[2019] UKFTT 277 (TC)

TC07116

Appeal number: TC/2017/06627

VALUE ADDED TAX – DIY Builders scheme for refund of VAT – whether construction met condition in Note 2(d) to Group 5 Schedule 8 VATA – **Lady Pearson** ***applied – appeal allowed – whether building an annexe also considered – whether prohibition of separate use or disposal also considered – observations on aptness of penalties letter issued with initial rejection (without proper reasons) of claim – costs considered.***

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHRISTOPHER SWALES **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS
ELIZABETH BRIDGE

Sitting in public at the Magistrates Court, Regent St, Cambridge on 11 February 2019

The Appellant in person

Mr Oladapo Sanusi, litigator, HM Revenue & Customs for the Respondents

DECISION

1. This was an appeal by Mr Christopher Swales ("the appellant") against a decision made by an officer of the Respondents ("HMRC") on 31 May 2017 to refuse his claim to a refund of VAT under the "DIY Builder's scheme". The refusal was upheld in a review which varied the decision and the appeal was made to the Tribunal on 4 September 2017.

2. At the start of the hearing of the appeal the appellant asked the Tribunal to require HMRC to inform him what issues were still in dispute. Mr Sanusi agreed with the appellant that the only issue still in dispute was whether what the appellant had done fell within the scope of Note 2(d) to Group 5 of Schedule 8 to the Value Added Tax Act 1994 ("VATA"), that Note applying to a claim to a refund under s 35 VATA as it applied to a claim to zero rate under Group 5 a supply of construction services.

3. Notwithstanding this concession, Mr Sanusi, in making his submissions, made a number of points about other parts of Group 5 and about s 35 VATA and associated regulations. We have considered those points and make observations about them, and about other aspects of HMRC's consideration of the appellant's claim which have troubled us, including their suggestion that the appellant might have been liable to a penalty for an inaccurate claim, something they have not retracted.

Law

4. It is we think helpful to set out the law here so that the facts can be put in the relevant context. The relevant law relating to the refund of VAT to private individuals is in section 35 Value Added Tax Act 1994:

> "**35 Refund of VAT to persons constructing certain buildings**
>
> (1) Where—
>
> (a) a person carries out works to which this section applies,
>
> (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—
>
> (a) the construction of a building designed as a dwelling or number of dwellings;
>
> …
>
> (1B) For the purposes of this section goods shall be treated as used for the purposes of works to which this section applies by the person carrying out the works in so far only as they are building materials

which, in the course of the works, are incorporated in the building in question or its site.

…

(2) The Commissioners shall not be required to entertain a claim for a refund of VAT under this section unless the claim—

(a) is made within such time and in such form and manner, and

(b) contains such information, and

(c) is accompanied by such documents, whether by way of evidence or otherwise,

as may be specified by regulations or by the Commissioners in accordance with regulations..

…

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

…

Schedule 8

Group 5—Construction of buildings, etc

NOTES

…

(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.

…

(16) For the purpose of this Group, the construction of a building does not include—

(a) the conversion, reconstruction or alteration of an existing building; or

(b) any enlargement of, or extension to, an existing building except to the extent the enlargement or extension creates an additional dwelling or dwellings; or

(c) subject to Note (17) below, the construction of an annexe to an existing building.

…

(18) A building only ceases to be an existing building when:

(a) demolished completely to ground level; or

(b) the part remaining above ground level consists of no more than a single façade or where a corner site, a double façade, the retention of which is a condition or requirement of statutory planning consent or similar permission.

…"

5. Part 23 of the Value Added Tax Regulations 1995 (SI 1995/2518) ("the VAT Regulations") are also relevant:

"**200 Interpretation of Part XXIII**

In this Part—

"claim" means a claim for refund of VAT made pursuant to section 35 of the Act, and

"claimant" shall be construed accordingly;

"relevant building" means a building in respect of which a claimant makes a claim.

201 Method and time for making claim

A claimant shall make his claim in respect of a relevant building by—

(a) furnishing to the Commissioners no later than 3 months after the completion of the building the relevant form for the purposes of the claim containing the full particulars required therein, and

(b) at the same time furnishing to them—

(i) a certificate of completion obtained from a local authority or such other documentary evidence of completion of the building as is satisfactory to the Commissioners,

(ii) an invoice showing the registration number of the person supplying the goods, whether or not such an invoice is a VAT invoice, in respect of each supply of goods on which VAT has been paid which have been incorporated into the building or its site,

(iii) in respect of imported goods which have been incorporated into the building or its site, documentary evidence of their importation and of the VAT paid thereon,

(iv) documentary evidence that planning permission for the building had been granted, and

(v) a certificate signed by a quantity surveyor or architect that the goods shown in the claim were or, in his judgement, were likely to have been, incorporated into the building or its site.

201A—The relevant form for the purposes of a claim is—

(a) form VAT 431NB[1] where the claim relates to works described in section 35(1A)(a) or (b) of the Act; …

...."

Facts

The evidence

6. HMRC had prepared a bundle which included the documents supplied by the appellant in response to HMRC's requests as well as the claim to a refund on form VAT431NB and the correspondence between the parties about the claim.

7. In his comprehensive submissions the appellant also produced a number of documents, many of which duplicated HMRC's bundle, and at the start of the hearing he offered up to the Tribunal an article from an architectural magazine (Build It) about the dwelling in question which he named Xanadu. We briefly read the articles before the start of the hearing, as did Mr Sanusi, but we asked the appellant nevertheless to produce to us after the hearing a .pdf version of the article, which he did.

8. The appellant, who is a retired architect, also gave evidence in elaboration of the submissions he made and was cross-examined by Mr Sanusi. We found the appellant to be a truthful and very credible witness who was obviously very well acquainted with the planning system and the concepts and jargon used and the details of the work carried out, but obviously less familiar with VAT legislation.

The property before the works

9. We had plans and photographs of the property before any works were carried out. 15 Pelham Road, Clavering, Essex occupies a long and narrow site roughly oriented north-south and fronting onto the B1038 road and backing on to agricultural land. Similar plots are on either side.

10. The house is on the north end of the plot and at roughly 50 metres from the southernmost part of the house was a building described as a shed, approximately 6mx6m. This was a single storey construction with a pitched roof. From the house patio-type doors were visible slightly inset so that the footprint of the building was L-shaped but the roof plan was rectangular.

11. From photographs and the appellant's evidence we find that the building was timber framed with 75x75mm posts and built directly onto a concrete slab with no foundations, something which did not comply with the Building Regulations. The building was untreated for vermin and damp and the timbers were not fire rated, nor did they meet the minimum required headroom of 2.4 metres for habitable rooms, and none of these features complied with the Building Regulations.

[1] Despite the space in the regulations the form calls itself "VAT431NB".

12. The shed was clad with timber shiplap (supported by the 75mm posts) and was a fire hazard as the western wall was less than 1 metre from the neighbouring property.

The planning applications

13. The property is owned by Mr Tristin Swales, the son of the appellant. He wished to create separate accommodation for his parents in the grounds of 15 Pelham Road.

14. On 15 November 2014 Tristin Swales applied to Uttlesford District Council ("UDC") for planning permission for what was described as:

> "Demolition of garden shed and erection of detached annexe."

15. Permission was refused on 23 December 2014. The reason given for the refusal was:

> "The proposed residential Annexe at the rear garden of the of the dwelling house at 15 Pelham Road, Clavering would not be compatible in scale, form, layout, appearance and materials with the surrounding buildings; it would harm the existing two trees which supports nature conservation; its scale and mass would harm the character and appearance of the Conservation Area; and its location and pedestrian access would generate nuisance and noise which would harm the living condition of the adjoining occupiers contrary to Policies GEN2, GEN4, GEN7, ENV1, ENV8 and H4 of the Adopted Uttlesford Local Plan (2005).
>
> …
>
> Notes:
>
> 1 The local planning authority has taken into account all the relevant material planning considerations, has considered the possibility of negotiating revised plans or imposing conditions, however it was not considered possible that the material harm to the Conservation Area and the residential amenities of adjoining occupiers could be overcome by negotiation."

16. The location plan supplied with the application shows that the proposed new building was 28m from the house and had a footprint of approximately 13mx8m. It was completely separate from the shed which was shown as remaining to the south of the proposed building.

17. On 7 January 2015 Tristin Swales applied to Uttlesford District Council ("UDC") for planning permission for what was described as:

> "Erection of extension to outbuilding and conversion to residential annexe."

18. The description of the proposed works in the application said:

> "Change of use and extension of existing rear outbuilding from shed/workshop to granny annexe ancillary to existing main dwelling"

19. The application form showed that the proposal had been discussed with Mr Allanah of UDC's planning department who had advised:

> "Amendment to previous submission and plans of proposed new application in respect of change of use and extension of existing rear outbuilding from shed/workshop to granny annexe ancillary to existing dwelling."

20. Under the heading "Materials" the application included:

Walls - description:

Description of *existing* materials and finishes:
Weatherboard siding to timber frame
Description of *proposed* materials and finishes:
Extension of weatherboard siding to match existing. Paint all black.

Roof - description:

Description of *existing* materials and finishes:
Concrete tiles on timber trusses
Description of *proposed* materials and finishes:
Blue-black Marley slate on timber trusses. Existing tiles removed and replaced with slate. Existing trusses reconfigured to match symmetrical profile.

21. The Design Report submitted with the application shows:

> "6.4. Appearance and Materials
>
> The proposed finishes of the granny annexe comprising blue/black Marley slate roof and black painted timber cladding is compatible with numerous houses and barn conversions in the immediate vicinity (number 17 Pelham Road adjacent is clad with black painted timber) The black finishes tend to minimise the visual impact on the environment particularly against a lush green background which exists on site. There is no design motivation to mimic the existing house as it is some 43m from the proposed granny annexe. The nearest dwelling is to the East which is 28m distant.
>
> 10. Services
>
> All services (water, electricity, sewer, and telephone) will be connected to the main dwelling and no new service connections will be sought. It is noted that gas will not be connected to the proposed granny annexe.
>
> 11. Construction Logistics
>
> The materials and methods adopted take into account the constrained access to the East of the main house (approximately 1.2m width)

- The floor slab design is "continuous" i.e. The footings and slab are cast in one pour thus ensuring only one concreting operation. The use of pumped ready-mix concrete avoids the use of using wheel barrows to transport the material. It is estimated that the pour and levelling will take no longer than 1 hour. Using this methodology also ensures that individual concrete components i.e. sand, stone and cement (and their delivery) are not required.

- The new walls to the extension (wall area +/- 100m2) comprise SIPs (structural insulated panels) These panels are prefabricated off site in a factory and consist of an insulating foam core sandwiched between two structural facings, typically oriented strand board (OSB). The panels are 1.2m wide and 2.4m high and will delivered to the front of the house and stored temporarily in the existing garage. Thereafter by necessity they will be manually carried to the back of the property via the side access to the East of the main house. This operation will take no longer than 2 days.

- The new wall cladding to match the existing comprises small scale timber elements. Delivery to the rear is easily accommodated and the operation should take no longer than 2 days

- The wall structure of the existing shed will be retained but additionally insulated with sheep's wool panels and clad internally with plasterboard. This method ensures dry construction and should take approximately 2 days to complete ready for further trades.

- The roof will be modified using existing and new timbers to from trusses in situ. Whilst prefabricated trusses would be preferable the scale of the elements may prevent easy delivery to the rear of the property. This will however be further investigated with prospective suppliers. The construction of the roof including new roof covering is estimated at 4 days.

- Waterproofing of the roof and walls skins will take approximately 2 days

- The shell of the proposed granny annexe should be complete within 2 weeks allowing for inclement weather etc.

- The interior finishes, kitchen, sanitary, electrical and plumbing may take approximately 1 month to complete. However the work will be internal and no disruption due to noise and/or nuisance is envisaged. No weekend or night time work will occur."

22. On 7 March 2015 revised plans were submitted to UDC. They are not markedly different to the superseded plans and no revised Design Report was submitted.

23. There was an officer's report made by Mr Allanah following a site visit made by him on 18 February 2015. In this he reports:

> "Q: Does the site conform with submitted plans? Do plans, forms and description tally?
>
> A: Yes."

24. His view of the application includes a reference to the access ramp which was considered acceptable "because it demonstrates how the proposed annexe is ancillary to the main dwelling".

25. On 23 March 2015 UDC granted approval for:

> "Erection of extension to outbuilding and conversion to residential annexe at 15 Pelham Road ..."

Note 2 to the approval included:

> "The alterations permitted by this consent are restricted to those specified and detailed in the application. Any alteration, demolition or re-building not so specified, even if this should become necessary during the course of the work, must be subject of a further application. It is an offence to carry out unauthorised work to the interior or exterior of a Listed Building in any way, which would affect its character."

The building was not a listed building.

26. There were no conditions in the planning approval relating to the sale or use of the new building. Nor was there anything in it that required the retention of any of the walls of the shed.

The works

27. The work started in April 2016 and lasted 35 weeks. The photographs we saw and the magazine article make it absolutely clear that nothing of the original shed (or "summerhouse" as it was called in the article) remained except the concrete floor slab. That slab was not used as the base for any part of the new building, as a floating slab covering the whole footprint of the new building was installed and from which piles were sunk into the ground.

The appellant's request to HMRC for advice

28. HMRC's records exhibited show that on 28 August 2015 (after approval but before the start of works) the appellant submitted a structured email to HMRC which was obviously about VAT refunds on a new build because, although we do not have the contents of that email, we have the reply of Mrs Kath Regnard, a written enquiries officer. who referred in her email in reply to the appellant's enquiry of 28 August.

29. In that Mrs Regnard said that it was not clear from the enquiry whether he was undertaking the build himself or engaging a contractor.

30. She also said:

(1) That she should make it clear from the outset that the construction cost would not be "VAT free".

(2) VAT Notice 708 explained VAT liability for new builds and "outlines" the conditions for zero rating the construction of a new building.

(3) "As to whether the demolition of an existing building she (sic) qualifies for zero rating under the conditions in section 3.1.2." it may qualify if you have demolished the pre-existing building to ground level.

(4) If you are building the house yourself you cannot benefit from zero rating, but there is a refund scheme where you may be eligible to claim back the VAT on building materials you have purchased.

(5) Her advice was to refer to the notes on the HMRC website to see if you are eligible to make a claim.

31. On 7 September 2015 the appellant phoned HMRC. The Contact Centre sheet exhibited shows that the enquiry type was "DIY Builders" and that the caller was "referred to pn 708 sec 14.2.3".

32. On 14 September the appellant emailed a reply to Mrs Regnard, thanking her for the comprehensive reply he had received. He made seven points to her in order to clarify the situation:

1. He was appointing a contractor to do the work.

2. He was intending to purchase certain materials eg sanitary fittings, taps, kitchen fittings, built in cupboards and light fittings and he intended to claim back VAT on them which he presumed would be acceptable.

3. He had read relevant sections of VAT Notice 708 and he believed he qualified in terms of section 3 "Construction of new qualifying dwellings". He said that the building was "designed as a dwelling" (14.2) and would be used for a "relevant residential purpose (14.6)".

4. He attached the planning permission he had received and pointed out that there were no restrictions regarding rental, occupancy or sale or anything else for that matter except the approval of materials which was being discharged.

5. He and his wife would be occupying the house for residential purposes.

6. The new dwelling was partly (±50%) situated in the footprint of an existing shed. This was to be demolished to slab level. The existing slab might be retained.

7. He had submitted the detailed drawings to Building Control for full approval. He would obtain an appropriate certificate of completion.

33. Finally he said he was struggling to understand why the building would not be considered VAT free, and he would like to know what he should do next to obtain a definitive answer before he met financial commitments he could not afford.

34. On 16 September 2015 Mrs Regnard replied by letter. She addressed some of the points the appellant had raised, and her reply included the following remarks:

(1) It was for the main contractor to decide if the work qualified as properly zero rated under section 3 of Notice 708.

(2) As to points 4 to 6 she said that if all the **other** (her emphasis) conditions were met then the DIY scheme may be used for the project.

(3) As to providing the appellant with a definite answer he could not receive a decision from HMRC before the claim was submitted as it was the National DIY team who would decide whether the building is eligible.

The application for a refund of VAT

35. On 31 January 2017 the appellant sent his form VAT431NB and the required documentation. In his covering letter he said that:

(1) He had contacted the VAT enquiries team and he enclosed the response from Mrs Regnard (see §34). He highlighted her point (1) and said he had obtained a formal price from the contractor which stated the works are exempt from VAT, and accordingly he had entered into the contract.

(2) The "existing building" noted on the plans referred to an existing timber framed shed that was completely removed above ground level with only the slab remaining.

(3) "There are no conditions whatsoever that prevent us from selling or renting the new property (please refer to enclosed planning approvals)."

36. The form VAT431NB contained the following relevant entries in answer to certain questions:

> "Q9 Is the property that you have built a new build? By new build we mean a building that has been constructed from scratch which does not incorporate any part of an existing building.
>
> A9 Yes
>
> Q12 Has Planning Permission been granted for your new build? To obtain a VAT refund you must provide evidence that the works are lawful and send to us a copy of the Planning Permission
>
> A12 Yes
>
> Q13 Do the terms of your Planning Permission (or similar permission) prevent the separate disposal, or separate use, of the new building from any other pre-existing building?
>
> A13 Yes
>
> Q14 Has a Building Regulations Completion Certificate been granted by the local authority or by an approved inspector registered with the local authority building control?
>
> A14 Yes
>
> After Q14 the appellant has written:
>
> 'Note: The existing shed on part of the site was removed above ground level – only the concrete slab remains.'

Q15 Have you got your approved plans from your local authority?

A15 Yes

Q16 Are you intending to live in the property you are claiming for?

A16 Yes

Against Q23 Checklist the appellant stated he enclosed the "Full Planning Permission", "Completion Certificate", a full set of building plans and the original invoices for his claim (which was for £12,731.62).

37. The appellant also signed a declaration saying:

> "If you give incomplete (*sic*) or inaccurate information in this claim, we may charge you a financial penalty or prosecute you."

38. On 2 May 2017 (three weeks after their self imposed deadline for a reply in an acknowledgement of 7 February) an officer from the National DIY Team wrote in response to the claim. They said that after a detailed examination of the claim it had been rejected.

39. The letter quoted the heading of question 9 in the form VAT431NB and then said that a new build, unlike a conversion:

> "will not incorporate any part of an existing building. **This means that where a building is constructed on the site of a pre-existing building it will not incorporate any part of the former building above ground level.**" [HMRC's emphasis]

40. The letter then went on to say that Uttleswood (*sic*) DC had only given permission for the "'Erection of extension to outbuilding and conversion to residential annexe', but this was not the work that was carried out." Further they said that the Planning Application dated 2 September 2015 did not match the Planning Permission which was granted on 23 March 2015. The planning application dated 7 January 2015 was for "Change of use and extension of existing rear outbuilding from shed/workshop to granny annexe ancillary to existing main dwelling".

41. The letter continued by citing the "legal basis of this" as Note (2) to Group 5 of Schedule 8 to the VAT Act 1994. This was then set out in full and a copy of the relevant page of HMRC's VAT Construction Manual was enclosed which referred to the contractor's decision to zero rate and that it did not automatically qualify the work for a VAT refund.

42. Therefore, the letter said, "the works carried out in resect of the property do not satisfy the relevant criteria of the DIY scheme and therefore your claim has been rejected accordingly.

43. The letter then said that the appellant could ask for a review or make an appeal to the Tribunal.

44. On the same day, 2 May 2017, a Penalties Review Officer wrote to the appellant to say that because the claim had been rejected for the "reason (s)" (*sic*) detailed in the

accompanying decision letter, the submission of an ineligible claim meant that the appellant might be liable to a penalty under Schedule 24 Finance Act 2007.

45. The purpose of the letter was then stated to be to establish how the inaccuracies detailed in the accompanying decision letter occurred. To that end it asked for a full explanation for 6 matters about the VAT431NB form. The letter said that HMRC would not charge a penalty if "you took reasonable care to get things right but still made an error".

46. The deadline for a reply was "by return of post" to the "DIY Penalties Review Officer". Factsheets about the Human Rights Act and about penalties for inaccuracies in returns and documents were attached, and the letter asked that in the response (by return of post) the appellant should confirm "that he had received, read and understood the content of factsheet CC/FS9 'Human Rights Act'".

47. By a letter of 3 May 2017 (ie by return of post) the appellant responded to the penalties letter. He referred to his response to the claim rejection letter of the same day and said he had sent further information and would request a review or tribunal in due course as necessary. He asked if the liability for a penalty would be assessed after the additional information had been assessed, as he thought the rejection of the claim may be due to a misunderstanding. Nevertheless he replied to the 6 points.

48. On the same day, as mentioned in the last paragraph, the appellant replied to the letter of 2 May from the DIY Team. He made the point that the building was definitely a new build and referred extensively to the demolition of everything above ground.

49. He said that UDC had given approval to the dwelling as incorporated in the drawings referred to in their approval letter, and he did not understand why it was said that "this was not the work that was carried out". He said that "Erection of extension to outbuilding and conversion to residential annexe" implied, as the planners had told him, the use of the footprint of the shed. This was the UDC's wording, not his.

50. He then discussed in detail the meaning of "annexe", including as given in Notice 708 3.2.6. The previous application which HMRC had referred to was not relevant as it was for a different building in a different place.

51. He said that the so called Planning Application of 2 September 2015 (see §40) was not a planning application, but a Building Control Plans Full submission for the purposes of construction, not planning. He explained to HMRC how they could verify this on the UDC website.

52. He also argued that all the criteria in Note (2) to Group 8 had been met, and made many other points about the information given to him in 2015 by Mrs Regnard.

53. On 31 May 2017 Lee Heggie, a Technical Officer of HMRC, replied saying he had carried out a second look of the claim. He drew the appellant's attention to the Notes in the VAT431NB and quoted a passage that said:

"You **are not eligible** to use this Scheme if you:

• have constructed a property that, because of a condition in the Planning Permission (or similar permission such as a Planning Agreement), cannot be disposed of or used separately"

54. He then quoted Note (2) and paragraph 14170 of the VAT Construction Manual about the use by planners of the word "ancillary" to tie use of disposal of the permitted dwelling to something else, and concluded that the appellant's planning application and approval both showed that the building built was ancillary to the existing building.

55. He then immediately said "I am sorry that I have been unable to give you a more favourable decision"[2]. Rights to a review or appeal were repeated.

56. On 13 June 2017 the appellant responded to Mr Heggie. He noted that Mr Heggie had raised three aspects of the claim:

(1) Separate use.

(2) Building not designed as a dwelling.

(3) Use of the term "ancillary".

57. Accordingly, said the appellant, it must be assumed that Mr Heggie agreed with all the other aspects he had raised. He then responded in detail on the three aspects and also raised the point that no mention had been made of HMRC's letter of 16 September 2015. He requested a review.

58. On 20 June 2017 Mr Heggie replied. We consider the content of this letter later.

59. On 17 July the appellant was informed that HMRC would review the decision of 31 May 2017.

60. On 7 August 2017 Mr Hartley of Reviews and Litigation in HMRC's Solicitor's Office gave the conclusions of his review which were to uphold the decision to refuse the refund. He covered three points:

(1) Note 2(d) (Lawful works). The officer referred to the plans which he said showed the retention of three of the original walls.

(2) "Ancillary/Annex": This was not part of the conclusions of the review, but he made points for the appellant to consider by reference to Note 16(c) to Group 8.

(3) Prior approval: He considered the letter did not give prior approval.

61. On 4 September 2017 the appellant made his appeal to the Tribunal. In this he related that he had made an application for ADR on the same day. HMRC sought a stay of the proceedings and accordingly all time limits were stayed until 31 March 2018. This was renewed until 11 June 2018.

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[2] It is not clear to us what his actual decision was.

62. On 29 March 2018 the appellant told the Tribunal that ADR had not been successful.

What decisions are in dispute before the Tribunal?

63. We have referred to the appellant's request at the start of the hearing to be told what the issues still in dispute before the Tribunal were and to Mr Sanusi's agreement that it was only Note 2(d) to Group 8 of Schedule 5 VATA. However Mr Sanusi's submissions and his cross-examination of the appellant suggested that this was not quite what he had in mind in accepting the appellant's proposition that it was only Note 2(d).

64. We therefore think that we should examine carefully that way this dispute has proceeded to see what happened before the case reached the hearing.

65. The first decision was that of the anonymous member of the DIY Team who wrote on 2 May 2017 rejecting the claim. The grounds for rejection are nowhere explicitly stated, but reading between several lines it is that what was constructed was not a "new build" but an extension of an existing building because a building constructed on the site of an existing building cannot incorporate any part of that existing building above ground level. This is, we assume, a reference to Notes 16 and 18 to Group 5, though that it was not stated[3].

66. The second decision was made by Mr Heggie on 31 May 2017. Here he implied, though he did not explicitly say so, that the claim fails because the planning application and approval both showed that what the appellant had built was "ancillary" to the existing building. Two further inferences are required: by "existing building" we have to decide whether Mr Heggie meant the shed or the main house, as they were both existing buildings. The latter is more likely, but HMRC's seizure on the word "extension" in the planning documentation could imply that they regard the extension as ancillary to the shed. We assume that it is in fact the main house to which they regard the new construction as ancillary. We also note that the word "ancillary" which is the vital word in the decision does not appear in the legislation. It appears in the Notes for completion of VAT431NB in the context of Note 2(c).

67. Immediately before the paragraph setting out the reason for the rejection, Mr Heggie quoted from guidance in VCONST 14170 which he said "refers to this further". "This", we infer, must be his immediately previous quotation of Note 2. Mr Heggie only quoted a part of one paragraph of VCONST 14170 and did not put it in its context, or even refer to its heading. The context is HMRC's guidance about the interpretation of Note 2(c) – the condition that for a building to be "designed as a dwelling" the separate use or disposal of the dwelling must not be prohibited by the terms of any statutory planning consent. VCONST 14140 and 14150 set out HMRC's interpretation of the Note and which cases in this Tribunal and its predecessor officers should follow.

[3] Given the way the DIY team works, by reference exclusively to the VAT Notice and its own guidance, it is likely to be an indirect and unintended reference to those Notes.

VCONST 14160 is about the approach to be taken to attempts to remove a planning restriction by a retrospective application.

68. Mr Heggie's decision was therefore a decision that Note 2(c) prevented the construction of the new building from being the construction of a building designed as a dwelling for the purposes of s 35(1A)(a) VATA. This decision must, in our view, have superseded the previous decision as it justified the rejection of the claim for a different reason, not an additional one.

69. Matters are then complicated by a letter of 20 June 2017 from VAT DIY Team, not Mr Heggie. One complication is that this letter referred back to the superseded first decision of 2 May 2017 and failed to mention Mr Heggie's decision or the fact that appellant had accepted Mr Heggie's offer of a review. But whoever wrote it now linked the previous rejection on the grounds of Notes 16 an 18 to the fact that the planning application submitted by the appellant "sets out" that the annexe the appellant built is "ancillary to the existing dwelling". It then said that "[t]his is supported by your original completion of the form where you have indicated there is a prohibition on separate use and/or disposal of the annexe".

70. This last sentence mystified us at first. The 2015 planning application does indeed refer to construction of an annexe ancillary to the main building (Item 3). But nowhere did the form refer to a prohibition on separate use etc. It then occurred to us that the letter might, in referring to "your original completion of the form", not be talking about 2014 planning application (which did not use the words "annexe" or "ancillary") but the VAT431NB, even though there was only one completion by the appellant of the form (making the word "original" redundant). That last sentence was we therefore think a reference to the appellant's answer to question 13 on that form where the appellant had answered "Yes" to the question dealing with Note 2(c).

71. This letter then went on to say that to make the claim eligible for a refund the appellant would need to demonstrate that UDC were aware he intended to demolish the shed and did not disapprove and that the annexe can be used or sold separately and "when such right was granted". We do not treat this letter as a decision letter.

72. The third formal matter was Mr Hartley's review of Mr Heggie's decision, the second one. Mr Hartley said he upheld the decision that no refund was due under s 35 VATA. The problem with this review is that it reviewed the DIY Team's decision of 2 May 2017. Mr Hartley referred to a letter of 31 May 2017 (Mr Heggie's letter) as being from the DIY team and he noted that the claim was refused on a different basis (ie Note 2(c)) but does not mention that this letter was an appealable decision and superseded the first decision.

73. The sole basis on which Mr Hartley "upheld" the decision of which a review was sought was that Note 2(d) applied, ie that what the appellant had done was not in accordance with the planning consent notice. Thus he was varying Mr Heggie's decision without realising it.

74. He went on nonetheless to point out the provision of VATA explicitly referring to annexes in Note 16(c) and to suggest that if the appellant appealed to the Tribunal he might also need to demonstrate to the Tribunal that the works were not an annexe. He did not explicitly mention Note 2(c) (or (a) and (b)). Mr Hartley suggested that to show that that the works were not an annexe, the appellant might wish to approach UDC to establish what they mean by "residential annexe" and if they consider the construction was tied or bound to the existing house in any meaningful way.

75. We fail to understand why Mr Hartley did this. He had just varied (or upheld as he thought it) Mr Heggie's decision on the basis that Note 2(d) scuppered the claim, so that, as he put it, the "ancillary/annex" point was "not determinative for the purposes of this review". How did he think then that it would be put in issue in the Tribunal?

76. Mr Hartley also addressed the question of "prior approval" by Mrs Regnard of what the appellant was doing and concluded that there was no prior approval. He then told the appellant what he should so if he felt he had received misleading advice, and rightly said that this was not a matter which could be properly considered in a statutory review. The Tribunal is not able to consider this issue, for example whether Mrs Regnard's letters amounted to a misrepresentation or gave the appellant a legitimate expectation that his application would succeed.

77. The next step taken by the appellant was to send his notice of appeal to the Tribunal. In this he also noted that "after extensive correspondence the HMRC have finally defined their rejection of my VAT claim on the basis that the constructed building does not comply with the planning permission", ie the Note 2(d) point.

78. But the appellant also noted that "failing determination of the above the HMRC also claim that the 3 existing walls of the existing shed … should have been retained". On the face of it this seems to us to be a reference to Note 18 of Group 8 but looking back at the correspondence this was something that Mr Hartley also referred to in the context of his conclusion on Note 2(d), and we do not read what Mr Hartley said as putting Note 18 in issue: rather he was using the failure to retain the walls as evidence that the consent had not been followed.

79. Thus at this stage the appellant had filed grounds of appeal only on Note 2(d) and HMRC's variation of Mr Heggie's decision described Note 2(d) as the only issue for determination.

80. The appellant's statement of case filed on 23 September 2018 includes an "Exit Agreement for Partial Resolution" dated 19 December 2017 which was completed as part of the ADR outcome. This document on its face said that it was accepted by HMRC as a document on which the appellant could rely, and indeed it stated that there was information and/or evidence which it set out and which it said the parties agreed would assist in subsequent litigation and that it could be disclosed outside the ADR process. The document also said that Note 2(c) was in issue between the parties as well as Note 2(d).

81. The exit agreement then set out stages for action by the appellant rather than information and evidence. These were that:

(1) The appellant would ask UDC to confirm in writing that demolition to slab level was permitted under the planning approval by the end of January 2018.

(2) The appellant would ask UDC to confirm in writing that the building "can be used and disposed of separately from 15 Pelham Road for example rental and long lease of 21 years or more as of 23rd March 2015" by the end of January 2018.

(3) The appellant would share any such confirmations with HMRC within 14 days of receiving them.

(4) Mr Heggie would then revisit the claim and notify his decision within 14 days, and if "confirmations" were accepted the appellant would withdraw his appeal and the next steps would be for Mr Heggie to consider the invoices.

82. The appellant said that though he was extremely reluctant to revisit the approval which he thought was absolutely clear, he did meet the duty planning officer, Clive Theobald on 14 February 2018. He said that Mr Theobald responded on the two points as follows:

(1) As to the existing walls he said that they could not have been retained as they were not compliant with building regulations. It was not a condition of the planning approval that they must be retained (that was only done for listed buildings) and where it was required it was always listed in the approval. And it was not in the public interest to enforce the retention of unsafe structures.

(2) As to separate use or disposal Mr Theobald said there was no such condition in the approval, and had UDC required such a condition it would have been specifically included in the planning approval. The omission of the word "ancillary" indicated there was no tie between the new dwelling and the main house. As to "annexe" UDC had said in another application which referred to an annexe that the building had no ties to the main complex.

(3) However the planning office was emphatic that the only way to get the information in writing was to formally apply and pay for a Lawful Development Certificate ("LDC") as the council would not simply confirm a discussion in writing.

83. This information was conveyed to HMRC who rejected all the appellant's submissions, even an LDC, and insisted on a letter from the council.

84. The HMRC statement of case ("SoC") dated 6 August 2018, drafted by Mr Sanusi, presumably from the papers he had from the DIY Team, said in its first paragraph that the claim failed because the Note 2(d) condition was not met. The SoC, under "point(s) at issue", rather unhelpfully said that they were whether planning permission was required for the works (no one had disputed that) and whether the claim was eligible for the DIY scheme.

85. The SoC gave as the relevant law and guidance the law referred to in the relevant section of this decision, the VAT431NB Notes, Notice 708 and VCONST 02270 which

is about the retention of façades. It also mentioned two cases *Scott Kernohan v HMRC* in the FTT and *Asim Patel v HMRC* in the Upper Tribunal (which latter is of course binding on us.

86. As to HMRC's contentions, after introductory paragraphs [30] to [34] the SoC refers in [35] to [40] to Note 2(d) and to the approval by UDC of the application which it says cannot be construed as permission for the demolition of the whole building and its replacement with a completely new building.

87. But at [41] to [44] the SoC discusses the issue of annexes, making among others the point that the appellant had not provided evidence from UDC to confirm what they meant by "residential annexe" and if they considered the construction is "bound or tied" to the existing house in a meaningful way.

88. There are then from [45] to the end of the section on HMRC's contentions paragraphs dealing again with the Note 2(d) issue and the regulations and with the question of whether any retrospective permission that might have been granted could help the appellant – and they refer to the case of *Asim Patel*.

89. The appellant's response was to produce his own SoC in which he set out his arguments on three points. Two of them were those covered in the ADR Exit Agreement while the third was to do with his pre-construction application, about which we say no more here as it is not relevant to the appeal hearing. He discussed in depth both the question whether the demolition was permitted under the planning approval and the "use and disposal separate from existing dwelling."

90. He also mentioned case law relating in particular to the "separate use and disposal point", and some on annexes including *Colchester v HMRC* [2014] UKUT 83 (TC) ("*Colchester*") and *St Brendan's 6th Form College v HMRC*.

91. He then responded in detail to HMRC's SoC and in particular to the point that he had said "Yes" to question 13 on the VAT431NB. He said that this was clearly an unfortunate error by the appellant as the Planning Approval did not impose any such restrictions.

92. He also referred to the penalties letter (about which we say more later). The rest of his SoC dealt with the Note 2(d) issue which we deal with below.

93. It is clear to us from, in particular, the appellant's own SoC that he was wholly justified in asking Mr Sanusi through the Tribunal to clarify what HMRC were seeking to argue at the hearing and in particular if Note 2(c) was still in play. We absolve Mr Sanusi from any blame in causing confusion and stress (and we imagine unnecessary cost) to the appellant, as he clearly prepared the SoC using the reviewing officer's conclusions letter as his starting point. The problem for the appellant was caused by the way Mr Heggie for HMRC contributed to the ADR proceedings. He had no business seeking to come to a settlement on conditions about the Note 2(c) point as it had been settled by Mr Hartley.

Discussion of the matter still in dispute

94. Given all the material discussed in the previous section of this decision we should set out what we think was not in issue before us. We do not consider as part of the appeal (although we comment later on some):

(1) The letters from Mrs Regnard in 2015 before construction.

(2) The penalties letter.

(3) The issue of separate use or disposal in Note 2(c).

(4) Whether the works were the construction of an annexe (see Notes 16(c) and 17). This is not a matter on which Note 2(d) itself has any bearing as it is part of the definition of what counts as the "construction of a building" for the purposes of s 35(1A) VATA, a matter which as Mr Hartley pointed out was not determinative of the correctness of the decision he was reviewing.

HMRC's submissions

95. For HMRC Mr Sanusi submitted as grounds for saying that the Note 2(d) was not met:

(1) The planning permission given was for work on an existing building so the claim was ineligible.

(2) The Notes to Group 8 apply for the purposes of s 35 VATA and Note 16 provides that "construction of a building" does not include the conversion, reconstruction or alteration of an existing building nor any enlargement of, or extension to, an existing building except where it creates an additional dwelling or dwellings.

(3) UDC granted planning permission for an extension to the shed and its conversion to a residential annexe. This cannot be construed as permission for the demolition of the entire existing building and its replacement with a completely new building.

(4) The Completion Certificate says the work was "alterations and additions to existing shed to form new dwelling" and so UDC considered the works to be the conversion of an existing building.

(5) Because what there is is a new building, as the appellant maintains, it as not constructed in accordance with the planning permission and so the Note 2(d) condition is not met, and consequently neither is s 35(1A)(a).

(6) Despite the appellant's argument that UDC were aware of the demolition, HMRC have seen no evidence that they knew or approved of the demolition. The plans suggest the contrary and that three of the existing walls would be retained, so the works were actually works of an extension and conversion.

(7) The appellant has not sought to obtain planning permission for the change in the works, and even if he did it could not be retrospective. It is however HMRC policy to accept claims if the appropriate planning permission is received within

three months of the completion. As this was not done the claim fails by virtue of regulation 201(b)(iv) of the VAT regulations.

The appellant's submissions

96. The appellant concentrated in his submissions on the question whether demolition of the shed to slab level was permitted by the planning consent. He takes as his starting point HMRC's statements in their correspondence that they had "seen no evidence to suggest that UDC knew or approved of the complete demolition of the existing building nor that an entirely new building would replace it" and that the blue lines on the planning drawings submitted with the claim and approved by UDC "show that walls on three sides of the existing shed would be retained".

97. He made 15 points:

(1) The most conclusive factor against HMRC was that retention of the 3 walls was not a specific restrictive condition of the planning approval.

(2) The appellant met the UDC planners and there was no doubt that only the slab of the shed would be retained as part of the footprint of the new building.

(3) Nowhere on the drawings was it indicated that the "blue walls" would be retained: they merely showed the location of the existing walls to demonstrate that the footprint was being conformed with.

(4) The planning drawings were required to show before and after on the same plan and the blue lines showed the existing plan of the walls and the green lines the new.

(5) The existing timber 75x75mm structure was too small to accommodate the 120mm insulation required to meet the National Building Regulations.

(6) That timber structure was built directly onto the slab which had no foundations and did not comply with the National Building Regulations. Thus new foundations were needed and to put those in, all walls had to be removed.

(7) That timber structure was untreated for damp and vermin and did not comply with the National Building Regulations.

(8) That timber structure was not fire rated and constituted a life threatening hazard in terms of the National Building Regulations.

(9) That timber structure was of insufficient size to support the structural timbers of the external walls which required at least 125x75mm engineered timbers to comply with the National Building Regulations.

(10) The existing timbers did not meet the 2.4 metre headroom requirements and were too short to accommodate the altered and raised roof.

(11) The existing shiplap cladding was a fire hazard under the National Building Regulations.

(12) The new dwelling was larger (longer) than the footprint and the extended portion had to be in a new cladding material, so it would have been illogical to

retain the two side walls in the existing unmatched cladding. The north wall was to be demolished anyway as shown in the drawings.

(13) As one of the Planning Conditions was that samples of materials had to be supplied to UDC, the planners were aware that new external cladding and consequently walls were to be constructed.

(14) The fact that the north wall was to be demolished suggests it would have been illogical for the planning authority to insist that the other three walls must be retained.

(15) Had it been possible to retain the other three walls the appellant would have done so, as it would have saved him money.

98. He further states in his document that on 20 June 2018 he was sitting on the deck of the new house and saw Mr Allanah, the planning officer in this case pass by on the agricultural land to the south. He invited Mr Allanah to have a look round and subsequently sent him the article in "Build It" magazine which we have seen. He said that a salient point of sending the magazine article was to confirm that Mr Alannah had in fact visited the property after construction and that UDC had not sent him any correspondence to say that any conditions may have been breached.

99. He also contested several statements made in HMRC's SoC. Many are not relevant to the appeal, but those that are include:

(1) The only relevant documents are the planning permission and that the terminology in it refers to the fact that the new building had a greater plan area than the old but incorporates the footprint of the old.

(2) The maxim "if it is not documented it does not exist" applies to planning approvals.

(3) It is necessary to read a planning permission as an entirety including the drawings.

(4) The issue of the completion certificate and the visit of Mr Alannah both without comment are strong evidence that the planning consent was complied with and knew of the demolition.

(5) The title on the planning application is irrelevant. After it is made there may be many discussions with the planning officers which lead to the approval of something different to the original application.

100. The appellant inferred that HMRC has assumed the role of the planning officer by making judgments about what they assume the planning outcome ought to have been – and not what the Planning Approval actually states.

Our consideration

101. To put the argument about Note 2(d) in context it is worth repeating it:

> "A building is designed as a dwelling … where in relation to [the] dwelling the following conditions are satisfied—

…

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

102. There is no dispute about whether statutory planning consent had been granted in respect of the construction of Xanadu or that Xanadu is a dwelling. The only issue is whether its construction had been carried out in accordance with the consent. We agree with the appellant that the only relevant documents in this context are the planning consent itself and the documents attached to it, which in this case included the plans and drawings for the work, the design report and photographs of the existing building.

103. We also agree with the appellant that neither the description he gave to UDC of what he planned to do nor UDC's description of it (where it differed) mattered: what matters is that UDC approved the application including the plans and drawings subject to two conditions neither of which is at all relevant to the appeal.

104. We also make the point that when applicants, planning officers and others use terms they are not to be taken to be using them in the sense that they may have in VATA where VATA may, indeed in this area does, give the terms a specialised tax meaning. For example, no normal person would say that a building was not constructed for use as a dwelling simply because there was a condition in the planning consent that it could not be sold separately from some other dwelling.

105. We therefore think that the approach here by HMRC was misguided. Planning consents are not statutory texts, and even if they were, HMRC's approach owes more to the era of literal interpretation than to today's approach of construing legislation by reference to its purpose.

106. Because we had thought that on the basis of our pre-reading it was relevant, we raised with the parties, and HMRC in particular, whether they were aware of and had considered, the decision of this Tribunal in *Lady Henrietta Pearson v HMRC* [2013] UKFTT 332 (TC) (Judge Colin Bishopp and Mr Richard Thomas) ("*Pearson*"). Neither had, and so we sent each party a copy of the decision after the hearing and directed that the parties may, but need not, make submissions on the effect of the decision on this case. Neither party did so.

107. What the Tribunal said in *Pearson* that is relevant here is this:

"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. [**Our emphasis**]

108. HMRC refer to *HMRC v Asim Patel* [2014] UKUT 361 (TCC) ("*Patel*") in the Upper Tribunal. This was a case heard by that Tribunal after *Pearson*. Judge Bishopp was the presiding judge in the Upper Tribunal and *Patel* was a case which dealt with Rule 2(d). We are sure that if Judge Bishopp had had any doubt about what he had said in *Pearson* he would have raised it.

109. We follow *Pearson* not only because any decision of Judge Bishopp, the then President of the Tax Chamber of the First-tier Tribunal, is worthy of great respect even if not binding, but because Judge Thomas, a member of the *Pearson* Tribunal, has reconsidered the decision to which he was a contributing party and sees no reason to change his mind.

110. The evidence from the appellant is that no one in UDC was under the impression that the three walls were to be retained and certainly not that it was a condition of the planning consent that they must be. This was not based on speculation but on his discussions with Mr Theobald of UDC. The appellant's account of his discussion was of course hearsay, but HMRC were well aware of that fact and what the appellant said about UDC's attitude and did not seek to challenge it. They relied instead on the fact that Mr Heggie had demanded the appellant produce a letter in writing from UDC, something UDC were not prepared to do. We say more about this misguided approach later.

111. This is a classic example of what the Tribunal in *Pearson* said was not appropriate. The appellant has shown us convincing evidence in the form of Planning Circular 11/95 that the retention of walls where there would otherwise be a demolition to ground level is something that would only appear in a planning approval if it was required in relation to a listed building.

112. The shed was not listed and the planning approval contained no condition. But beyond that the plans do not give any indication that the walls were to be retained apart from, arguably, the blue lines. But that is highly arguable: HMRC were putting themselves forward as experts in architectural and planning drawings, again usurping a function that is not rightly theirs. We find the appellant's explanations of this convincing – he is after all an architect used to planning applications and drawings. We find that the thicker blue lines do not indicate any intention to retain the walls.

113. We are also convinced by the appellant's point that retaining the walls would itself have made the works unlawful under the Building Regulations.

114. But we do not need to be convinced by what the appellant says about the plans or the effect retention would have. The walls were not retained, as the photographs make

absolutely clear, so Notes 16 and 18 have the effect that in law the shed ceased to be an existing building, even though the slab was retained, and consequently what was done was in tax terms construction of a dwelling, not an extension or enlargement of an existing building (whatever the correct description, if there is a need for one, in planning terms).

115. The demolition of the walls was not contrary to the planning consent because there was nothing in the consent and the plans which form part of it that required their retention and forbade their demolition, or even assumed their retention, and applying *Pearson* we find that there was no action by UDC to suggest otherwise, even after Mr Allanah had seen what was done. And any points HMRC made about the application under and compliance with the Building Regulations were given their quietus by the fact that the appellant got a completion certificate.

116. We therefore find that the appellant met the condition in Note 2(d). It follows that the appellant's claim meeting the requirement of regulation 201(b)(iv) of the VAT Regulations was in time for the purposes of regulation 201(a).

Other matters

117. It is entirely possible that HMRC will seek to appeal this decision and may obtain leave to do so. We obviously do not give any view of what our reaction would be to such an application, and in any case if we were to refuse leave, HMRC could seek leave from the Upper Tribunal.

118. Against that possibility we think it might be helpful if we set out our views on some of the other points that were canvassed by HMRC and which engaged the parties in detailed correspondence and in ADR proceedings.

119. The matters we discuss here are the "no separate use or disposal" issue (Note 2(c)) and the "annexe/ancillary" issue.

No separate use or disposal

120. We recognise that this issue did not feature in Mr Hartley's review letter or Mr Sanusi's SoC. But as late as 14 February 2018, five months after the notice of appeal against Mr Hartley's variation of Mr Heggie's decision, Mr Heggie was still plugging away at the issue and on 29 March 2018, having refused to accept the appellant's evidence as good enough for his purposes, seems to have assumed that the issue would feature in the appeal hearing.

121. Note 2(c) makes it a condition of a building satisfying the test that it is "designed as a dwelling" that:

> "the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision".

122. In this case as there was a statutory planning consent we do not need to look further than it.

123. Mr Heggie gave the appellant a paragraph (14170) from their VCONST Manual on this topic (see §54). VCONST 14170 is headed:

> "Dwellings - an explanation of terms: what 'designed as a dwelling or number of dwellings' means: how Note 2(c) is expressed in planning notices."

124. It starts by saying:

> "You should not expect the wording of Note 2(c) to appear as an explicit condition in the planning permission. Planners tend to adopt a form of wording that meets the particular circumstances of the case and often use the word 'ancillary' to tie use or disposal of the permitted dwelling to something else."

125. What in fact Mr Heggie gave the appellant was the second sentence of the extract in §124 and he did not quote or refer to the heading. Nor did he refer to the remainder of the Manual page. What the next paragraph says is:

> "The following are examples of how a Note 2(c) prohibition has been expressed in a planning permission:"

126. There follows a list of typical conditions in planning approvals which HMRC constituted prohibitions on separate use or disposal, including one in Planning Circular 11/95 issued by ODPM (as it then was – now DCLG). After that there is a list of cases from before 2010 where Note 2(c) was in issue and the particular prohibition in the planning consent in the case, with the Manual indicating whether the wording used in the planning consent in that case fell within Note 2(c) or not.

127. What Mr Heggie was failing to disclose then was that it was HMRC's view that the prohibition had to be found in the conditions of the planning consent (a view wholly consistent with the wording of the Note). The appellant had supplied a copy of Circular 11/95 in his SoC. The Circular is headed "The Use of Conditions in Planning Permissions". What VCONST 14170 says of it is:

> "Planning Permission Circular 11/95, issued by the Office of the Deputy Prime Minister, provides the following model planning condition where the creation of an additional dwelling would be unacceptable for planning purposes:
>
> > The extension (building) hereby permitted shall not be occupied at any time other than for purposes ancillary to the residential use of the dwelling known as [ ].
>
> This model condition doesn't meet Note 2(c).
>
> Planning Authorities aren't obliged to follow this model condition and can set their own condition. The Tribunal has examined alternative conditions in the cases below. Where a condition is framed in the same way, the Tribunal's decision can be followed, except where indicated. If you are in any doubt about whether a covenant, planning consent or similar document meets Note 2(c), you should consult the Construction Unit of Expertise."

128. On "Granny/Staff Annexes" the Circular says:

> 98. Some extensions to dwellings are intended for use as 'granny annexes'. It is possible that a 'granny annex' which provides independent living accommodation, could subsequently be let or sold off separately from the main dwelling. Where there are sound planning reasons why the creation of an additional dwelling would be unacceptable it may be appropriate, to impose a planning condition to the effect that the extension permitted shall be used solely as accommodation ancillary to the main dwelling house. See model condition 47. [The one in VCONST 14170]
>
> 99. The same is true for separate buildings (often conversions of outbuildings) intended for use as 'granny annexes'. In these cases it is even more likely that a separate unit of accommodation will be created.

129. It is in our view absolutely clear that the Condition in Note 2(c) was met.

"Annexe/ancillary"

130. This is the issue which Mr Hartley did not consider in his review, but which he said might come up before the Tribunal. It didn't because Mr Sanusi agreed it as not in issue, but he had, as we have mentioned, put forward HMRC's contentions on the point, which he took from Mr Hartley's letter in which he was drawing the appellant's attention to points about the issue, and in particular Note 16(c) to Group 5 which says:

> "(16) For the purpose of this Group, the construction of a building does not include—
>
> …
>
> (c) subject to Note (17) below, the construction of an annexe to an existing building."

Note 17 is irrelevant as it applies only where an annexe is intended to be used for charitable purposes.

131. HMRC's submissions started with a reference to the planning application that refers to a "granny annex ancillary to existing main dwelling", and to the planning consent which refers to a residential annexe. They argued that the appellant had not provided evidence that the "property" (sc the "annexe") had a "council tax band" (sc a separate council tax liability from the main house) and that the property had a different address.

132. Nor, they said, had the appellant provided a confirmation from UDC that the property could be sold separately nor evidence from them to confirm what they meant by a "residential annexe" and if they considered that the construction was bound or tied to the existing house in any meaningful way.

133. The appellant refers to VAT Notice 708 3.2.6 on "annexe" although primarily in connection with the "separate use or disposal" argument, as HMRC were saying that

because the building was described as an annexe in the planning consent, it must follow that the separate use restriction applied and the condition in Note 2(c) was not met.

134. Despite what HMRC said about the definition in 3.2.6 applying only where Note 17 is in issue, there is no other definition of annexe in the VAT Notice. In this context the appellant referred to *Colchester*.

135. We are grateful to the appellant for bringing *Colchester* to our attention as not only is it a binding authority in its own right, it comprehensively discusses another binding authority, *Cantrell and another (t/a Foxearth Lodge Nursing Home) v Commissioners of Customs and Excise (No 2)* [2003] EWHC 404 (Ch), [2003] STC 486 ("*Cantrell No 2*"). Rather than try to summarise the decisions we think we can do no better than set out several paragraphs from *Colchester*:

> "15. In its second decision, the Tribunal found that the new building was an annexe and dismissed the appeal. Mr and Mrs Cantrell appealed again to the High Court. In [*Cantrell No 2*], Sir Andrew Morritt V-C defined annexe in Note (16) to Group 5 of Schedule 8, at [16] – [17] of the judgment, as follows:
>
> > 'The reference to an "annexe" in Note (16) when compared with the references to "enlargement" of or "extension" to the existing building introduces a different concept. Thus they may be physically separate so that the connection between the two is by way of some other association. But the Tribunal seems to have thought that any association is enough. In my view that cannot be right. If there were a sufficient association between building A and building B, on the Tribunal's conclusion each would be an annexe of the other. So to hold would ignore the plain inferences to be drawn from the use of the word "annexe".'
>
> An annexe is an adjunct or accessory to something else, such as a document. When used in relation to a building it is referring to a supplementary structure, be it a room, a wing or a separate building.
>
> 16. Sir Andrew Morritt observed, at [20] of the judgment, that:
>
> > 'The judgment of Lightman J was directed primarily to the conclusion of the Tribunal in their first decision that the Phase I works constituted the enlargement of the New Barn. In that context, and in the context of an extension, I understand and agree that the relevant considerations are those which arise from the comparison of physical features of the existing building before and after the works in question. But in the case of an alleged annexe the requirement that such a construction should be an adjunct or accessory to another may require some wider enquiry. It is unnecessary to reach any concluded view on that question to decide this case.'"

136. Pausing there we would, were we called upon to decide, have no hesitation in saying that Xanadu was not an adjunct or accessory to the main house. We go on with *Colchester*:

> "22. … Mr Colchester criticised the FTT for omitting the final sentence of [20] of *Cantrell No 2* which says: "It is unnecessary to reach any concluded view on that question to decide this case."
>
> 23. Mr Colchester submitted that the final sentence of [20] of *Cantrell No 2* showed that Sir Andrew Morritt adopted and applied Lightman J's approach. We regard this submission as unsustainable. Reading [20] and [21] of *Cantrell No 2* together, it is clear that Sir Andrew Morritt considered that there was no need for a wider enquiry where there was nothing in the physical features of a building to suggest that it was an adjunct or accessory to another and thus an annexe. He did not make a wider enquiry in *Cantrell No 2* because he did not need to do so. Sir Andrew Morritt did not rule out the need for a wider enquiry in cases where the position is less clear than it was in *Cantrell No 2* but rather accepted that it may be necessary in such cases. Because he did not need to undertake a wider enquiry in *Cantrell No 2*, Sir Andrew Morritt's observations on this point are obiter dicta. Nevertheless, we consider that they indicate an approach in relation to the issue of whether a structure is an annexe which is clearly correct and should be followed where the physical features of a building in themselves do not clearly lead to a conclusion as to whether or not it is an annexe. The status of the new building in this case was not as clear as in *Cantrell No 2*. We consider that the FTT adopted the correct approach to determining whether the new building was an annexe of the Cottage when it undertook a wider enquiry, ie considered matters other than the physical characteristics and functionality of the new building only.
>
> …
>
> 25. Mr Colchester contended that if a wider enquiry were needed, which he did not accept, then the FTT had erred by considering irrelevant factors such as the intended use of the new building as indicated by the Written Justification document. We consider that the FTT in this case properly considered evidence that was relevant to the issue of whether the new building was an adjunct or accessory to the Cottage. In our view, such evidence includes, in addition to the physical characteristics of both structures which may or may not be determinative of the issue, the matters identified by Lightman J in *Cantrell No 1* as illuminating the potential for use inherent in the building, namely "the terms of planning permissions, the motives behind undertaking the works and the intended or subsequent actual use". Where the physical features do not provide (as they did in *Cantrell No 2* but did not do in this case) a clear indication of whether or not a structure is an annexe, it is necessary to conduct a wider enquiry and consider matters such as the planning permission and intended use of the new building in order to determine its status."

137. In our view there would be no need in this case to make the "wider enquiry" referred to by the Vice-Chancellor in *Cantrell No 2*. The gap of over 40 metres is sufficient to show that Xanadu is not an annexe. But were there a wider enquiry it would, we think, simply point in the same direction. The terms of the planning permission did not prohibit separate sale or disposal, and although they did use the term "annexe" we do not agree that this term in the planning permission must be construed by reference to its meaning in Note 16 of Group 8 (see for example paragraphs 98 and

99 of the Planning Circular 11/95 quoted at §128). The motives for the work were to give the appellant and his wife as much independence as possible in a self-contained building designed for them (eg the access ramp) and to get out from under the feet of their son Tristin, while still being available for child minding duties. And that was the actual use.

138. We put little store by VAT Notice 4.2.6. It clearly supports the appellant's position, but as the Upper Tribunal pointed out in *Colchester* at [30] it requires an annexe to be actually abutting the main building, which from *Cantrell No 2* can be seen not to be a requirement[4]. We do not however accept HMRC's view that the VAT Notice is only relevant at this point to charities falling within Note 17. The reference in Note 17 to an "annexe" cannot possibly have a different meaning from that in Note 16: what Note 17 is doing is carving out a subset of Note 16 annexes which do qualify for zero-rating.

139. HMRC's questions in this about council tax and a different address are irrelevant to whether Xanadu was an annex. More relevant is that all utilities were separate. And we observe that the facts in *Colchester*, where this Tribunal held that the outbuilding was an annexe are a very long way removed from those in this appeal. The building in *Colchester* was clearly ancillary to and used for the purposes of the household occupying the main house: the opposite is the case here.

The penalty letter

140. No assessment to any penalty was before the Tribunal, and from what we have seen none has to date been issued. But one has been threatened, and the time limit for making a penalty assessment under Schedule 24 FA 2007 (the provision mentioned by HMRC) does not expire until 12 months after the date of determination of this appeal. HMRC have not said that they would not raise a penalty assessment after the determination. Even though this decision has gone against HMRC there does not seem to be anything to prevent HMRC issuing a "protective" penalty assessment pending a decision from the Upper Tribunal on any appeal.

141. Obviously what we say below is not necessary for our decision and that decision is in any case not binding authority. But there are aspects of what had been said, and the effect on it on the appellant, about which we think we should comment.

142. The matters which we find disquieting are these:

(1) The penalty letter refers to the rejection of the claim in a letter of the same day for the "reason (s)" detailed in that rejection letter. No one who was not an expert in the law relating to s 30 and Group 5 Schedule 8 VATA reading that letter would understand the reason (singular) why it was rejected, but that is a criticism of the rejection letter, not the penalty letter.

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[4] We observe that HMRC are in something of a cleft stick over annexes. A liberal view of what is an annexe will limit the ability of a claimant to establish that a building is a new build, unless the claimant is a charity in which case a narrow view will limit the extent of the exception in Note 17.

(2) The letter required a response by return of post. That is quite ridiculous when among other things the letter suggested that the recipient liaise with his "Agent" (he didn't have one though). The appellant in fact complied for reasons which he explained.

(3) The penalty letter says that an ineligible claim was submitted. That can only be determined after and not before the process of contesting the rejection, including where necessary up to the tribunal, is complete.

(4) No explanation is given of why the submission of an ineligible claim means that the claimant is liable to a penalty under Schedule 24 FA 2007. What HMRC must show is that there is an inaccuracy in the claim and that that inaccuracy amounted to, or led to, a false or inflated claim to payment of tax and that the inaccuracy was careless or deliberate on the claimant's part. Nothing of the sort was shown.

(5) Because of that, any claimant receiving such a letter might reasonably refer back to the claim form VAT431NB. There in the declaration at item 24 a claimant is told that HMRC may charge a financial penalty for giving "*incomplete* or inaccurate" information in the claim, and that they may be prosecuted for the same cause. Had the appellant in this case anxiously re-examined his claim form, we cannot see what he would have found in the form as submitted that he could on reflection have regarded as inaccurate, except for one thing – he said "yes" to the question (13) whether the terms of his planning permission prevented (the form's odd use of that verb, not the appellant's) disposal separately from any other pre-existing building. Nothing however was incomplete. What then concerns us particularly is the possibility that HMRC had seized on this inaccuracy and would for that reason impose a penalty, much as they did in *C J Palau & R C Loughran v HMRC* [2015] UKFTT 38 (TC), that was, for the reason given in that case, simply wrong-headed. [Our emphasis].

143. To be fair to HMRC however, it seems that they did not in fact notice the incorrect answer, because had they done so they would surely have given that as their reason for rejecting the claim in much more clear and forthright terms than they actually used. So the inaccuracy must be sought for elsewhere. Unfortunately it seems that the inaccuracy on which HMRC would rely is simply the rejection by them of the claim, as if it was self-evident that there must be an inaccuracy within the meaning in paragraph 1 Schedule 24. It is not. No question in the form relates to whether the construction was in accordance with the planning consent[5]. Question 12 asks whether planning permission had been obtained, to which the appellant's truthful answer was "yes". Under the question itself the form says:

> "To obtain a VAT refund you must provide evidence that the works are lawful and send to us a copy of the Planning Permission."

[5] Judge Thomas has been here before: see *Howells & Anor v Revenue & Customs* [2015] UKFTT 412 (TC).

144. The appellant sent the planning permission. The word "lawful" here is clearly meant to be a reference to s 35(1)(b) VATA[6], and can only we think be a reference to whether planning consent had been obtained, given the words used immediately after it in Question 12. It is surely not meant to be a requirement on the claimant that he self-certifies that he actually did everything and no more than the planning permission required whether explicitly or by implication, which is what HMRC's submissions in this case amount to.

145. Despite the decision letter revealing no inaccuracies, the penalties letter said that HMRC required information to establish how the inaccuracies came about. One of the pieces of information required was "Please explain why you consider your claim to be eligible under the DIY scheme?" If HMRC could not understand from the claim form why the appellant thought he was eligible, then surely the action should be questions to the appellant to establish it, not an unreasoned rejection of the claim.

146. The claimant was also asked for details of any "exceptional circumstances or information" they feel to be relevant. How any claimant is expected to know what circumstances are exceptional in this context or what information that HMRC did not have was relevant we cannot fathom.

147. That these questions are singularly unhelpful can be seen from the appellant's reply, by return of post, as requested. On the matter of why he thought he was eligible for a refund, the appellant simply pointed to his letters of 31 January 2017 (the covering letter with the claim) and his reply to the rejection letter of 3 May. He said that he didn't believe there were exceptional circumstances because he had complied with HMRC advice – here the appellant has not realised that what HMRC had in mind (we think) is that there may have been exceptional circumstances which excused the inaccuracy.

148. It is unnecessary and wrong for the recipient to be told, having been asked for relevant information without any clue as to what is or is not relevant, that they **must not** (the words "do not" are emboldened in the letter) include any details about their claim that are not relevant.

149. The recipient was given a factsheet CC/FS9 called "Compliance [misspelled by HMRC] Checks – Human Rights Act." They are told in bold letters that when they respond they are to confirm in writing that they have received, read and understood the contents of the factsheet. The factsheet explains the appellant's right to silence.

150. The letter says that if the recipient did not reply in writing by the 30th day after the date of the letter a decision would be made and HMRC would write. It doesn't say what would happen if the recipient did reply by then, ie what the next step would be. Common sense, elementary politeness and good customer service would suggest that any response, particularly one by return of post, should elicit a response from HMRC

[6] We do wonder why it is in s 35 VATA at all. There is no reference to "lawful" in Items 1 to 4 of Group 5, but Note 2(d) still applies.

either seeking further information, saying that a penalty would be issued or saying that no penalty would be issued. None of those things happened.

151. The appellant in his SoC brought the Tribunal's attention to the penalties letter while admitting it did not have a direct bearing on the issues in the appeal. He pointed out, as we have done, that the letter was issued despite the fact that he had not had an opportunity to respond to HMRC's rejection of his claim. The effect of it was to exert pressure on him not to pursue the claim. He says his family were against contesting the matter because of the threat by the government to prosecute and they exerted pressure on him to drop the mater for fear of prosecution. This placed him under extreme and unnecessary pressure. This type of threatening correspondence was, he says, tantamount to intimidation and should not have been issued by HMRC until all of his arguments were at least recorded.

152. We agree with the appellant.

Decision

153. In relation to the DIY Builders scheme in s 35 VATA, the only appealable decision is one with respect to the amount of any claim (see s 83(1)(g) VATA). HMRC's decision was that the amount was nil. As we have upheld the appeal it falls to us to say what the amount of the successful claim is, and it is therefore £12,731.62 (Item 21 on Form VAT431NB) that amount which falls to be repaid. It is irrelevant that HMRC purported to reserve the right to scrutinise the individual invoices should the appeal succeed: it is too late for that. This was established in *Lady Henrietta Pearson v HMRC* [2014] UKFTT 890 (TC) (Judge Howard Nowlan and Mr Richard Thomas). That was the decision in the second appeal in the case and arose because after Lady Pearson's claim was upheld on appeal in the 2013 decision (see §§106 to 109) HMRC had attempted to reduce the amount claimed on the grounds that the 5% reduced rate should have been charged on the goods acquired by Lady Pearson. The Tribunal held that to be an illegitimate attempt to reopen the appeal.

Costs

154. It will be apparent from what has gone before that we were not impressed, to put it mildly, by HMRC's conduct of this case up to the hearing. We think we should let Mr Swales know that although in the normal run of things in appeals to this Tribunal each party meets their own costs, an exception can be made if the Tribunal considers that a party has acted unreasonably in bringing, defending or conducting the proceedings. The "proceedings" here start when the appeal is made to the Tribunal, so it is only costs incurred after that which can be paid by one party to the other, but the conduct of that party before the appeal may be considered when deciding it was unreasonable.

155. We know of course that the appellant acted in person and is retired, so that the amount of expenses incurred may not be enormous. We therefore leave it to the appellant to decide if he wants to make an application for costs. If he does then he should set out why he thinks HMRC's conduct was unreasonable and send his

application to the Tribunal within 28 days of the date of release of this decision. He should also send a copy to HMRC and we will give HMRC the opportunity to make representations. Once we have them we will make a decision. We should stress that it is by no means certain that we would award costs to the appellant: it depends on our view of what he says and what HMRC say.

156. 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 THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 25 APRIL 2019