[2016] UKFTT 0129 (TC)

TC04917

Appeal number: TC/2015/02762

VALUE ADDED TAX – Section 30 Value Added Tax Act 1994 – Group 5 of Schedule 8 to that Act – conversion of property – grant of first major interest – whether grant is zero-rated supply – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

LANGUARD NEW HOMES LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JANE BAILEY
MRS GILL HUNTER

Sitting in public at Royal Courts of Justice, London on 5 January 2016

Mr Edwards, Croner Group Limited, for the Appellant

Mr Robinson, HMRC Presenting Officer, for the Respondents

DECISION

Introduction

1. By Notice of Appeal dated 8 April 2015, the Appellant appealed to this Tribunal against the Respondents' decision to raise assessments to recover input tax paid to the Appellant for VAT periods ending 02/11 to 08/14. The amount of input tax still in dispute is £92,050.

Background and facts found

2. The parties provided a Statement of Agreed Facts which was included in our bundle. Mr Gibbons, a director of the Appellant, also prepared a witness statement and appeared to give evidence. From the Statement of Agreed Facts and witness evidence we find the following facts:

3. On 21 August 2009 the Appellant purchased, as a going concern, the Haberdashers public house in Battersea ("the public house"). At that time the manager of the public house was a sitting tenant. In early 2010 the Appellant ceased to operate the public house as a business and the manager left.

4. In late 2009 the Appellant sought planning permission to convert the public house into four self-contained dwellings. The planning application was later revised to include the addition of a further floor. Before conversion works started the public house consisted of three floors: a ground floor, which was entirely commercial (and therefore non-residential), and a first and second floor, both of which were used entirely as accommodation by the public house manager (and so were residential).

5. Following the grant of planning permission in 2010, the Appellant carried out conversion works to the public house. As a result of those works, the ground and first floors of the public house were converted vertically into two maisonettes (the "lower maisonettes"). Each of the lower maisonettes contained a part which was previously the commercial ground floor of the public house, and a part which was previously the manager's accommodation. As part of the conversion, the Appellant added a third floor to the public house. The second and (newly created) third floors of the public house were converted vertically to form another two maisonettes (the "upper maisonettes"). Each of the upper maisonettes contained a part which was previously the manager's accommodation, and a part which was the newly created third floor.

6. Therefore, when looked at as a whole, the building which was originally partly public house and partly manager's accommodation was converted into a building which, with the addition of the third floor, comprised of four maisonettes.

7. In 2011 the Appellant sold its interests in each of the lower maisonettes and the upper maisonettes to third parties. Each of those sales by the Appellant constitutes the first grant of a major interest in the respective maisonette.

8. The Appellant originally treated the grant of the major interest in each of the maisonettes as a supply which was zero rated under Section 30 Value Added Tax Act 1994 ("VATA 1994"). On the basis that each grant was a taxable supply, the Appellant reclaimed input tax in relation to the conversion of the whole of the public house. The Respondents disagreed that each grant was a taxable supply, contending instead that each grant was exempt from VAT.

9. It is now agreed that the major interest grant in each of the upper maisonettes is exempt from VAT, and so the Appellant cannot recover input tax in relation to this aspect of the conversion of the public house.

10. The position in relation to the lower maisonettes remains in dispute.

The dispute

11. The Appellant submits that the conversion of the commercial ground floor of the public house constitutes the conversion of non-residential part of a building into a number of dwellings, within Item 1(b) of Group 5 of Schedule 8 to VATA 1994. Therefore the grant of the first major interest in each of the two lower maisonettes is zero rated and the Appellant is entitled to relief under Section 30 VATA 1994.

12. The Respondents contend that the grant of the major interest in each of the lower maisonettes is exempt rather than zero rated, as the conversion does not fulfil the criteria in Group 5 of Schedule 8.

Onus and standard of proof

13. The onus of proof is upon the Appellant to establish that the major interest grant in each of the lower maisonettes is a zero rated supply. The standard of proof is the balance of probabilities.

Authorities

14. We were referred by the parties to the following authorities:

- *Calam Vale Limited v Commissioners of Customs and Excise* (Decision No. 16869 of the VAT and Duties Tribunal) ("*Calam Vale*");
- *Customs and Excise Commissioners v Jacobs* [2005] EWCA Civ 930 ("*Jacobs*");
- *Alexandra Countryside Investments Limited v HMRC* [2013] UKFTT 348 ("*Alexandra Countryside*"); and
- *DM and DD Macpherson v HMRC* [2015] UKFTT 626 (TC) ("*Macpherson*").

Appellant's submissions

15. Mr Edwards, for the Appellant, submitted that the conversion of the ground and first floors of the public house into the lower maisonettes was a conversion of a non-residential part of a building within Item 1(b) of Group 5 to Schedule 8. Mr Edwards

set out his submissions in a thorough and detailed skeleton argument which took us through the authorities and their application to the facts of the present appeal.

16. Mr Edwards' submissions started with his analysis of *Alexandra Countryside*, which adopted the reasoning of the Court of Appeal in *Jacobs*. Mr Edwards submitted that the reasoning in *Alexandra Countryside* was to be preferred due to the careful analysis set out by the Tribunal. Mr Edwards submitted that *Alexandra Countryside* was also to be preferred on the basis that it had been decided more recently than *Calam Vale*, and noted that the Tribunal in *Calam Vale* had described its own conclusion as absurd.

17. Mr Edwards submitted that the recent decision of *Macpherson* should not be followed due to the lack of a suggestion in that decision as to when Note 9 of Group 5 would, or could, be engaged. Mr Edwards also submitted that the Tribunal in *Macpherson* had ignored the reasoning in *Jacobs*, and that we should prefer the Court of Appeal's construction of the phrase "into a building designed as a dwelling or number of dwellings". Mr Edwards submitted that even if we did not consider ourselves bound by *Jacobs*, we should still follow its compelling analysis.

Respondents' submissions

18. Mr Robinson, for the Respondents, set out in his skeleton argument the Respondents' submission that the conditions in neither Note 7 nor Note 9 of Group 5 are met in this case, and therefore the Appellant does not meet the requirements of Item 1(b) of Group 5. Mr Robinson submitted that the correct position was as set out in HMRC's Business Brief 22/05.

19. Where the authorities differed, Mr Robinson submitted that *Calam Vale* was to be preferred over the more recent *Alexandra Countryside*; alternatively *Macpherson* should be preferred. Mr Robinson submitted that *Jacobs* was not binding upon this Tribunal as it was a decision concerning the DIY refund scheme under Section 35 VATA, and not a decision in relation to zero-rating under Section 30 VATA 1994.

Decision

20. We start with the relevant legislation. Section 30 VATA 1994 provides that a supply of goods or services which are of a description specified in Schedule 8 to VATA 1994 shall be treated as a taxable supply but the rate at which VAT is charged is nil. The relevant group of Schedule 8 is Group 5, and below we set out the parts of Group 5 which are in dispute:

> Item 1 The first grant by a person-
>
> > (b) converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings …
>
> of a major interest in, or in any part of, the building, dwelling or its site.

> Note 7 For the purposes of item 1(b), and for the purposes of these Notes so far as having effect for the purposes of item 1(b), a building or part of a building is "non-residential" if-
>
> (a) it is neither designed, nor adapted, for use-
>
> (i) as a dwelling or number of dwellings, …
>
> Note 9 The conversion … of a non-residential part of a building which already contains a residential part is not included within items 1(b) or 3 unless the result of that conversion is to create an additional dwelling or dwellings.

21. We are satisfied that the public house consisted of both residential and non-residential parts prior to its conversion, and that the ground floor was "a non-residential part of a building". Although the Respondents contended in their skeleton argument that Note 7 was not met in this case, we understand that this argument extends only to the first floor of the public house and not to the ground floor. It is agreed that the first and second floors of the public house were residential. The issue for us to determine is whether the ground floor was converted "into a building designed as a dwelling or number of dwellings".

22. The same question came before the VAT and Duties Tribunal (a predecessor of this Tribunal) in *Calam Vale*. The facts in *Calam Vale* were very similar: a public house was part residential and part non-residential prior to its conversion into two dwellings. Each of the two new dwellings was formed from a residential part and a non-residential part. The Tribunal in *Calam Vale* was asked to decide whether the conversion fell within item 1(b), and spent some time considering the effect of Notes 7 and 9 before concluding that item 1(b) did not apply. At paragraph 10 of its decision, the Tribunal held:

> But the conversion here does not fall within Item 1(b) in the first place: it is not the simple conversion of a non-residential part of a building but the conversion of that part plus a residential part. If only Item 1(b) had read "converting … into a building or part of a building" the position would be entirely different. But that is not what it says, and zero-rating has to be construed strictly; there is no question of any Human Rights-style "reading in".

23. The Tribunal obviously reached this conclusion with great reluctance, continuing:

> 11. We are accordingly forced by an absurd (and perhaps none too carefully drafted) law into an absurd decision which flies in the face of common sense, of equity and of the "social purpose" which is supposed to underlie and inform zero-rating. … As we suggested to Mr Grodzinski, if you take a four-storey office block with a wide frontage and a caretaker's flat occupying the whole of the attics and convert that block vertically into four town houses (each incorporating a quarter of the attic) you will get no relief; if you convert it horizontally into four flats, leaving the attics

> untouched, you will get relief. That seems a strange result. Equity would suggest that there should be apportionment; the Act, whether inadvertently or by design, makes no provision for this. "Social purpose" suggests that the conversion of a commercial building and its none too desirable, in effect "tied", flat into two normal dwellings is something to be encouraged, apparently it is not.

24. This interpretation is relied upon by the Respondents as providing the correct approach to Item 1(b). Mr Robinson urges us to follow that approach and conclude that the ground floor of the public house was not "converted into a building designed as a … number of dwellings" on the basis that the lower maisonettes comprise other parts of the public house in addition to the non-residential ground floor.

25. Although there is an attractive straightforwardness to the construction adopted by the Tribunal in *Calam Vale*, we are concerned that this construction does not fully take account of the purpose and context of Item 1(b). As pointed out by the Tribunal in *Calam Vale*, the social purpose for zero-rating the conversion of non-residential property into dwellings is not respected by this interpretation.

26. In addition, we do not consider that this construction of Item 1(b) (which the Tribunal in *Calam Vale* felt obliged to adopt) fits comfortably with the remainder of Group 5, in particular Note 9 which was drafted at the same time. Note 9 requires consideration of the number of dwellings before and after the conversion, and provides that a conversion is not included in Item 1(b) unless there are additional dwellings after the conversion. Our concern is: If the conversion of a non-residential part of a building is within Item 1(b) only if the new dwelling is formed solely from non-residential parts, then – under the construction asserted by the Respondents – there would always be additional dwellings as a result of the conversion. If the Respondents are correct then we struggle to see what purpose would be served by the test in Note 9. We asked Mr Robinson when Note 9 would be engaged if the construction adopted by the Tribunal in *Calam Vale* is the right approach. Mr Robinson was unable to suggest any circumstances in which Note 9 could be engaged, or any purpose or function for Note 9. We agree with Mr Edwards, for the Appellant, that the draftsman of Group 5 must have intended Note 9 to have a purpose and that it would be unsatisfactory to adopt an approach to Item 1(b) which leaves Note 9 without any meaning or function.

27. Mr Robinson suggested, as an alternative to the construction of Item 1(b) set out in *Calam Vale*, that the correct interpretation was as set out in the recent Tribunal decision of *Macpherson*. In *Macpherson*, the Appellant converted a building into two dwellings. Prior to conversion the building consisted of residential and non-residential parts, and each of the two new dwellings which was created was formed from residential and non-residential parts. The Tribunal in *Macpherson* reviewed the authorities and agreed with HMRC that the decision in *Calam Vale* was to be preferred over *Alexandra Countryside* (which we consider below). The Tribunal in *Macpherson* held:

> 31. When construing item 1(b), to see whether, in any particular case, a person is converting (or has converted) "a non-residential building or a

non-residential part of a building into a building designed as a dwelling or number of dwellings", one has, in our judgment, to examine the conversion actually carried out. In this case it is clear that the Property (taken as a whole) was not a non-residential building within the definition in the applicable Note (7). This is because it was designed for use as a dwelling by virtue of the living accommodation contained within it. Although we accept that if one divided up the Property one would find that it contained both a residential part and a non-residential part, nevertheless it would not be correct to describe the conversion works in this case as the conversion of the non-residential part of a building – they were works of conversion of the entire Property. For this reason we hold that the Partnership has not converted a non-residential building or non-residential part of a building and we are therefore in agreement with the conclusion of the Tribunal in *Calam Vale* that the conversion does not fall to be zero-rated, because it does not come within item 1(b), not being "the simple conversion of a non-residential part of a building but conversion of that part plus a residential part".

28. The Tribunal in *Macpherson* considered the conversion should be looked at as a whole, and held that as the conversion could not be described as the conversion of the non-residential part of a building then Item 1(b) did not apply. This analysis appears to us to differ from the approach taken by the Tribunal in *Calam Vale*. (Given the Tribunal's example in *Calam Vale* of the differing outcomes if a building is converted into four townhouses or four apartments, we do not consider that the Tribunal in *Calam Vale* would have concluded that a conversion would not fall within Item 1(b) because it was not a conversion of a non-residential part of a building but a wider conversion of a whole.)

29. If the conclusion in *Macpherson* is correct, the majority of conversions which could meet the conditions of item 1(b) would be those where non-residential buildings are converted into dwellings. The only scope for a conversion of a mixed use building to be within Item 1(b) would be where the residential parts of a mixed use building are completely untouched by the conversion. This seems unnecessarily strict and goes further than HMRC's position as set out in Business Brief 22/05. We asked Mr Robinson what view the Respondents would take if the conversion before us had been horizontal rather than vertical, and each floor of the public house had been converted into an apartment (as in the example given in *Calam Vale*). Mr Robinson confirmed that the Respondents' view was that a conversion of solely the ground floor of the public house into one complete dwelling would be within Item 1(b). This is despite the conversion, looked at as a whole, being of the whole of the public house.

30. Although Mr Robinson suggested we should follow *Macpherson* as an alternative to following *Calam Vale*, the analysis in *Macpherson* would seem to contradict the reasoning in Business Brief 22/05 which the Respondents contend sets out the correct position. In our opinion *Macpherson* would deny relief to a taxable person who had undertaken a horizontal conversion of a building similar to the public house on the basis that the conversion when looked at as a whole was not the conversion of a non-residential part but of a mixed use building. The make-up of the

final dwellings appears irrelevant to the *Macpherson* analysis although it is critical to the reasoning set out in the Respondents' Business Brief 22/05.

31. We do not consider that the correct approach to Item 1(b) can be one which excludes conversions from the whole of mixed use buildings. Although zero-rating provisions should be construed narrowly, we do not consider that such a narrow interpretation of Item 1(b) can be correct. In addition, while this approach would avoid the distinction between vertical and horizontal conversions which was identified as an absurdity by the Tribunal in *Calam Vale*, this approach also does not appear to leave Note 9 with any purpose. The Tribunal in *Macpherson* stated that Note 9 was not engaged on the facts before it. However, it is difficult to see any circumstances in which Note 9 could ever be engaged if the *Macpherson* approach is correct.

32. Therefore we turn to the reasoning of the Tribunal in *Alexandra Countryside* which Mr Edwards, for the Appellant, submitted was to be preferred. *Alexandra Countryside* again concerned the conversion of a public house into two dwellings. Before conversion the building had been part residential and part non-residential; after conversion each new dwelling was formed from residential and non-residential parts of the building. In *Alexandra Countryside* the Tribunal was referred to the decision of the Court of Appeal in *Jacobs*, which concerned the conversion of what used to be a residential school into a very substantial family home, including three self-contained staff flats. Mr Jacobs' claim was not under Section 30, but under Section 35 VATA 1994, known as the DIY refund scheme. The relevant part of Section 35 provides:

> "(1D) For the purposes of this section works constitute a residential conversion to the extent that they consist in the conversion of a non-residential building, or a non-residential part of a building, into-
>
> (a) a building designed as a dwelling or a number of dwellings;
>
> (4) The notes to Group 5 of Schedule 8 shall apply for construing this section as they apply for construing that Group."

33. The Court of Appeal held that the effect of importing the notes of Group 5 was that Note 9 of Group 5 was to be read as if it was part of Section 35 VATA 1994. From that conclusion it was stated that four points emerged. Mr Edwards pointed us to the fourth of these points which, he submitted, was crucial:

> 34 (iv) … But paragraph (a) [of Section 35(1D) set out above] also applies to the extent that a non-residential *part* of a building is converted. The question then arises, "Into what is that part to be converted?". The clear answer given by the language of the subsection is that just as in the case of the conversion of the building itself, the part of the building likewise has to be converted into a building designed as a dwelling or number of dwellings. Paragraph (a) does not require the part of the building to be converted into a part of the building designed as a dwelling. The subsection does not say that. Words would have to be written in to give it that meaning. It seems to me therefore that on the proper construction of paragraph (a) it is enough if the non-residential part is converted into, that is to say changed in its character and made part of, the new building

which results from the conversion and it is in the building as a whole that one must look to find whether it – the building as a whole – has been designed as a dwelling or number of dwellings."

34. The Tribunal in *Alexandra Countryside* applied the reasoning in *Jacobs* and held that the correct approach to Item 1(b) was to look at the non-residential part of a building and consider into what it had been converted. Where that non-residential part became part of a new property then it was appropriate to look at that new property as a whole to determine whether it (the new property) was designed as a dwelling or number of dwellings. In *Alexandra Countryside* the non-residential part had been combined with a residential part to form two new dwellings. As there was originally one dwelling in the building before conversion, and two dwellings after conversion, then the Tribunal determined that Item 1(b) applied and that the supply of a major interest grant in each of the two new dwellings should be zero rated.

35. In considering whether the non-residential part of the original building had formed part of an eventual building which, looked at as a whole, was designed as a number of dwellings, the Tribunal in *Alexandra Countryside* avoided the "absurd" conclusion which the Tribunal in *Calam Vale* considered itself obliged to reach. The approach in *Alexandra Countryside* is also one which allows Note 9 to have a valid role in considering a claim.

36. Having reviewed the authorities we must now reach a decision in respect of the appeal before us. Our consideration of the legislation, assisted by our review of the authorities, has led us to the conclusion that the correct interpretation of Item 1(b) must be one which sets it in the context of Group 5 as a whole, which provides a role for Note 9 and which meets the social purpose. We do not consider that an interpretation of Item 1(b) which leaves Note 9 without any function can be correct.

37. We consider that the purpose of Note 9 is to exclude from Item 1(b) any conversion of a mixed use building into dwellings unless additional dwellings (when compared to the building as a whole before conversion) have been created as a result of the conversion of the non-residential part of the mixed use building. The draftsman of Item 1(b) must have considered that the conversion of the non-residential parts of mixed use buildings into dwellings would fall within Item 1(b) in order to have considered it necessary to draft Note 9 to exclude some of such conversions.

38. As the effect of converting the non-residential part of a building alone (that is to say the non-residential part not combined with any residential part) into a dwelling would always be to create more dwellings than previously existed, we conclude that the draftsman must have contemplated the possibility that one or more new dwellings would be created from bringing together residential and non-residential parts of the mixed use building. We bear in mind that to achieve the social purpose of creating additional housing it does not matter from what constituent parts the new dwellings are created provided that additional dwellings are created as a result. However Note 9 would be required in order to ensure that relief is available only in those situations where additional housing is created.

39. If we are correct in our understanding of Note 9 then a mixed use building which previously contained one dwelling would be excluded from Item 1(b) if the result of converting the non-residential part was to create one large dwelling. However, the conversion would be included in Item 1(b) if the building was converted into two or more moderately sized dwellings. In the second case, housing stock is increased and so relief under Section 30 would be available. This is in accordance with our understanding of the social purpose behind Group 5.

40. Looking at Item 1(b) in the light of our conclusions regarding Note 9, we conclude that "converting … a non-residential part of a building into a building designed as a … number of dwellings" should be construed as meaning that the non-residential part of a building has changed its character and now forms part of a building designed as a number of dwellings. It follows that we agree with the Appellant and prefer the careful reasoning of the Court of Appeal in *Jacobs* and of the Tribunal in *Alexandra Countryside*. It seems to us that this is the better interpretation of Item 1(b) as it enables Group 5 to be interpreted as a coherent whole.

41. Applying our interpretation of Item 1(b) to the facts found, the non-residential part of the public house has been converted into, i.e. changed its character into, a building designed as four dwellings (the lower maisonettes and the upper maisonettes).

42. In considering Note 9 we have regard to the number of dwellings which existed in the public house before the conversion, and the number of dwellings which exist as a result of the conversion of the non-residential part. There was one dwelling in the public house prior to conversion. As a result of the non-residential part of the public house becoming part of a building designed as four dwellings, four dwellings exist. So we conclude that the major interest grant in each of the lower maisonettes does fall within Item 1(b) of Group 5, and is not excluded by Note 9.

Conclusion

43. The Appellant's appeal is allowed for the reasons set out above.

44. 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.

JANE BAILEY
TRIBUNAL JUDGE

RELEASE DATE: 25 FEBRUARY 2016