



[2020] UKFTT 0018 (TC)

TC07524

VAT –whether reduced rate available for supplies of goods and services in the conversion of a dwelling to a house in multiple occupation- whether subsequent extension subject to reduced rate or standard rate, whether subsequent conversion of extension into single dwelling zero or reduced rate and from when the reduced or zero rate should apply. Appeal allowed in part.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2018/03763

BETWEEN

GARETH BERTRAM

Appellant

-and-

**THE COMMISSIONERS FOR
HER MAJESTY’S REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JUDGE HEATHER GETHING
MEMBER MR CHRISTOPHER
JENKINS**

Sitting in public at Taylor House, London on 20 November 2019 at 10.30 until 2.15 pm

Mr Gareth Bertram in person

Mr Greg Miller, Officer of HMRC for the Respondents

DECISION

INTRODUCTION

1. This case concerns an appeal against an best judgment assessment raised by HMRC under section 73(1) Value Added Tax Act 1992 (VATA) in circumstances where HMRC consider the Appellant has failed to maintain adequate records in respect of services supplied by the Appellant to a property dealing company (PropCo) owned also by the Appellant in respect of which the Appellant claims were reduced rated supplies. The issue concerns nine VAT quarters, 12/14, 03/15, 06/15, 09/15, 12/15, 03/16, 06/16, 09/16, 12/16 and 03/17.

2. The Appellant had reclaimed £18,286.52 VAT on goods and services in connection with the residential conversions into homes of multiple occupation (**HMOs**), subsequent extensions of those HMOs and in some cases conversion of the extension into new single dwellings which supplies had been treated by the Appellant as subject to the lower rate of 5%. HMRC having made an enquiry raised a best judgement assessment in respect of under declared output tax of £59,184.

3. We heard evidence from the Appellant, Mr Haliburton a developer with many years' experience in developing HMOs, and Mrs Jones the Case officer of HMRC

THE FACTS

4. We find the following facts from the evidence given, the witness statements and documents in the bundle and those not in the bundle but presented to the Tribunal at the hearing:

(1) The property company owned by Mr Bertram ("PropCo") acquired two storey residential properties (Class 3) with a view to converting them into HMOs which are Class 4.

(2) At first Propco acquired terraced houses but later recognised the potential of being able to extend the dwelling if he acquired semi-detached properties with land at the side. Propco could increase the number of occupants in the HMO, or if planning permission were obtained, he could create a separate dwelling out of the extension.

(3) Applications for planning permission to create a separate dwelling were made while the construction of the extension was in progress. Propco followed this phased approach to ensure it maximised its resources at all times. The Appellant had informed HMRC of the phased approach at his first meeting.

(4) The Appellant informed us that PropCo acquired one property that did not need an extension. It was so configured that it was possible to create two separate dwellings if planning permission were received. In the period after acquisition and before planning permission, works were undertaken to create an HMO.

(5) We were advised by Mr Haliburton that often there is very little work to do to convert a single dwelling to an HMO. Most of the cost involved can relate to furnishing the property to bring it to a marketable state. Certificates are needed for electricity, gas and fire and work may be needed to obtain those certificates such as rewiring. Some properties in a very bad condition may require more work to the fabric of the building.

(6) We were also advised by Mr Haliburton that conversion from a single dwelling to an HMO did not require planning permission. Planning permission has not been required for the conversion from Class 3 to Class 4 under the General Development Order since 2010 provided there are fewer than 6 occupants in the HMO. Building Regulation approval may be needed if there were major structural alterations. Mr Haliburton also informed us that in some local authorities some Building Control

officers would consider that consent was needed for a conversion from class 3 to class 4.

(7) There are 25 properties under consideration. All had the benefit of an extension and 14 were converted into two or more separate dwellings.

(8) Mrs Jones the case officer had visited the offices of Appellant and had inspected his records. She found that his records relating to the building supplies he made to Propco were not sufficiently full for Mrs Jones to identify exactly what works were carried out by him in relation to each of the 25 properties under consideration to bring about the conversion. Mrs Jones noted that materials with a value of £100,000 were said to have been applied in the construction services provided by Mr Bertram. This seemed to be an enormous amount of material and more likely used in the course of construction of the extensions than on the conversion to HMOs.

(9) Mrs Jones had asked for planning permissions in relation to the conversions to try to assist her establishing what works were involved. The Appellant indicated there were no planning permissions as none were needed.

(10) Mrs Jones obtained information about planning permission obtained in respect of the properties. She found the permissions granted in respect of applications to extend and to convert to separate dwellings from the local authorities concerned. This affected 14 of the 25 properties.

(11) Mrs Jones had not seen any evidence of multiple occupation or what works were needed to create an HMO.

(12) The Appellant explained that Propco did not directly let the properties to individual tenants. PropCo let the properties to residential letting companies who sublet the properties and he would be able to obtain information about the use of the properties as HMOs.

(13) The Appellant thought he would have some difficulty showing what works were done to convert into an HMO in every case, some were more memorable than others. He recognised some information could be obtained from estate agent's details when the properties were acquired.

(14) The parties agreed the VAT liability of the supply of the Appellant's construction services is determined at the time of the supply.

(15) HMRC have indicated that the VAT assessment under appeal concerns 9 quarterly periods and is, owing to the lack of any or sufficiently detailed records maintained by Mr Bertram, based on HMRC's best judgment. The methodology applied by Mrs Jones was:

- (a) in the absence of any evidence of multiple occupation and of works undertaken to convert to an HMO, the estimated assessment assumes there are no reduced rate supplies in relation to the conversion from single dwellings to HMOs.
- (b) the value of the supplies are divided equally between the 25 properties, save where there was an indication that supplies were delivered to a particular property.
- (c) only 14 of the properties benefited from planning permission to convert to two or more dwellings, and in relation to those properties the supplies were treated as zero rated from the date when the planning permission for conversion was granted. The pre planning permission supplies were standard rated.

- (d) Eleven of the 25 properties were regarded as standard rated supplies on the construction of the extensions.

THE LEGISLATION

5. The relevant statutory provisions are set out below.

Section 73 Value Added Tax Act 1994 (VAT Act)

(1) Where a person has failed to make any returns required under this Act ... or to keep any documents and afford facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgement and notify it to him."

S29A VAT Act

"VAT charged on-

- (a) Any supply that is of a description for the time being specified in schedule 7A, or*
- (b) ...*
- shall be charged at the rate of 5 per cent."*

Schedule 7A

Charge at Reduced rate

"Group 6: Residential Conversion

Item No.

- 1. The supply in the course of a qualifying conversion, of qualifying services related to the conversion.*
- 2. The supply of building materials if-*
- (c) The materials are supplied by a person who, in the course of a qualifying conversion, is supplying qualifying services related to the conversion, and*
- (d) Those services include the incorporation of the materials in the building concerned or its immediate site.*

"2. Meaning of Qualifying Conversion

(1) A "qualifying conversion" means-

- (a) A changed number of dwellings conversion (see para 3);*
- (b) A house in multiple occupation conversion (see paragraph 5); or*
- (c) A special residential conversion (see paragraph 7).*

(2) Sub paragraph (1) is subject to paragraphs (9) and (10)."

"3. Meaning of 'Changed number of dwellings conversion'

(1) A changed number of dwelling conversion is-

- (a) a conversion of premises consisting of a building where the conditions specified in this paragraph are satisfied, or*

(b) a conversion of premises consisting of a part of a building where those conditions are satisfied.

(2) The first condition is that after the conversion the premises being converted contain a number of single household dwellings that is-

(a) different from the number (if any) that the premises contain before the conversion, and

(b) greater than or equal to, one.

(3) The second condition is that there is no part of the premises being converted that is a part that after the conversion contains the same number of single household dwellings (whether zero, one or two or more) as before the conversion."

4. Meaning of 'single household dwelling' and 'multiple occupancy dwelling'

(1) For the purposes of this Group 'single household dwelling' means a dwelling-

(a) that is designed for occupation by a single household, and

(b) in relation to which the conditions set out in sub paragraph (3) are satisfied.

(2) For the purposes of this group 'multiple occupancy dwelling' means a dwelling that –

(a) that is designed for occupation by persons not forming a single household,

(aa) that is not to any extent used for a relevant residential purpose, and

(b) In relation to which the conditions set out in sub-paragraph (3) are satisfied.

(3) The conditions are-

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

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

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

(d) That the separate disposal of the dwelling is not prohibited by any such terms.

"10. Conversion not qualifying if planning consent and building control approval not obtained

(1) A conversion is not a qualifying conversion if any statutory planning consent needed for the conversion has not been granted.

(2) A conversion is not a qualifying conversion if any statutory building control approval needed for the conversion has not been granted."

"11. Meaning of supply of services"

(1) In the case of the conversion of a building, supply of qualifying services means a supply of services that consists in –

(a) The carrying out of works to the fabric of the building

(b) The carrying out of works within the immediate site of the building that are in connection with-

(i) The means of providing water, power, heat or access to the building,

- (ii) *The means of providing drainage or security to the building, or*
- (iii) *The provisions of means of waste disposal for the building.*

(2)

(3) *In this paragraph –*

- (a) *References to the carrying out of works to the fabric of a building do not include the incorporation, or installation as fittings, in the building of any goods that are not building materials,*
- (b) *References to the carrying out of works to the fabric of a part of a building do not include incorporation, or installation, or installation as fittings, in the part of any goods that are not building materials.*

Group 7 Residential renovations and alterations

1. *The supply, in the course of renovation or alteration of qualifying residential premises, of qualifying services related to the renovation or alteration*
2. *The supply of building materials if-*
 - a. *The materials are supplied by a person who, in the course of the renovation or alteration of a qualifying residential premises, is supplying qualifying services related to renovation or alteration*
 - b. *These services include the incorporation of the materials in the premises concerned or their immediate site*

"2(1) for the purposes of this Group

"Qualifying residential premises" means-

- (a) *a single household dwelling*
- (b) *a multiple occupancy dwelling, or*
- (c) *a building or part of a building, which, when it was last lived in, was used for relevant residential purposes."*

" (4) The following expressions shall have the same in meaning in this group as they have in group 6-

Multiple occupancy dwelling

Single household dwelling

Items 1 and 2 only apply where premises have been empty for at least two years.

(1) Item 1 and item 2 does not apply unless-

- a. *The first empty home condition is satisfied, or*
- b. *If the premises are a single household dwelling, either of the empty home conditions is satisfied.*

(2) "The first "empty home condition is that neither-

- a. *(a) the premises concerned , nor*
- b.

have been lived in during the period of 2 years ending with the commencement of the relevant works."

"(3) The second empty home condition is that-

c.

Schedule 8

Group 5 – Construction of Buildings etc

"2. The supply in the course of construction of –

(a) A building designed as a dwelling or number of dwellings or intended for use solely for a relevant residential purpose or a relevant charitable purpose; or

(b) ...

of any services related to the construction other than the services of an architect, surveyor or any person acting as a consultant or in a supervisory capacity."

"4. The supply of building materials to a person to whom the supplier is supplying services within item 2 and 3 of this Group which include the incorporation of building materials into the building (or its site) in question."

Respondents' Submissions

6. The Respondents' case is that there are three categories of supplies made by Mr Bertram to PropCo:

- (1)** lower rated supplies made to convert a single dwelling to an HMO,
- (2)** standard rated supplies made in relation to the extensions, and
- (3)** zero rated supplies in relation to the construction of a separate dwelling.

7. As no evidence had been provided of the value or nature of the alleged lower rate supplies HMRC consider that the supplies are either standard rated supplies or zero rated supplies. Only the standard rated supplies are in dispute. The parties accept that 14 of the properties are affected by this issue.

8. HMRC consider that the zero rate applies only to supplies of building services made after the planning permission has been granted to create two separate dwellings.

9. HMRC consider that building services to create extensions to the dwellings are standard rated and not zero rated because in each case the period for which the property must be vacant is not satisfied in Para 3 Group 7 Schedule 7A.

10. HMRC has raised an assessment under section 73 VAT Act to the best of their judgment in relation to the supplies because of the lack of adequate records kept by Mr Bertram. HMRC has applied the following principles:

- (1)** The value of supplies referable to each property are allocated equally to each property, unless there was evidence to the contrary.
- (2)** None of the supplies can be treated as reduced rate as no evidence had been produced of the building work undertaken to convert a single dwelling house into an HMO for any of the 25 dwellings.
- (3)** Supplies are zero rated if they are made after planning permission has been granted to create two separate dwellings.
- (4)** Supplies in connection with the construction of the extensions are in every case standard rated the until planning permission is obtained to convert into a separate dwelling.

The Appellant's Submissions

11. The Appellant contended that all of the services he had performed for Propco were either:
- (1) Reduced rated supplies in the course of a qualifying conversion within Group 6 of Schedule 7A comprising an HMO conversion as defined in para 2 of Group 6, for which neither statutory planning consent nor building control approval is required as mentioned in para 10. These services are liable to VAT at the reduced rate.
 - (2) Reduced rated supplies rendered in the course of constructing extensions to semi-detached dwellings that he had converted to an HMO, which supplies were within Group 7 of Schedule 7A concerning residential renovations and alterations. Or
 - (3) Reduced rated supplies being supplies in the course of a qualifying conversion resulting in a changed number of dwellings within the meaning of Schedule 7A, Group 6, items 1 and 2, and where the changed number of dwellings conditions set out in para 2(1)(a) and 3(1)(a) are satisfied. In each case, where the extension is converted into a separate dwelling the number of single dwelling households is greater than or equal to one.
12. The Appellant accepted that the test in each case was to be applied to the facts at the time the services were being provided.
13. The Appellant indicated that he had provided to HMRC answers to all questions asked of him. He had explained his business model which was structured always to ensure that the land acquired by PropCo was generating income as quickly as possible. HMRC had persisted in requesting details of planning permission and he repeatedly explained that permission was not needed to convert from a single dwelling to an HMO. Further, no Building Regulation Consent was required for the conversion for a single dwelling to an HMO.
14. The Appellant had given the officer access to his records. He accepted that he would have difficulty identifying the expenditure relevant to each property he had converted from a single dwelling to an HMO. He may be able to identify those that needed substantial work with the assistance of estate agents' particulars.

Discussion

S73(1) VATA Assessments

15. We accept HMRC's submissions that Mr Bertram has failed to keep adequate records relating to his construction business to enable HMRC to identify the value of goods and services acquired by him (in respect of which he incurred input tax) that were used by him and supplied by him in each of three phases of development of 25 properties acquired by Propco, namely:
- (1) Conversion from single dwelling to HMO.
 - (2) Extensions to the HMO. And
 - (3) The construction of a separate dwelling.

In consequence HMRC were entitled to raise assessments under section 73(1) VATA.

16. Assessments under section 73 must be made to the best of HMRC's judgment and the authorities indicate that the principles to be taken into account are *Wednesbury* reasonableness principles. This Tribunal may not set aside the assessments made by HMRC simply because we would exercise judgment differently. HMRC's judgment may only be disregarded if the decision made by the Commissioners was dishonestly made or capricious or based upon spurious reasoning or unreasonable.

Conversion from single dwelling to HMO

17. We find that planning permission is not required for conversion from a single dwelling to an HMO where the property is only two storeys high and that all of the properties acquired by Mr Bertram were two storeys high.

18. We accept that Mrs Jones had struggled to identify in the Appellant's records any costs specifically incurred in relation to the conversions from single dwelling to HMOs. As the Appellant had undertaken the task on at least 25 occasions we find it difficult to understand why he was unable to assist Mrs Jones. Further we are influenced by Mr Halliburton, an expert engaged on behalf of the Appellant when he advised the Tribunal that very little expenditure was usually required to convert a dwelling into an HMO. We would expect that in every case locks would be fitted to the bedrooms. As the properties were three bedroom properties after the conversion if not before we would expect expenditure of the order of £1,000 for purchasing and installing the locks in each property.

19. The expenditure that is subject to the reduced rate is that which results in materials applied and embedded in the structure of the building. The reduced rate does not apply to the purchase of furniture etc.

20. We also accept that it is possible that some significant amount may have been needed to convert a property acquired in very poor state. We were struck that the Appellant could not readily bring to mind any single such property. Mrs Jones assessed as zero the expenditure attributable to the conversion to HMOs. We think it unreasonable to exclude the minimum possible expenditure per property which we assess at £1,000 per property but otherwise we do not upset the assessment.

Residential renovations and alterations

21. We accept that it is possible for the supplies of services and goods in the course of building an extension to an HMO are capable of being reduced rated if the conditions set out Group 7 of Schedule 7A are satisfied. One condition that must be satisfied where the building being altered is no longer a single dwelling, is that at the time of the alteration the premises must not have been occupied for a period of two years immediately prior to the commencement of the works, see Paragraph 3(1)(a) and Para 3(2)(a) of Group 7 VAT Act.

As Mr Bertram indicated that he bought residential dwellings and let them immediately this condition was not satisfied because at the point in time when the works began in each case the premises were occupied as an HMO. We do not alter the assessment in this regard.

Construction of a separate dwelling – reduced rate

22. The parties agreed that the nature of the supply was to be determined at the date the construction services were rendered.

23. The reduced rate may be available in relation to services supplied and used in the construction of a qualifying conversion which can include the creation of a new single private residence separate from the HMO, in accordance with VATA 1994 Schedule 7 within Group 6, item 1 and 2. The creation of a single dwelling is specifically provided for in Note 3(2)(b). The creation of a single dwelling is however subject to the condition in Note 10 which deals with planning consents. The reduced rate is only available where the when planning permission needed for such a qualifying conversion has been obtained. Prior to the planning permission being granted the conversion was not a qualifying conversion.

24. To expand on our logic here. There are two possibilities in relation to when Group 6 items 1 and 2 could apply. They could apply:

(1) where the applicable planning and building control consents ("the applicable consents") have been granted either generally by the national legislation (the General Permitted Development Order) or specifically by the local authority at the time of the relevant supply or

(2) where, despite the absence of such consents when the works or other operations requiring applicable consents were carried out, the applicable consents are in the event granted after the time of supply.

25. We consider that the construction at 24.(1) and not the construction at (b) is correct. The alternative reasons for this conclusion are as follows:

(1) The construction at 24 (2) above would imply that in a case where applicable consents are necessary, the VAT liability of relevant goods and services could only be identified after the end of a "wait and see" period (the "waiting and seeing" being necessary to establish whether or not the applicable consents are in the event forthcoming). The legislation does not expressly provide for any wait and see period, nor does it define the length of such a period and a wait and see period sufficient to establish whether the relevant consents will be granted could easily extend at least to months and possibly to years (for example if consent is initially refused but an appeal is made.) The efficient functioning of the VAT system depends, as the CJEU has explained on numerous occasions, on a stage by stage approach whereby inputs are matched against outputs within the time frame established by the return period, normally three months. The stage by stage approach is facilitated by establishing the correct VAT liability at the time of the supply rather than applying any wait and see approach. The Tribunal concludes that these practical matters strongly support the construction at (1) above and not that at (2); and

(2) The evident legislative purpose behind Schedule 7A Group 7 is to improve the suitability of housing stock to the needs of the occupiers to whom it is designed to appeal, by facilitating renovations and alterations. The system of planning and building control is enforced by empowering the planning authorities requiring the demolition or alteration back to the previous condition, in relation to works or other developments which required applicable consents but for which the applicable consents are not in the event granted. Consequently, renovations or alterations which required applicable consents but for which the applicable consents had not been granted at the time when the renovation or alteration works were carried out are precarious, and may need to be demolished or altered back if it is later found that the applicable consents cannot be obtained. The Tribunal considers that it would be an extravagant construction of Schedule 7A Group 7 to conclude that the legislation was intended to apply the zero or the reduced rate to precarious works of this kind because such application would not further the legislative purpose.

In our view, therefore, the requirement of Note 10 must be satisfied at the time of the relevant supplies.

Construction of separate dwelling- zero rate

26. This was argued for by HMRC. This requires the satisfaction of the conditions in Schedule 8, Group 5, Note 2 the details of which are set out above. We consider that the creation of a separate dwelling in the course of construction of an extension would fall within the meaning of a building designed as a dwelling provided that the dwelling consists of self-contained living accommodation, with no provision for indirect access to the dwelling or part of the dwelling, there is no prohibition on disposal of the dwelling or part and where statutory planning permission has been granted and the construction has occurred in accordance with the

permission. We consider that planning permission must have been obtained for the zero rating to be available.

HMRC's best judgment assessment.

27. We accept as reasonable a straight line apportionment of standard rated and zero rated construction supplies before and after the date of the local planning permission is granted to create the single dwellings.

Decision

28. For the reasons set out above we allow the appeal in part.

29. The assessment be amended so as to allow relief for £1,000 for the cost of each conversion of the 25 single dwellings to HMOs

30. The supplies in relation to the construction of a single dwelling for the 14 of the 25 properties should be zero rated and the apportionment of the expenditure on a straight line basis is reasonable in the absence of any other information as to what expenditure was incurred in relation to each property.

31. The balance of the supplies be standard rated.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

32. 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.

JUDGE GETHING
TRIBUNAL JUDGE

Release date: 9 January 2020