 (grant to individual for construction of dwelling).

30 (4) Paragraphs 12 to 17 (anti-avoidance: developers of land etc) provide for certain supplies to which any grant gives rise to be excluded from the effect of paragraph 2.

(5) Paragraphs 18 to 30 deal with—

(a) the scope of the option to tax,

35 (b) the day from which the option to tax has effect,

(c) notification requirements,

(d) elections to opt to tax land subsequently acquired,

(e) the revocation of the option,

(f) the effect of the option to tax in relation to new buildings, and

(g) requirements for prior permission in the case of exempt grants made before the exercise of an option to tax.

(6) Paragraphs 31 to 34 deal with definitions which apply for the purposes of this Part, as well as other supplemental matters.

The option to tax

Effect of the option to tax: exempt supplies become taxable

2

(1) This paragraph applies if—

(a) a person exercises the option to tax any land under this Part of this Schedule, and

(b) a grant is made in relation to the land at any time when the option to tax it has effect.

(2) If the grant is made—

(a) by the person exercising that option, or

(b) by a relevant associate (if that person is a body corporate),

the grant does not fall within Group 1 of Schedule 9 (exemptions for land).

(3) For the meaning of "relevant associate", see paragraph 3.

…

Dwellings designed or adapted, and intended for use, as dwelling etc

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(1) An option to tax has no effect in relation to any grant in relation to a building or part of a building if the building or part of the building is designed or adapted, and is intended, for use—

(a) as a dwelling or number of dwellings, or

(b) solely for a relevant residential purpose.

(2) In relation to the expression "relevant residential purpose", see the certification requirement imposed as a result of the application of Note (12) of Group 5 of Schedule 8 by paragraph 33 of this Schedule.'

12. The legislation does not deal with the calculation of the apportionment between the residential and commercial parts of a property. It was common ground that this must be analysed on a case by case basis in order to achieve a fair result.

13. Notice 700/57 (Part 2), which does not have the force of law, sets out an agreement which was reached between HMRC and the Brewers' Society as to input ta in respect of brewers' tenanted estates ("the Brewers' Society Agreement"). This provides as follows:

‘*Agreement with the Brewers’ Society about deduction of input tax in respect of brewers’ tenanted estate.*

1. This agreement, which had effect from 1 August 1989, covers only those brewers who elect to waive exemption of the rents from all their tenanted properties under paragraph 2 of Schedule 6A to the VAT Act 1983. Brewers who do not elect, or elect from some, but not all, of their tenanted properties, are outside the agreement and should contact their local VAT office if they wish to negotiate special arrangements.

2. Under the agreement, the entitlement to deduct input tax in respect of tied tenanted licensed houses containing a residential element is as follows:

(a) An agreed percentage of the input tax incurred on the maintenance and repair of, and capital expenditure on, tenanted property and of that incurred in selling or leasing such properties, including professional fees shall be deemed to be non-deductible.

(b) This restriction of an agreed percentage of input tax shall cover the whole matter of the tenanted estate so that no further restriction of input tax shall be required in respect of the exempt supplies made in the form of tenanted rents received and deemed to relate to the domestic accommodation.

(c) The property expenditure referred to in paragraph 1 above does not include expenditure on tenants’ furniture, fittings and equipment, on the costs of cellarage or dispense equipment, advertising and other management expenses.

(d) The method will be used for at least 2 years. However, Customs and Excise reserve the right to review the arrangements should there be a change in brewers’ circumstances which affected significantly the amount of input tax they are entitled to deduct.

(e) A brewers’ tenanted estate shall be the houses actually tenanted throughout the relevant period. Where this is difficult to ascertain, Customs and Excise will accept an average based on the total of houses tenanted at the beginning and end of the appropriate period.

(f) Nothing in the agreement affects the right of any brewer to question the correctness of the apportionment of his input tax in this way, although in such circumstances Customs and Excuse would also be entitled to propose an alternative basis of apportionment.’

14. Our attention was also drawn to a document entitled VATVAL 13420, again which does not have the force of law but explains HMRC’s policy on the matter. The relevant excerpt provides as follows:

‘Option to tax rents of tenanted pubs: Apportionment of supply covering both commercial and domestic premises.

The option to tax land transactions, including rents, does not apply to rents of domestic premises. When a supply of mixed commercial and

> domestic premises is covered by a single rent, the supply and therefore the rent must be apportioned.
>
> Pub tenancies - in the case of pub tenancies, almost all of which include domestic premises, the Brewers Society has suggested to its members that the split might be 90:10 as between the commercial and domestic elements. This was done on the basis of research that it had carried out. Customs' HQ has neither formally agreed that split nor dissented from it.
>
> Partial exemption - whatever the VAT on the commercial element, that VAT will be fully recoverable by the tenant as his input VAT in all (or virtually all) cases. Partial Exemption branch have agreed with the Brewers Society a revised formula which deals with the consequences for input VAT recovery by the Breweries. This agreement can be found in Notice 700/57 VAT: Administrative agreements entered into with trade bodies, and has been reproduced below.
>
> VATable value of rents - in practice, you should not question apportionment of the rent on the 90:10 basis by brewers in respect of their tenanted pubs unless it appears to distort values significantly and deductibility of input tax by either brewers or tenants is affected.'

15. It was common ground that the agreed ratio pursuant to the Brewers' Society Agreement is 90% commercial and 10% residential. It was also common ground that the Brewers' Society Agreement only directly related to input tax but is relevant to considering output tax in circumstances such as the present, and also that this is nothing more than a non-binding presumption.

16. The relevance of the Brewers' Society Agreement and the ability to challenge it in any particular case were both confirmed by Newey J in *Enterprise Inns plc v Unique Pub Properties Ltd* [2012] UKUT 240 (TCC) at [11] to [14], [25] to [29] and [45] to [47] as follows (albeit that this was in the context of the apportionment of rent):

> '[11] Until 2008, the Appellants proceeded on the basis that 10% of the rent they received related to the residential areas of their pubs and therefore accounted for VAT on 90% of the rent. As the Tribunal noted (in paragraph 2 of the Decision), the 90:10 split "was in accordance with standard practice in the brewing sector which was based on a suggestion by the Brewers' Society at the time the option to tax was introduced in 1989".
>
> [12] The Appellants would invoice tenants for rent in accordance with the 90:10 apportionment. This was the case regardless of whether the relevant pub in fact contained residential accommodation. The Tribunal said this about the invoicing arrangements (in paragraph 52(11) of the Decision):
>
>> "The invoices for the supplies of the tenancies in the public houses apportioned the rent between the commercial and residential parts of the premises on a 90/10 ratio. The Tribunal was not convinced with the Appellants' assertion that the

> invoices were wrong. The Appellants had applied the 90/10 apportionment in their invoices without question for almost 20 years. During that time the Appellants accepted that no tenant had challenged the correctness of the invoices. The Appellants placed weight on the fact that the invoices applied a 90/10 apportionment to public houses without residential accommodation. This error applied to an insignificant proportion (two per cent) of the Appellants' estate, which suggested that the Appellants tolerated the error because the 90/10 apportionment accurately reflected the rental position for the overwhelming majority of public houses in the estate".

[13] In April 2008, the Appellants challenged the correctness of the 90:10 apportionment. They informed HMRC that they had concluded following a review of their agreements with tenants that all the rent should be subject to VAT. Since HMRC continued to adhere to the view that rent fell to be apportioned, the Appellants appealed to the Tribunal.

[14] The Appellants' case before the Tribunal was to the effect that the rent for the pubs at issue was based solely on the profit that it was anticipated that the pubs could generate. The residential accommodation was, the Appellants maintained, provided free of charge.

…

Are the contracts decisive?

[25] Mr Raymond Hill, who appeared for HMRC, argued that it is not necessary to look beyond the relevant contractual arrangements in the present case. Mr Hill's argument on this aspect was on the following lines. The contracts between the Appellants and tenants provided for each tenant to pay a single amount of rent for the whole of the relevant pub. That being so, the rent for the pub must have related to the residential areas as well as the commercial ones unless there was an implied term attributing it to just the commercial parts. No such implied term was argued for or existed. Rent thus related at least partly to the residential areas.

[26] I am not convinced by this argument. The question in this case is whether part of the rent paid in respect of each pub was attributable to its residential areas. To my mind, that question cannot necessarily be answered by merely construing the contracts between the Appellants and their tenants. It is apparent from their contracts with the Appellants that tenants would pay rent in respect of the *whole* of a pub. In my view, however, it does not inevitably follow that rent is to be attributed to every *part* of a pub.

[27] As already mentioned (in paragraph 1 above), the issue before the Tribunal was whether *any* of the rent was attributable to the residential areas of the pubs. The Tribunal did not need to consider *how much* rent was to be attributed to the residential areas because it

was common ground that, if some rent was attributable to the residential areas, the 90:10 split was appropriate. Had there, though, been an issue as to apportionment, the Tribunal would have had to consider the extent to which rent was attributable to residential areas. The contracts not having so stated, there could, as it seems to me, have been no question of every square foot of a pub automatically being treated as of equal value. (In fact, I would guess that that the 90:10 apportionment implies that commercial parts of a pub have a higher value per square foot than residential parts.) If areas can differ in value, I can see no reason why, in an appropriate case, an area might be considered not to have any value at all.

[28] It is possible to conceive of a lease being granted of premises including an area that was universally recognised to be a burden rather than a benefit (say, because a large financial liability attached to it for some reason). The overall rent could then be expected to be lower than would have been the case had the particular area been omitted from the lease. On Mr Hill's case, rent would nonetheless be attributable to the area in question unless (which would seem improbable) the lease incorporated a term to contrary effect. I do not think that can be right.

[29] Had the agreements between the Appellants and the tenants, on their true construction, attributed some of the rent to the residential areas, that might well have been determinative of itself. I do not think, however, that they did so. The contracts were, as it seems to me, silent on the point.

…

[45] As mentioned above (paragraph 12), invoices to tenants apportioned rent between the commercial and residential areas on a 90:10 basis. The Tribunal considered that the invoices provided evidence of what had been agreed in relation to the rent.

[46] Mr Hitchmough criticised the Tribunal's reliance on the invoicing arrangements. He pointed out that the Appellants' practice in relation to invoicing had been flawed on any view since the 90:10 split was adopted regardless of whether a pub in fact contained residential accommodation. He argued too that, while only a small proportion of the Appellants' overall estate lacked residential areas, the number (viz. 151) was still significant in absolute terms.

[47] To my mind, however, it was open to the Tribunal to attach weight to the invoices. The Tribunal's view was, as it seems to me, a reasonable one.'

17. It follows from paragraph 5 of Schedule 10 that the removal of a property or a part of a property from the option to tax requires an intention to use the property or the relevant part solely for a relevant residential purpose. In *Watters v The Commissioners of Customs and Excise* [1995] Lexis Citation 920, Stephen Oliver QC (as he then was) dealt with the question of intention as follows at pages 4 and 5:

‘Conclusions. We think that both parties went through with this transaction on the assumption that VAT would have to be charged on the purchase price. Mr Watters had been wrongly advised. Had he been correctly advised he would have communicated his intention and insisted, through his solicitor, on VAT being excluded from the sale price. Mr Ridley and Mrs Hansell took it for granted that VAT was payable because Ridleys had elected to waive exemption; consequently their solicitors proceeded with the legal documentation on the basis that VAT was payable. Had it occurred to the Ridleys side that the sale might have been an exempt supply, they would have looked into the position. They might have looked more closely at the Mundays Snow report and read the statement that Mr Watters intended to convert the premises to a private residence; Mrs Hansell might have had second thoughts about the earlier conversation on the telephone with Mr Watters. She might have seen a different relevance to his statement of his intention to use The Fountain as a residence. This is all against the background that, as far as Ridleys were concerned, The Fountain had no future as a public house. It must have been evident that a change of use was on the cards and that a change of use to residential was likely and, if anything, was more likely than a change to office use. The position of The Fountain does not, we think, obviously lend itself to office use.

Assuming without deciding the point that the communication of the buyer's intention to use the purchased building is necessary to establish the building as one intended for use as a dwelling (for purposes of paragraph 2(2)(a)), Mr Watters' intention was, we think, sufficiently communicated to Ridleys. Ridleys were actually informed of the intended change of use. That they paid no attention to the information provided to them was because neither side thought it had any bearing on the tax position of the sale. For those reasons, we think that Mr Watters has satisfied us that the building was intended for use as a dwelling when the supply was made. It is not, therefore, necessary for us to express a view on the question of whether paragraph 2(2) (a) is disapplied where the buyer has a fixed intention to change the use of the building to a dwelling but wholly fails to communicate his intention to the seller.’

18. Similarly, in *Ebley House Ltd v HMRC* [2013] UKFTT 422 (TC), the Tribunal (Judge Christopher Staker and Mr John Coles) analysed intention as follows at [5] to [7] and [38] to [39]:

‘[5] There was some discussion at the hearing about the meaning of the word "intended" in paragraph 5(1). The provision does not expressly state who is required to have the relevant intention, the seller or the buyer. Presumably it must mean the buyer, since it is the buyer who controls the use to which the building will be put after the purchase is completed. If so, the effect of the provision, if read literally, would be that the operation of paragraph 5 depends solely on what the intention of the buyer actually was, regardless of what the seller was informed about the buyer's intention, and regardless of what

> the seller may reasonably have believed the intention of the buyer to be.
>
> [6] However, HMRC Public Notice 742A states in paragraph 3.4 that "Your option to tax will not apply if you supply a building, or part of a building, and the purchaser or tenant *informs you* that they will be using it solely for a relevant residential purpose" (emphasis added). This suggests that in the view of HMRC, the word "informs" does not have such a literal meaning. Alternatively, it may simply be that HMRC in practice applies paragraph 5 in a way more favourable to the seller than the wording of the paragraph itself.
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> [7] It is noted that a later version of that Public Notice, dated June 2010, which post-dates the events material to this appeal, contains an additional sentence: "Whilst there is no requirement for a formal certificate to be given, we strongly recommend that you obtain confirmation of the intended use in writing and retain it with your VAT records". On behalf of the Appellant, it was argued that this indicates that it is not a requirement of paragraph 5 that the buyer's intention be formally confirmed in writing at the time of sale, and Mr Bingham did not seek to argue otherwise.
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> …
>
> [38] While there is some evidence that may seem to point the other way, the Tribunal on its consideration of the evidence and arguments as a whole is satisfied on a balance of probability that at the time of sale, the purchaser intended to use the property as a residential school.
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> [39] In the circumstances, it is unnecessary to consider whether it would be sufficient that the Appellant reasonably believed that the property was intended for use as a residential school, even if the purchaser in fact had a different use in mind. For completeness, the Tribunal finds on a balance of probability that the Appellant did reasonably believe that the property was intended for use as a residential school.'

19. Neither *Watters* nor *Ebley House Ltd* are binding on us but they do provide useful illustrations of the correct approach in such cases.

20. As this is an appeal against an assessment pursuant to section 83(1)(p) of VATA 1994, we have a full appellate jurisdiction. This was not an exercise of a discretion and we can consider whether or not HMRC's decision was correct and, if necessary, substitute our own (see the very useful analysis by the Tribunal (Judge Robin Vos and Mr Julian Sims) in *David Love Marketing Ltd v HMRC* [2015] UKFTT 506 (TC) at [42]).

21. It was also common ground that the burden of proof is on Mr and Mrs Matthews and that the standard of proof is the balance of probabilities.

The Evidence

22. Mr Matthews gave evidence but was not cross-examined by Mrs Fletcher. There was no oral or witness evidence on behalf of HMRC. We also considered a substantial bundle of documents.

Findings of Fact

23. Given the common ground between the parties, we make formal findings of fact to the effect of the matters set out in the factual background at paragraphs 2 to 8 above.

24. Mr Matthews gave evidence as to the circumstances of the sale. Mr and Mrs Matthews had tried hard to sell the Property, advertising it as having the potential for conversion into dwellings. The Property had been placed in auction but it failed to sell. They were subsequently approached by the eventual purchaser of the Property ("the Purchaser") who was looking to convert it into a restaurant. The Purchaser advised Mr and Mrs Matthews that the sale was not subject to VAT and so VAT was not added to the purchase price (although we were told that a VAT invoice for the additional sum has now been issued). The sale was then placed in the hands of solicitors who did not give any contrary advice. We accept Mr Matthews evidence as to these matters and note that he accepts that the sale is in principle subject to VAT, the only question being that of apportionment.

25. We were not given any evidence at all as to what the Purchaser's intention was at the time of the sale or as regards the Flat. Mr Matthews told us that the Flat has now been converted into a lounge for the restaurant but there was no evidence that any such intention was communicated to Mr and Mrs Matthews at the time of the sale or even that the Purchaser had any such intention. Given the intention to convert the Property into a restaurant, we find as a fact that there was no intention to convert the commercial parts of the Property into residential accommodation. However, we are not in any position to make any findings as to the Purchaser's intention in respect of the Flat.

26. Mr Matthews gave a great deal of evidence as to the value of the Property and the relevant contributions of the Flat and the commercial areas to that value. In short, he sought to demonstrate that the only real value was in the Flat. He sought to do this by reference to comparable evidence of flats and, to an extent, public houses in the area as well as academic and professional texts and articles. In fact, he also sought to provide evidence for the proposition that the Public House actually reduced the overall value of the Property. In particular, Mr Matthews said that if it had been converted to residential flats, the Property would have been worth approximately £150,000, not taking into account the expenditure required to do this. He showed us details of a residential property of similar size which had sold for £190,000, although this was not a converted commercial property. We were also shown a schedule of housing benefit allowances in the area, ranging from £232.47 per month for a single room to £650 per month for a five bed dwelling. We were also shown various

printouts from websites showing the prices that properties had been sold for, although these were all residential.

27. Despite the clear research, time and effort that Mr Matthews has invested in this part of his evidence, he is not a qualified valuer or chartered surveyor. The following paragraphs of rule 15 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) 2009 are of particular relevance in considering the impact of this:

> 'Evidence and submissions
>
> 15.
>
> (1) Without restriction on the general powers in rule 5(1) and (2) (case management powers), the Tribunal may give direction as to –
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> (a) issues on which it requires evidence or submissions;
>
> (b) the nature of the evidence or submissions it requires;
>
> (c) whether the parties are permitted or required to provide expert evidence, and if so whether the parties must jointly appoint a single expert to provide such evidence;
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> …
>
> (2) The Tribunal may –
>
> (a) admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom; or
>
> (b) exclude evidence that would otherwise be admissible where –
>
> … …
>
> (iii) it would otherwise be unfair to admit the evidence.
>
> …'

28. It follows that the fact that opinion evidence is being given by a non-expert does not of itself render that evidence inadmissible. Rule 15 expressly allows for such evidence to be received if the Tribunal allows it. If admitted, the question becomes one of weight. This is underlined by the comments of Arnold J in *Megantic Services Ltd v HMRC* [2011] STC 1000 at [80]:

> '[80] Secondly, r 15(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, SI 2009/273, allows the tribunal to admit evidence whether or not the evidence would be admissible in a civil trial. It follows that the tribunal is entitled to admit evidence which would not be admissible in a court and give it such weight, if any, as the tribunal considers that it is worth. What weight should be given to the evidence is a matter for the tribunal to decide in the light of all the evidence at the hearing. Even if Mr Downer is not qualified to give expert evidence, that would not prevent his opinion evidence

> being received by the tribunal. As for the reliability of the FCIB evidence, Mr Letherby's statement in these proceedings does contain some evidence as to the reliability of the FCIB documents. Furthermore, I am quite unpersuaded that the other statement of Mr Letherby relied on by Megantic demonstrates beyond argument that the FCIB evidence is unreliable. It may well provide material for cross-examination of Mr Letherby in due course, but that is another matter.

29. Mrs Fletcher did not take issue with us considering the valuation evidence. Indeed, HMRC included all the documentary evidence provided by Mr Matthews in the bundle which HMRC themselves prepared. As such, we treat the evidence as admitted by consent. However, we have reached the conclusion that we should give Mr Matthews' valuation evidence no weight. This is for the following reasons.

30. First, Mr Matthews has not suggested that he has any specialist knowledge of valuation matters. We asked Mr Matthews whether or not he wished to apply for an adjournment in order to obtain expert evidence (without expressing a view as to whether or not any such application would be successful). He declined this opportunity.

31. Secondly, this is a technical area of valuations that requires qualified expertise. This is highlighted by the level of analysis contained in the professional documents provided to us which show movements of the residential housing market. Mr Matthews is not in a position to explain how this correlates with the present case and the extent to which they are relevant to flats without an independent access and to public houses.

32. Thirdly, there are gaps in the technical evidence. Mr Matthews has provided us with comparables of house prices but, again, we do not know how or why these relate to flats without an independent access and to public houses. Crucially, Mr Matthews' evidence focused upon residential properties but did not provide any real assistance in the valuation of commercial properties. As such, we are not in a position to value the Public House in order to compare it to the value of the Flat.

33. Fourthly, we were not told how housing benefit fits into this process.

34. It follows that we are not in a position to make any findings of fact at all as to the value of the respective parts of the Property and do not do so.

Submissions

Mr and Mrs Matthews

35. Mr Matthews argued that the most appropriate way of apportioning the supply was to consider the capital value of the Flat as against the Public House. This was because the Property was not really being sold as a public house at all as the Property's real value was in the Flat. The essence of this submission was that the Public House was disused and had no value. Indeed, he went further and argued that

the Public House actually detracted from the value of the Flat. He illustrated his argument by reference to the comparables referred to above and also made the point that, with the exception of the Purchaser, any interest in the Property had been by reference to the potential conversion of the whole Property into flats.

5 36. Mr Matthews disputed HMRC's reliance upon the Brewers' Society Agreement. He submitted (as HMRC frankly accepted) that it was not binding upon him. Crucially, he also made the point that the 90% commercial and 10% residential apportionment could not be relevant to a disused public house as there was no business for the Flat to be subservient to. He said that a 'one size fits all' approach
10 does not apply to a failed public house with no turnover.

37. This led to Mr Matthews' preferred ratio of 100% residential and 0% commercial. As an alternative, he accepted that the Public House was still a developable space and so allowed for an apportionment of 10% for commercial. As a further alternative, Mr Matthews suggested that the achievable rental value should be
15 taken into account in apportioning the supply. However, he did not provide us with any evidence as to the separate rental yields beyond the housing benefit allowances for similar sized residential properties. As a final alternative, Mr Matthews suggested that the respective floor spaces could be used. Although he did not put a figure on this, we assume that he meant that this would result in an equal division, as he was
20 keen to point out that the ground floor and first floor had equal floor space, making the point that the cellar should not be included in considering the Public House's apportionment because it was quiet small and could only be used for a public house.

HMRC

38. Mrs Fletcher submitted that it was reasonable to apply to the 90% commercial
25 and 10% residential apportionment and urged us to uphold the decision. She said that Mr and Mrs Matthews had not provided any evidence which would justify a movement away from this presumption. Even though the Public House was disused, it was still capable of being used for commercial purposes, whether as a public house or otherwise. Indeed, she made the point that the Purchase had in fact used it for
30 commercial purposes as he had converted it into a restaurant.

39. Mrs Fletcher submitted that there was insufficient evidence to provide a value based comparison, whether upon the basis of capital values or rental yield. Further, Mrs Fletcher argued that a comparison of floor space was not appropriate because that would not take into account the fact that the Flat and the Public House were
35 intrinsically linked because the Flat had been used as service accommodation and could only be accessed through the Public House.

Discussion

40. We note that HMRC accepted in the decision and in the review that the residential exclusion from the option to tax applied to the Flat, subject to the
40 appropriate apportionment. This carries with it an acceptance that there was an intention to use the Flat solely as a dwelling. This is notwithstanding that the decision

letter acknowledges that the whole of the Property was subsequently used for commercial purposes. This position was maintained by Mrs Fletcher at the hearing, even after the evidence had concluded and so we were not invited to treat the exclusion as not applying at all for any want of the necessary intent. As such, we will not go behind HMRC's position that the only issue is apportionment rather than the applicability of the exclusion.

41. It emerged from the parties' submissions that the following alternative approaches to apportionment can be taken in the present case. We make the point that these alternatives are not of general application as each case will turn upon its own merits.

(1) The presumption arising from the 'Brewers Society Agreement.

(2) The comparative capital values of the Flat and the Public House.

(3) The comparative rental yields of the Flat and the Public House.

(4) The comparative useable space of the Flat and the Public House.

42. We propose to examine each of these in turn.

43. The presumption arising from the Brewers' Society Agreement would have been sensible in the present case if the Public House had been sold as a going concern. The lease in place when the Property was purchased covered both the residential and commercial elements and the "Permitted Use" of the Property limited the residential use to "ancillary use" as follows:

> 'Permitted Use: a fully licensed public house to carry on the business only within the buildings on the Premises including the sale of food for consumption on the Premises and ancillary residential use although this shall not prevent the consumption of food and drink in any beer garden set aside for that purpose.'

44. Whilst tenanted, this ancillary use was reinforced by the fact that the Flat was occupied by the owner or manager of the Public House. However, by the time of the sale by Mr and Mrs Matthews, the lease had been surrendered, there were no restrictions upon who could occupy the Flat, and neither the Flat nor the Public House were in fact occupied. As such, it is difficult to see that the Flat was ancillary to the Public House, or at least not to the degree dictated by a 90% commercial to 10% residential apportionment. It is of note that paragraph 2(e) of the Brewers' Society Agreement itself requires that the relevant public houses actually be tenanted during any relevant period. We therefore find that the Brewers' Society Agreement does not produce a fair apportionment in the present case.

45. Any apportionment on the basis of capital value or rental yield would require findings of fact as to valuation evidence. As set out above, we ascribe no weight to Mr Matthews' own opinion evidence. As such, we find that Mr and Mrs Matthews are unable to establish on the balance of probabilities that an apportionment based upon respective values would be different to the 90% commercial to 10% residential within

the disputed decision or, crucially, what it should be instead. It follows that we are not in a position to apportion by reference to capital values or rental yield.

46. Of the methods of apportionment suggested by the parties, therefore, we are only in a position to consider the floor space. In any event, we find that this is the most appropriate method of apportionment, albeit that we add the extra nuances that this should be a broad brush comparison and that this should be of the useable areas of the whole Property and its grounds, taking to account both size and accessibility. This is because neither the Flat nor the Public House were occupied prior to the sale and had not been for some time, neither was subject to a lease, the Flat was not restricted by any covenant as to how it was to be used or by whom it was to be used, and there is no evidence as to the intended use of the various parts of the Property other than that at least the Public House was going to be converted into a restaurant.

47. Having decided that the apportionment should broadly follow the useable space (in the sense explained above), the next question is as to what the correct apportionment should be using that method. We find that the correct apportionment is two thirds commercial and one third residential. This is because although the floor space of the ground floor and the first floor are broadly equal, the Public House has the appreciable benefit of both the cellar and the beer garden. Although the Flat also has access to the roof space, this has not been boarded out and is offset against the reduction in the Flat's practical utility caused by its physical access being via the Public House.

Decision

48. For the reasons set out above, we allow the appeal. However, we do not accept that the apportionment should be as contended for by either HMRC or Mr and Mrs Matthews and so substitute an apportionment of two thirds commercial and one third residential. We leave the parties to agree the recalculation both of the assessment and the default surcharge. Each party has permission to apply to seek a determination as to these matters if agreement cannot be reached.

49. 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.

RICHARD CHAPMAN
TRIBUNAL JUDGE

RELEASE DATE: 18 OCTOBER 2016