TC01523

Appeal number TC/2010/07496

VAT – Registration – Whether intending to make taxable supplies – Whether work undertaken to turn a detached property into two dwellings was a conversion, alteration, extension or enlargement of an existing building – If so whether extension or enlargement created an additional dwelling – VATA 1994 schedule 8 Group Note 16 – Whether apportionment possible – Appeal allowed

FIRST-TIER TRIBUNAL

TAX

ALAN & MAUREEN WRIGHT **Appellants**

- and -

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

TRIBUNAL: JOHN BROOKS (TRIBUNAL JUDGE)
WILLIAM HAARER (MEMBER)

Sitting in public at Keble House, Southernhay Gardens, Exeter EX1 1NT on 11 October 2011

Garry Alexander of Wheelers Accountants for the Appellant

Christopher Shea of HM Revenue and Customs, for the Respondents

DECISION

Background

1. Mr and Mrs Wright bought and made their home at "Thornlea," a detached, three bedroomed, seventeenth century manor cottage in the village of Woodbury in Devon. In 2006, having lived at the property for approximately 20 years they decided to undertake a speculative building project, with a view to a profit, by turning their home into two separate semi-detached houses and selling one of the houses whilst continuing to live in the other.

2. Although there was not sufficient land on either side of the house to build a second property it was possible to create two semi-detached properties by building on each side of the existing house. The project consisted of:

(1) building on to both sides of the existing property to create additional rooms and create a symmetrical look to the building;

(2) raising the height of the four outside walls of the property by approximately four feet to give both dwellings an additional floor;

(3) the construction of a party wall just to the left of the front door of the existing property; and

(4) the construction of a new roof.

In addition the internal fabric of the existing building was almost completely gutted and the existing internal walls, floors, windows and the old roof were removed.

3. The end result was the creation of two semi-detached properties, "Thornlea" with three bedrooms and an additional floor, which was retained as a home by Mr and Mrs Wright and "Well Court", a five bedroom property consisting of a ground, first and second floors which they sold. Approximately 35% of the total floor space of Well Court had previously been part of the existing building with the remaining 65% being newly constructed.

4. In order to recover input tax attributable to Well Court Mrs and Mrs Wright applied to HM Revenue and Customs ("HMRC") to be registered for VAT as "intending traders" on 2 March 2010.

5. The application was refused by HMRC on 4 June 2010 on the grounds that Mr and Mrs Wright were "making or intending to make entirely exempt supplies". The decision to refuse VAT registration was formally reviewed and subsequently confirmed by HMRC on 19 August 2010.

6. This is an appeal by Mr and Mrs Wright against the decision to refuse their application to register for VAT.

Law

7. Section 25 of the Value Added Tax Act 1994 ("VATA") provides that a "*taxable person*" is "*entitled to credit for so much of his input tax as is allowable under section 26* [VATA]."

8. Insofar as it applies to the present case s 26 VATA entitles a "*taxable person*" to credit input tax on supplies received that are attributable to "*taxable supplies*" made by him "*in the course or furtherance of his business.*"

9. A "*taxable person*" is defined by s 3 VATA as someone who "*is, or is required to be registered under this Act.*"

10. Paragraph 9 of Schedule 1 VATA provides:

> *Where a person who is not liable to be registered under this Act and is not already so registered satisfies the Commissioners that he–*
>
> *(a) makes taxable supplies; or*
>
> *(b) is carrying on a business and intends to make such supplies in the course or furtherance of that business,*
>
> *they shall, if he so requests, register him with effect from the day on which the request is made or from such earlier date as may be agreed between them and him.*

11. Section 4(2) VATA defines a "*taxable supply*" as "*a supply of goods and services made in the United Kingdom other than an exempt supply*".

12. An "*exempt supply*" is, according to s 31(1) VATA, a supply of goods or services if it is of a description specified in schedule 9 VATA. This includes the "*grant of any interest in or a right over land*" (see Item 1 Group 1 schedule 9 VATA).

13. Section 30(1) VATA provides:

> *Where a taxable person supplies goods or services and the supply is zero-rated, then, whether or not VAT would be chargeable on the supply apart from this section–*
>
> *(a) no VAT shall be charged on the supply; but*
>
> *(b) it shall in all other respects be treated as a taxable supply;*
>
> *and accordingly the rate at which VAT is treated as charged on the supply shall be nil.*

14. A zero-rated supply, which is to be treated as a taxable supply, is a supply of goods or services of a description specified in schedule 8 VATA (see s 30(2) VATA).

15. Item 1 of Group 5 schedule 8 VATA provides:

> *The first grant by a person–*
>
> *(a) constructing a building–*
>
> *(i) designed as a dwelling or number of dwellings; or*

(ii) intended for use solely for a relevant residential purpose or a relevant charitable purpose; or

(b) converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or a number of dwellings or a building intended for use solely for a relevant residential purpose

of a major interest in, or in any part of, the building or its site.

16. However, the Group is to be read subject to the Notes appended to it. The relevant Notes in this case are Notes 10 and 16. Note 10 states:

Where-

(a) part of a building that is constructed is designed as a dwelling or number of dwellings or is intended for use solely for a relevant residential purpose or relevant charitable purpose (and part is not); or

(b) part of a building that is converted is designed as a dwelling or number of dwellings or is used solely for a relevant residential purpose (and part is not)-

then in the case of-

(i) a grant or other supply relating only to the part so designed or intended for that use (or its site) shall be treated as relating to a building so designed or intended for such use;

(ii) a grant or other supply relating only to the part neither so designed nor intended for such use (or its site) shall not be so treated; and

(iii) any other grant or other supply relating to, or to any part of, the building (or its site), an apportionment shall be made to determine the extent to which it is to be so treated.

17. Note 16, so far is it is relevant to the present case, provides:

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) ... the construction of an annex to an existing building."

18. The question of whether works carried out fell within Note 16(b) were considered in *Cantrell and another (trading as Foxearth Lodge Nursing Home) v Customs and Excise Commissioners* [2000] STC 100 ("*Cantrell*"). In that case Lightman J referred to the two-stage test for determining whether works carried out constituted an enlargement, extension or annexe to an existing building saying of the test, at [4], that:

"It requires an examination and comparison of the building as it was or (if more than one) the buildings as they were before the works were

> carried out and the building or buildings as they will be after the works are completed; and the question then to be asked is whether the completed works amount to the enlargement of or the construction of an extension or annexe to the original building (see *Customs and Excise Comrs v Marchday Holdings Ltd* [1997] STC 272 at 279). I must however add a few words regarding how the question is to be approached and answered. First the question is to be asked as at the date of the supply. What was in the course of construction at the date of supply is in any ordinary case (save for example in case of a dramatic change in the plans) the building subsequently constructed. Secondly the answer must be given after an objective examination of the physical characters of the building or buildings at the two points in time, having regard (inter alia) to similarities and differences in appearance, the layout and how the building or buildings are equipped to function. The terms of planning permissions, the motives behind undertaking the works and the intended or subsequent actual use are irrelevant, save possibly to illuminate the potentials for use inherent in the building or buildings."

Submissions

19. The primary case advanced by Mr Shea, for HMRC, is that if the two-stage *Cantrell* test is applied the work undertaken by Mr and Mrs Wright must be a "*conversion, reconstruction or alteration*" of an existing building as before the work commenced there was a single detached dwelling and after there were two semi-detached dwellings each of which included a substantial proportion of the original dwelling.

20. This, he submits, brings it within Note 16(a) and as such it cannot be the "construction of a dwelling" within Item 1 of Group 5 and is not a a zero-rated but an exempt supply being a "*grant of any interest in or a right over land*" within Item 1, Group 1 of schedule 9 VATA.

21. Alternatively HMRC contend that if the works were an extension or enlargement of an existing building they are nonetheless excluded from zero-rating by Note 16(b) itself. In support of this argument we were taken by Mr Shea to Item 1(a) of Group 5 schedule 8 VATA which refers to "*a building*" whereas Item 1(b) refers to "*part of a building*" and Item 3(a) to "*a building or part of a building*".

22. This, Mr Shea submits, makes it clear that the draftsman has used the expression "*a building*" quite deliberately and that if it had been intended that Item 1(a) should apply to part of a building it would have been expressly stated. Insofar as Note 16 applies to Item 1 it must be in relation to a building and not part of a building and therefore apportionment cannot apply. Also, as Note 16 does not refer to "part of a dwelling" Mr Shea contends that unless the extension or enlargement, of itself, creates an additional dwelling any such dwelling formed in part of an existing building and in part of an extension or enlargement cannot meet the conditions of zero-rating.

23. In the circumstances, as Mr and Mrs Wright were not making or intending to make taxable supplies, Mr Shea contends that HMRC were right to refuse their application to register for VAT.

24. Mr Alexander, who appears for Mr and Mrs Wright, contends that they enlarged or extended an existing building and thereby created an additional dwelling which is a zero-rated supply by virtue of Item 1 of Group 5 schedule 8 VATA as interpreted in accordance with Note 16. He cites the decision of the VAT and Duties Tribunal in *Michael, Gillian and Norman Smith v Customs and Excise Commissioners* (Decision No 17035) ("*Smith*") to counter HMRC's argument that the additional dwelling must fall wholly within the footprint of the extension or enlargement to qualify for zero-rating. In that case the Tribunal Chairman (Mr C P Bishopp) said, at [15]:

> "… I see no reason to import the notion that the additional dwelling must be incorporated wholly within that enlargement or extension."

25. In addition Mr Alexander relies on the decision of this Tribunal in *Ali Kia Jahansouz v HMRC* [2010] UKFTT 355 (TC) ("*Jahansouz*") in which this issue was considered and in which the Tribunal Judge (Paulene Gandhi) observed, at [46], that "Note 16(b) itself does not contain the words 'wholly'."

26. Mr Alexander also submits that if it is appropriate to do so it is possible to rely on Note 10 (to Group 5 of schedule 8 VATA) to apportion the input tax between the work undertaken on the construction of the zero-rated enlargement or extension and that attributable to the existing property.

27. Mr Shea sought to distinguish *Smith* and *Jahansouz* on the facts and noted that despite the comments of the Tribunal Judge in *Jahansouz* the new dwelling in that case was wholly within the extension or enlargement. Alternatively, relying on the "part of a building" argument Mr Shea contends that *Smith* was wrongly decided.

Discussion and Conclusion

28. The issue we have to determine is whether Mr and Mrs Wright intended to make taxable, which include zero-rated, supplies when they applied to be registered for VAT as "*a person constructing a building*" designed as a dwelling within Item 1 of Group 5 schedule 8 VATA. It is clear from Note 16 that the construction of a building does not include the conversion reconstruction or alteration of an existing building. It also does not include the enlargement of, or extension to, such a building "*except to the extent*" that this creates an "*additional dwelling or dwellings*".

29. We first consider Note 16 and whether the work undertaken by Mr and Mrs Wright amounts to a conversion reconstruction or alteration of the existing building within Note 16(a) as Mr Shea submits or, as Mr Alexander contends, it is the enlargement of or an extension to that building within Note 16(b).

30. This requires the application of the *Cantrell* two-stage test. As the Tribunal Chairman said in *Smith*, at [11]:

> "It is well established that, when considering Note (16) in its application to cases of this kind, it is necessary first to determine precisely what has been done. To do so, one should examine the original building and then the finished development and, by comparing the two, put oneself in a position to determine whether the result amounts to 'the conversion, reconstruction or alteration of [the] existing building', on the one hand, or the 'enlargement of, or extension to, [the] existing building', on the other; and if the answer is the latter, one must then move on to consider the proviso to paragraph (b) of the Note."

31. Having considered the work undertaken and compared the original building and the completed project (as described in paragraphs 2 and 3, above) we find that, given additional rooms have been built on each side of the original property which has also been increased in size by the creation of an additional floor, there has been an enlargement or extension as opposed to a conversion, reconstruction or alteration of the existing building.

32. Although we have found the work undertaken by Mr and Mrs Wright to be an enlargement or extension of an existing building (for the purposes of this decision it is not necessary for us to determine which) it is only "*to the extent*" that it "*creates an additional dwelling or dwellings*" that it becomes the zero-rated construction of a building. In regard to this we agree with and adopt the words of the Tribunal Chairman in *Smith* where he said, at [15]:

> "In my view, the natural meaning of the words used in Note (16) is that an enlargement or extension qualifies for zero-rating if it creates an additional dwelling."

33. We therefore need to consider whether the enlargement or extension of the existing building by Mr and Mrs Wright created an additional dwelling.

34. Clearly not every extension or enlargement to an existing building will result in the creation of an additional dwelling. The division of a detached house into two semi-detached dwellings could be enlarged or extended by the addition of a porch to one or both of the new properties and in such a case it is extremely unlikely that such an extension would be enough to create an additional dwelling. However, as in *Smith*, a "small" part of an existing building may be incorporated into a new property which becomes an additional dwelling. It must therefore be a matter of fact and degree, in the light of all the circumstances of the particular case, whether an enlargement of or extension to an existing building creates an additional dwelling.

35. In the present case it is clear that an additional dwelling been has created from an existing building. We find that this would not have been possible without the enlargement of, or extension to, the existing property and, to this extent, the additional dwelling has been created by the enlargement or extension. That it is not incorporated wholly within the enlargement or extension does not, in our view, preclude us from concluding that it falls within the Note 16(b) and therefore included within the meaning of "*construction of a building*" for the purposes of Item 1 Group 5, schedule 8 VATA.

36. As the Tribunal Judge observed in *Jahansouz*, Note 16(b) does not contain the word "wholly" requiring the additionally created dwelling to be wholly within the enlargement or extension. This is consistent with the decision of the Tribunal Chairman in *Smith* who saw "no reason to import the notion that the additional dwelling must be incorporated wholly within that enlargement or extension." He went to say, at [15 - 16]:

> "[15] … it seems to me that the draftsman has quite deliberately used the expression 'except to the extent that' because it refers back to Note (11), which Mr Poole [for HMRC] dismissed as irrelevant. Note (11) reads
>
> "Where a service falling within the description in items 2 or 3 is supplied in part in relation to the construction . of a building and in part for other purposes, an apportionment may be made to determine the extent to which the supply is to be treated as falling within items 2 or 3."
>
> [16] The supply in this case falls within item 2, which I have set out above. Mr Smith has constructed a new dwelling; it is zero-rated in principle (item 2) but excepted from zero-rating because it is an extension (Note (16), up to the opening words of paragraph (b)), but then taken out of the exception 'to the extent the enlargement or extension creates an additional dwelling'; and where, as here, the development consists partly of zero-rated new building and partly of standard-rated 'conversion, reconstruction or alteration', Note (11) requires an apportionment to be made. This interpretation, it seems to me, also caters for a case where an extension has been built which contains both a new dwelling and some additional rooms for the existing dwelling and addresses too Mr Poole's point about possible absurdity since zero-rating would be available only to the extent that there was new work, incorporated in a new dwelling. There may well come a point where the new work is so limited that it cannot realistically be described on an extension or enlargement, but that is plainly not the case here.

37. However, the present case concerns Group 1 which, unlike Groups 2 and 3, is not specifically included in Note 11. Although Mr Alexander submitted that apportionment was possible in the present case under on Note 10 (which we have set out in paragraph 16, above) we disagree. Note 10 applies when a part of a building that is constructed is designed as a dwelling and part of the building is not. In the present case the entire building has been designed as a dwelling and therefore does not fall within the circumstances envisaged by Note 10.

38. This raises the issue of whether there is any other provision under which apportionment is possible in the present case.

39. As in *Smith* Mr and Mrs Wright have constructed a new dwelling. This is zero-rated in principle (Item 1) but excepted from zero-rating because it is an enlargement or extension (Note 16, up to the opening words of paragraph (b)), but then taken out of the exception "to the extent the enlargement or extension creates an additional dwelling".

40. However, the development in the present case consists partly of zero-rated new building and partly of an exempt supply of land (ie the part of the existing building incorporated into the new dwelling). In the circumstances and in view of the use of the words "*except to the extent*" in Note 16, we consider that it is appropriate for an apportionment to be made.

41. Although, as we have already noted Note 11 does not apply in the present case, Item 1 of Group 5 provides for the zero-rating of the first grant by a person constructing a building designed as a dwelling of a major interest in "*any part of*" the dwelling. In our judgment this can be properly applied to that part of the additional dwelling created by the enlargement or extension to the existing building. As such zero-rating would be available but only to the extent of the new work, incorporated in the new dwelling. It does not matter that we do not have the information to be able to make an apportionment as this is not necessary for the purposes of this appeal.

42. For the above reasons, we find that Mr and Mrs Wright did intend to make taxable, zero-rated, supplies and not exempt supplies when they applied to be registered for VAT. As such they were entitled to be registered under VATA. The parties have agreed that if we find, as we have, for Mr and Mrs Wright the effective date of registration is 1 October 2006.

43. The appeal is allowed.

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.

JOHN BROOKS

TRIBUNAL JUDGE
RELEASE DATE: 27 October 2011