[2021] UKFTT 0290 (TC)

TC08232

VAT – Substantial reconstruction of a residential listed building – Group 6 Sch 8 VATA – whether Note 4 to be read as permitting the retention of internal elements necessary for structural integrity – whether retained items de minimis; whether Group 6 breached the principles of fiscal neutrality and proportionality.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/7169

BETWEEN

RICHMOND HILL DEVELOPMENTS (JERSEY) LTD **Appellant**

-and-

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

TRIBUNAL: JUDGE CHARLES HELLIER
JULIAN STAFFORD

The hearing took place on 24, 25 and 26 May 2021. With the consent of the parties, the form of the hearing was by video on the Tribunal video platform. A face to face hearing was not held because of the covid 19 pandemic

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Nicola Shaw QC instructed by Stewarts Law LLP for the Appellant

Howard Watkinson instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

Introduction

1. The Royal Star and Garter Home (the "RSGH") was built in the early 1920s to provide nursing facilities for servicemen returning from service in the first world war. It stands at the top of Richmond Hill in Surrey overlooking Petersham Common and the Thames beyond Richmond. It is opposite one of the gates into Richmond Park. It is a large and impressive building, listed[1] grade 2.

2. Sited on the brow of the hill, at the front (facing we shall say East), it presents as five storeys (from street level, levels D to H together with level I in the roof) facing towards the entrance to Richmond Park, and nine storeys (levels A to H plus I) facing West over Petersham Common. There was space on most floors for some 60 rooms for those being looked after there.

3. At the rear there was a formal garden flanked by two colonnades stretching like arms from the main building. Also facing West at the rear on Level B, were two large rooms known as the King's Room and the Queen's Room, between them spanning the width of the rear elevation, one on each side of a passageway leading to the formal garden. These rooms were two storeys high, having their floors on Level B and their ceilings at the level of Level C ceilings.

4. Changes in medical practice and need led the charity which owned the building to move its operations elsewhere and in 2013 the last resident moved out. The building was then sold to the Appellant ("RHD").

5. In an operation which lasted some 2½ years RHD converted the building into 86 residential units (we shall call them "flats" even though some had more than one level) which it sold. The King's Room was converted into a swimming pool and gymnasium and the Queen's Room was to be converted into a communal sitting room, or for use for large receptions or dining.

6. The issue in this appeal is whether the sales of the flats were zero rated or exempt for VAT purposes. If zero rated RHD would be able to recover all[2] the input tax on the conversion works; if exempt it could not.

The Domestic Legislative Setting

7. As a result of sections 8, 30, 31 and Sch 9 VAT Act 1994 ("VATA") the transfer of a flat is exempt from VAT unless zero rated. Groups 5 and 6 Sch 8 VATA provide for the zero rating by a developer of the supply of certain new dwellings.

8. Group 5 zero rates the supply of: (i) a new dwelling constructed from a bare site, (ii) a dwelling in a building converted from a building previously used for non-residential purposes and (iii) on certain conditions, a dwelling constructed on the site of a previous residential dwelling which has been demolished apart from up to two walls.

9. Group 6 Item 1 zero rates the supply of dwellings which are the result of a "substantial conversion" of a listed building. Note 4 to Group 6, which is the battleground in this appeal, provides that for the purposes of Item 1:

> "a [listed] building is not to be regarded as substantially reconstructed unless when the reconstruction is completed, the reconstructed building incorporates no more of the

[1] under the Planning (Listed Buildings and Conservation Areas) Act 1990.

[2] Some was recovered on the basis that the part of the building from which they were converted had not been used for residential purposes for 10 years with the result that they were to be treated as converted from a non residential part of a building for the purposes of Note 7 to Group 5 and were therefore eligible to be zero rated by Group 5 .

original building (that is to say, the building as it was before the reconstruction began) than the external walls together with other external features of architectural or historical interest."

There is no doubt that in ordinary language the work undertaken on the RSGH was a substantial reconstruction. The issue which arises is whether the restriction in Note 4 – "unless…" - deprives it of that appellation.

10. The reconstruction of the RSGH left the walls and the roof substantially intact but also retained, in compliance with the planning application and consents, certain internal features, including the chapel, a marble staircase, the substantial majority of the reinforced concrete floor slabs and the chimney stacks.

11. HMRC say that these retentions deprived RHD of the benefit of zero rating under Item 1 because of Note 4. RHD says (i) features, such as the concrete floor slabs and the chimneys which were retained in order to maintain the structural integrity of the exterior are properly to be considered as part of the external walls and features for the purposes of Note 4, (ii) other retained features were de minimis, (iii) the EU principle of Fiscal Neutrality requires that a reconstruction of a listed building in which some part of the original structure is maintained should be treated in the same way as a reconstruction in which nothing other than the external walls are retained, and (iv) that the EU principle of Proportionality requires the restriction in Note 4 to be interpreted to permit the retention of internal features or else disapplied.

The Facts in More Detail

12. We heard oral evidence from Michael Broderick, who was a director and consultant structural engineer at the consultants appointed to the conversion work, and from Scott Brown, the CFO of the parent company of RHD who gave evidence of HMRC's approach to Note 4 in the case of another building.

13. Following a period of investigation, consultation with the local authority and design work, an application for planning permission and listed building consent was made in December 2013. The proposal was for the conversion of the building into 86 flats with communal gardens and other areas, and the construction of a lower floor below level A for a car park.

14. Planning permission and consent was given in October 2014. The approved works were subject to conditions (either express or as a result of the approval sought for the work) which included:

(1) the retention of the original walls and windows;

(2) the retention of the tiling on the roof;

(3) the approval of measures for structural support;

(4) the retention of the chapel on level A;

(5) the retention of the ceiling, fireplace and paintings in the King's Room;

(6) the retention of the walls and ceiling of the Queen's Room;

(7) the retention of the main entrance hall and the marble lined office corridors leading from it including the marble-lined Surgeon's Rooms;

(8) the retention of the marble staircase rising from level D to level G; and

(9) the retention of part of the colonnades.

15. The works were substantial: they took over 2 ½ years to complete, at the height of their activity 400 people were on site, the excavation of the new lower level involved the removal of 10,000 cubic metres of spoil, and the removal of the internal masonry walls between the rooms within the building on Levels C to H and other material generated another 10,000 cubic metres of waste. The works cost £95 million.

16. The works substantially changed the building. Internal masonry walls were removed at all levels and replaced by new walls defining the flats and the common parts. Electrical installations, plumbing, lifts, heating, floor finishes and woodwork were all removed and replaced. The exterior of the building looked substantially the same afterwards, but the internal plan of the building before the works was radically different from that afterwards, save for the retention of the grand entrance areas, stairs and the Queen's Room.

17. There were three material parts of the internal structure of the building which were retained wholly or substantially in the reconstruction. These were the floor slabs, the steel frame (the "truss") above level C and the chimneys.

The Floor slabs

18. When the building was constructed, reinforced concrete floors were installed at each level as the building rose. They were cast into the walls, and thus formed the internal lintels of the windows and stretched from one side of the building to the other.

19. In the reconstruction parts of the floor slabs were removed at various levels: among other things to create new staircases, to amend lift shafts and, in the King's Room, to create the swimming pool and a passage beneath it. Very approximately the following proportions of the area of the floor slabs at each level were removed:

Level I	25%
Level H	12%
Level G	12%
Level F	12%
Level E	1%
Level D	17%
Level C	10%
Level B	The King's Room
Level A	n/a

20. Mr Broderick told us, and we accept, that the decision whether to remove parts of the floor slabs was taken by reference to the risk that their removal would pose to the structural stability of the building. Had all the floor slabs been removed there would have been no lateral restraint on the walls (save for that provided by walls at right angles to one another). Providing adequate restraint if the floors were removed and then replaced would have required the progressive craning in of temporary scaffold to support the external walls. That he said would not have been practicable because: (i) the roof would have had to be removed and the roof tiles were required to be preserved and (ii) the planning consent condition that the windows be retained would have limited the ability to thread the temporary support structure through the windows. He said that removing all the floor slabs would not have been possible without

undermining the structural integrity of the building and English Heritage would not have agreed to it.

The Steel Frame or Truss

21. From the ceiling of Level D upwards the building was built around a large steel frame. Across the width of the building at each of levels E to H there stood, at regular intervals of about 20 ft, four vertical girders. Two of these were embedded in the walls and two stood in the interior of the building. These vertical girders were attached at their tops within the building to horizontal girders traversing the length of the relevant part of the building and at some levels also spanning the width of the building. At level E there were also diagonal girders stretching from the top of the vertical wall girder to the bottom of the adjacent girder in the set of four. In the roof space (at level I) the girders sloped to support the roof. From levels B to E there were no girders within the interior of the building and only girders embedded in the walls. Apart from the girders in the roof the internal girders had been hidden in the internal masonry walls of the rooms within the building.

22. Mr Broderick explained that the purpose of the steel truss frame was to transfer the load of the roof and the floors of the upper rooms to the external walls and that the diagonal girders at Level E enabled the provision of a space free of columns at levels B to D. This in particular enabled the King's room and the Queen's room to have a width equal to the width of the masonry walls above which was free of columns.

23. We accept that the truss was a sensitive part of the structure of the building as a whole.

The chimneys

24. The RSGH had 10 chimneys each extending some 14 ft (4 metres) above the roofline. The chimney stacks above the roof line were supported by masonry stacks some of which extended to the foundations.

25. Mr Broderick said, and we accept, that the internal chimney stacks were an integral part of the structural load paths, carrying the weight of the building through to the foundations. He said that they needed to be retained to ensure the structural stability of the building.

The Colonnades

26. The two colonnades at the rear of the building faced onto the formal garden. They consisted of a double height walkway looking through glazing and between pillars onto the formal garden, and, opposite that pillared glazing, a wall behind which there were rooms on two levels which had windows onto the walkway and at the back.

27. The whole of the southern colonnade was converted into one, two storey, flat, and the northern colonnade converted into two, two storey, flats. The internal walls between the walkways and the rooms were retained.

28. At the end of each colonnade was a panelled room. These were both retained with some minor alterations.

The King's Room and the Queen's Room

29. Both these rooms had two opposing external walls and two shorter opposing internal walls. All these walls were retained.

30. Between the two rooms, on Level B, was a wide passageway leading to the formal garden, and, on Level C, a large linen or screening room. The internal walls of the passageway

and the linen room were the internal walls of the two major rooms. The level B passageway was retained; the linen room was retained after the removal of the shelves, cupboards and floor coverings.

31. The King's Room and the Queen's Room were somewhat deeper (East/West) than the building above them, and a walkway ran along the western face of the building on top of the rooms of a width equal to the excess of the width of those rooms over that of the surmounting building. The load of the walls above the two rooms was carried by internal pillars within each room which were retained.

32. In the reconstruction work little was done to the Queen's Room. Mr Broderick told us that the room was required to be retained and restored under the listed building consent, and that the intention was to have it as a communal sitting or dining area, but that the work was not yet complete.

33. The King's Room was, as we have said, converted into a swimming pool and gymnasium. The floor was removed and there were excavations to create the pool and under it a new basement corridor. The fireplace and painting were removed during the work and then replaced. The ceiling and other plasterwork were retained.

Other retained internal features

34. In addition to the chapel, the marble staircase, the entrance and corridors on the entrance floor, two original secondary staircases were retained on levels B to E.

35. Mr Broderick provided some helpful calculations showing the proportion of each floor's area at each level and by reference to the floor area of the whole building which was represented by the retained areas. The calculations omitted the secondary staircases, the linen room and the panelled rooms, but making a rough adjustment for these items (allowing a floor area of 20 square metres for the staircases, 60 square metres for the panelled rooms and 30 square metres for the linen room) just over 9% of the total floor space of the building was represented by areas bounded by a least one retained internal wall if the King's Room was included, and about 7% excluding that room. The retained spaces at each level lay between 0% for levels H and I and 5.7% for level B including the King's Room and the Queen's Room.

Balfon Tower

36. In 2015 as part of due diligence in relation to the possible acquisition of another company, Mr Brown reviewed the correspondence between HMRC and the owner of Balfon Tower, a brutal but listed 25 storey 1960s tower block. Some of the correspondence related to the redevelopment of Balfon Tower and it included a letter in which HMRC accepted that the provisions of Note 4 would be satisfied where the size of the building and the scale of the development warranted the retention of internal elements necessary to the structural integrity of the building. On the facts presented to them HMRC had confirmed the sale of the redeveloped flats in Balfon Tower would qualify for zero rating.

37. The development of Balfon Tower involved the remodelling of the flats within the building but the retention of the substantial majority of the floor slabs.

Legislative History and Policy

38. In *C&E Comms v Zielinski Baker* [2004] 1 WLR 707, Lord Walker recounted the history of the VAT treatment of building works under the UK's domestic legislation.

39. As an exception to the general principle that all supplies should be taxed, the Second Directive permitted Member States to zero rate certain supplies for social reasons for the benefit of the final consumer. The Finance Act 1972, which introduced VAT, zero rated all

construction and alteration of buildings. In the light of the limited power to zero rate conferred by the Second Directive, the Commission contested the width of that zero rating, and in Finance Act 1984 the scope of zero rating was cut down by excluding almost all works of alteration other than those to listed buildings which were dealt with in a new schedule, the precursor of Sch 6 VATA (and excluded work of repair and maintenance).

40. The Commission pursued its objection to this more limited derogation and the dispute came before the ECJ (*Commission v UK* C 416/85). The ECJ held that the zero rating of housing fell within the purview of social reasons but that the zero rating of non-housing building works fell outside the ambit of the power given by the Directive. The outcome, Lord Walker explained, was a reshaping of domestic legislation in Finance Act 1989 so as to focus zero rating more directly on social objectives, that was to say on housing and certain charitable purposes.

41. Finance Act 1989 zero rated the construction and sale of new residential accommodation and also alterations to listed buildings. *Zielinski Baker* was concerned with the application of the rules in relation to the alteration of listed buildings in Group 6. Lord Walker noted at [42] that :

> "The European Court [in Case 416/85] did not have to consider the provision about [listed] buildings introduced in 1984, but it is clear that the changes made in 1989 focussed on home ownership (and similar purposes) in relation to what is now Group 6 [listed buildings] as well as in relation to Group 5. The protection of national heritage is no doubt another social objective, but it is less clearly articulated (especially since repair and maintenance, notoriously the heaviest burden on an owner of listed buildings, are excluded) and it appears to be subordinate to the housing objective."

42. *Zielinski Baker* concerned the operation of the 1989 provisions. These zero rated the supply of a new residential building substantially reconstructed from a listed building as well as works of alteration to a listed building: Group 6 zero rated-

> "Item 1 The first grant by a person substantially reconstructing a protected building, of a major interest in, or in any part of, the building or its site.
>
> Item 2 The supply, in the course of an approved alteration of a protected building, of any services other than the services of an architect, surveyor or any person acting as consultant or in a supervisory capacity.
>
> Item 3 The supply of building materials to a person to whom the supplier is supply in services within item 2 of this Group which include the incorporation of the materials into the building (or its site) in question."

26. A protected building was defined to mean a listed building designed to remain or become residential. Note 4 read:

> "(4) For the purposes of item 1, a protected building shall not be regarded as substantially reconstructed unless the reconstruction is such that at least one of the following conditions is fulfilled when the reconstruction is completed—
>
> > (a) that, of the works carried out to effect the reconstruction, at least three-fifths, measured by reference to cost, are of such a nature that the supply of services (other than excluded services), materials and other items to carry out the works, would, if supplied by a taxable person, be within either item 2 or item 3 of this Group; and

(b) that the reconstructed building incorporates no more of the original building (that is to say, the building as it was before the reconstruction began) than the external walls, together with other external features of architectural or historic interest; and in paragraph (a) above "excluded services" means the services of an architect, surveyor or other person acting as consultant or in a supervisory capacity."

43. By Note 6 approved alteration was defined to exclude works of repair and maintenance.

44. The distinction between works of alteration and works of maintenance led to much litigation and at the time of Finance Act 2012 the width of Group 6 was reduced by deleting Items 2 and 3 and the 60% test in Note 4, leaving it as it was at the times relevant to this appeal.

45. HMRC's 2012 Budget Notes describe the measure as having the effect that only "buildings reconstructed from a shell" could benefit from zero rating, and the policy behind these changes as being to reverse:

> "the perverse incentive [given by zero rating alterations but not repairs] to change a listed building rather than to repair it".

46. It seems to us that the deletion of paragraph (a) of Note 4, although the provision was rendered meaningless by the deletion of Items 2 and 3, partook of the taste of the deletion of Items 2 and 3 by ensuring that an alteration could not be called a "substantial reconstruction" simply because a large proportion of the work of reconstruction was approved alterations.

47. After these changes zero rating of new buildings was available for dwellings constructed on the site of a residential building which retained part of the former building only if either-

> (i) the existing building had been
>
> "demolished completely to ground level, or 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" (Note 18 Group 5); or
>
> (ii) the old building was listed and
>
> "the reconstructed building incorporates no more of the original building (that is to say, the building as it was before the reconstruction began) than the external walls, together with other external features of architectural or historic interest"; (Note 4 Group 6)

48. The stringency of the Note 18 requirements is clear: the building must not be simply demolished but "demolished to ground level"; all that may remain is one or two façades. The Note 4 requirements are more generous to listed buildings and indicative of the continuation of some of the social policy of protecting heritage albeit in weaker form. But there is the same stringency of language in what may be incorporated: "no more than". That suggests to us that the same stringency as to what remains inside the walls (and other external features) is to be read into Note 4 and that Parliament did not intend the "external walls" to extend to things which were not walls but were structurally necessary for the retention of the walls.

49. That such was the policy behind the changes is reflected in para 48 of the Consultation Document of 21 March 2012 issued before the changes were made. That paragraph refers to the changes putting "listed buildings in a similar position to new buildings where zero rating applies to a new building which retains a single façade (or for a corner plot a double façade) as a condition of planning consent".

50. We should mention Mr Watkinson's submission that one of the purposes of the 2012 changes was to "permit zero rating of buildings that are shells and to disincentivise those who seek to reduce buildings to shells simply to bring themselves within the scope of the relief".

51. A first sight the opposite seems to be the case since by reducing a building to a shell zero rating is obtained and thus the legislation might be seen as encouraging such action. But the result may depend on the amount of demolition which a developer wishes to undertake: if it is only partial demolition, the legislation, by removing zero rating for alterations may encourage lesser alteration and more repair, but if the proposed development involves the demolition of 90% of the inside of a building the legislation may encourage the removal of the remaining 10%. In HMRC's Budget Notice for the 2012 legislation it is said that (i) most alteration work was extension which was not necessary for heritage purposes, and (ii) the policy objective was to remove the perverse incentive to alter rather than to repair. Depending upon the view taken by the legislature as to the expected actions of developers, that policy might therefore encompass the disincentivisation of the reduction of buildings to shells. We do not however find that the available material is sufficient to permit us to reach this conclusion.

Discussion

<u>The application and construction of the domestic legislation.</u>

(1) The proper construction of Note 4

52. RHD argues that, purposively construed, the provisions of Note 4 permit the retention of those internal features which form part of the external walls etc or are structurally necessary to preserve them.

53. Miss Shaw says that in interpreting Note 4 the tribunal must seek to give effect to the policy objectives pursued by the legislation. Those objectives were articulated by Lord Walker in *Zielinski Baker*: home building and to a subordinate extent the protection of the national heritage. She says that although a strict construction of an exemption must be applied, that does not mean the most restrictive one: where two or more fair readings of the provision are possible, that which gives best effect to the policy of the provision may and should be adopted (*Expert Witness Institute v CCE* [2002]STC 42) even if that enables a wider range of transaction to fall within the exemption.

54. Miss Shaw says that the comparison in the parentheses in Note 4, "…the building as it was before the reconstruction began", when read in the context of a policy to preserve heritage is concerned with the appearance of the building: the appearance of the outside of the building must be preserved but the inside must look wholly new. The reference to the "building as it was" must refer to how it appeared. In the case of the RSGH anyone going into the building after the reconstruction would say that the interior was in all material respects wholly new and incorporated none, or only a de minimis amount, of the original building.

55. We agree that a strict construction does not require the most restrictive construction and that the policy of the provision is relevant to the determination of a fair reading. But it seems to us that the construction Miss Shaw urges upon us is not a fair reading of the provision. That is for three reasons.

56. <u>First</u> the policy of the provision after the 2012 amendments seems to us, for reasons already given, to be merely to extend the "2 walls rule" to the whole of the exterior of a listed building. Group 5 requires the complete demolition of the interior and all but up to two internal walls. There is no indication in the language that any different, more relaxed, policy applies in relation to the interior of a listed building.

57. Second, it seems to us that the words in parentheses in Note 4 are principally concerned with timing, that is to say in determining what was the "original" building and not directed to a test of appearance – so that for example if a Tudor building was remodelled in Georgian times the "original" for these purposes is the later Georgian remodelling.

58. Third, the words "the reconstructed building *incorporates* no more of the original…" do not suggest to us a test based on appearance, but one based on physical components: "incorporates" carries a corporeal meaning.

59. We accept that listing may be motivated by visual features, and that the policy of the provision may be to assist in the retention of some such features, but the words of the section are targeted only on the preservation of the exterior, and in relation to the interior cannot be read as imposing a test by reference only to appearance.

60. Miss Shaw argues that:

(1) "external walls" cannot just mean the external skin of the building: there is an interior element to any wall. Something which is a component of an external wall, and in particular is necessary for its stability, is part of the wall. The floor slabs were cast into the walls of the RSGH. If they had been taken away it would have been unstable. Their complete removal would have been impracticable. They were part of the external walls.

We agree that "external walls" does not mean only the outside skin of the walls: a "wall" in its ordinary meaning has breadth. We also accept that the foundations of a wall and a buttress are properly regarded as part of a wall. Both of the latter are intimately attached to the wall and necessary for its stability. They thus share some of the characteristics of the floor slabs, but they differ from the floor slabs in that they serve only the wall and have no other purpose and are closely attached to the wall. The floor slabs, by contrast, served the purpose of providing floors on which to walk and place objects and extended from one outside wall to the opposite one. They were more than mere adjuncts to the wall. In ordinary language they were not part of the walls.

Nor does the policy behind the provision seem to us to require a wider meaning, in particular to require that anything necessary for the stability of the wall should be regarded as part of it. The relationship with the Group 5 provision which so clearly limits the permissible retained feature to "no more than" a "façade" suggests that internal support is not included. Any limited policy in relation to the preservation of heritage is fulfilled if the cost of providing support as part of a reconstruction is to some extent balanced by zero rating.

(2) the roof, which comprised tiles laid on battens supported eventually by the steel truss, was, as a whole, an external feature. It would be nonsense to regard only the tiles as the external feature so that Note 4 would be satisfied only if all that supported them were removed and rebuilt.

In our opinion, in the same way that an external wall comprises not just the skin of the wall but its depth, an external feature such as a roof may in our judgement comprise more than its covering, and in the case of a roof will extend to the battens, purlins and other immediate support. The steels of the truss at level I bearing against the roof were part of that feature; those which were vertical and carried the load from them to the steels in the floors below were support for the feature but not part of it.

(3) the truss, the side steels of which were cast into the walls was part of the support for the roof and in turn part of the walls: it was both part of the walls and the external feature of the roof.

In our judgement the vertical steels which were cast into the external walls were part of those walls, but because the remainder of the structure supported in part the upper floor slabs and their load and did not serve only the walls or the roof they could not be regarded as part of the external walls.

(4) the chimney stack, which started at ground level and rose through the building supported the visible chimneys which rose above the roof of the building. The retention of the visible chimneys was dependent upon the stacks beneath them which were properly regarded as part of them.

We did not ask Mr Broderick whether the visible chimneys above the roof could have been preserved if the chimney stacks below them were removed, although he described the chimney stacks as necessary for the stability of the building. It seems to us that even if it would not have been possible to preserve the exterior chimneys without keeping the stacks below, those stacks cannot be called part of an external feature.

(2) De minimis

61. If we are wrong in our conclusion that the floor slabs, the majority of the truss and the chimney stacks were not part of the external walls or other external features, the question arises as to whether the other retained features can be ignored as de minimis in determining whether Note 4 is satisfied.

62. Miss Shaw says that in the context of the extraordinary scale of the works the retained items were de minimis and should thus be ignored. There were in, context, only a handful of items, each of which was only a small fraction of the building and even if taken together represented by area only a small percentage of the total area of the building.

63. *Boxmoor Construction Ltd* [2016] UKUT 91 (TCC) concerned the application of Note 18 in Group 5 (see para 47 above). The Upper Tribunal accepted that, unless a contrary indication appeared in a statute, the de minimis principal, that the law did not concern itself with trifling matters, applied. Note 18 referred to a building having been "demolished completely to the ground" and the FTT had found that that language displayed a statutory intention displacing the de minimis principle. The Upper Tribunal disagreed. It held that there was nothing in those words which displaced the principle, and that in deciding what was de minimis depended on the circumstances and the nature of the statutory provision ([48, 49]).

64. It seems to us that the same reasoning applies to Group 6 and Note 4 and Mr Watkinson did not disagree. There is nothing to suggest that the retention of one internal brick should not be ignored.

65. Miss Shaw suggests that the principle should be applied item by item. That does not seem to us to reflect the language of Note 4 which asks whether "no more of the original building" than the exterior walls etc is incorporated into the reconstructed building. Those words look to the totality of the retention not to individual items.

66. It seems to us that the question of whether or not retained elements are trifling is to be judged, as Miss Shaw submits, in the context of the building as a whole, but also by reference to their significance and not only by reference to the area or volume occupied by them.

67. In the context of the building as a whole, the retention of the original marble lined grand entrance and staircase and the passage therefrom to the formal garden at the rear were 3 significant features of the building after and before the reconstruction, and even in the context of a building with 86 flats would not be regarded as trifling. On this ground we would find that the de minimis exemption did not apply.

68. But even if the test were confined to or informed by the areas occupied by the retained items we would not hold that the retained items were de minimis. We accept that the area occupied by the King's Room should be substantially excluded from consideration as a large part of it and its features were quite changed. But even so doing some 7% of the floor space of the building was occupied by retained items, and that to our minds was not de minimis.

Domestic Construction – Conclusion

69. We conclude that on a domestic construction of Note 4 the reconstruction works were not a substantial reconstruction.

<u>Fiscal Neutrality</u>

The Principle

70. The principle of fiscal neutrality in relation to VAT and how the question should be approached was enunciated in *CCE v Rank Group plc* [2012] STC 23, where the CJEU said:

> [32]… the principle of fiscal neutrality precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes…
>
> [33]… the similar nature of any two supplies entails the consequence that they are in competition with each other.
>
> [34] Accordingly the actual existence of competition between two supplies of services does not constitute an additional condition for infringement of the principle of fiscal neutrality if the supplies are identical or similar from the point of view of the consumer and meet the same needs of the consumer…
>
> [36] …difference in treatment for the purposes of VAT of two supplies of services which are identical or similar from the point of view of the consumer and meet the same needs of the consumer is sufficient to establish an infringement of the principle…
>
> [44] Two supplies of services are therefore similar when they have similar characteristics and meet the same needs from the point of view of the consumer, the test being whether <u>their use is comparable,</u> <u>and where the differences between them do not have a significant influence on the decision of the consumer to use on such service or the other</u>…[our underlining]
>
> [50]…in certain exceptional cases…differences in the regulatory framework or legal regime governing the supplies…may create a distinction in the eyes of the consumer in terms of the satisfaction of his own needs.

Whether evidence is required of similarity or difference

71. In *LIFE* [220] 1 WLR 2828, the Court of Appeal considered that in the determination of whether supplies were the same or similar under the tests adumbrated above, European Law did not require the national court to have evidence such as a consumer survey but could make up its own mind using its own experience.

Discussion

72. Miss Shaw says that Note 4 creates an arbitrary distinction between a substantial reconstruction where nothing internal has been retained and one where some part of the interior has been retained. From the point of view of the consumer she says that two buildings (or flats in them) meet the same need: namely residential accommodation in a reconstructed building.

73. So far as concerns the retention of the concrete floor slabs Miss Shaw says that a typical consumer would not know or care whether the floor structure was new or old; and both met the same need.

74. Mr Watkinson says that the retention of internal listed non structural features could have a significant influence on consumer choice: they add glamour and impose restrictions on alteration. He draws an analogy between a mint condition vintage car and a car comprised of the bodywork of the same model but with a new engine. The former is more valuable than the latter because consumers value authenticity. The authenticity of the retained features in RSGH would affect consumer choice.

75. Mr Watkinson suggests that a building with an old façade but with wholly new insides will meet a different need from a building which has retained some original features. That we think may be true in some cases but if all that is retained is the floor slabs we agree with Miss Shaw that it would usually make no difference to the choice of the typical consumer

76. The test enunciated by the CJEU at [44] requires the identification of two components. The first is that of a comparable supply; the second the identification of any elements of the domestic legislative regime which would significantly affect a typical consumer's choice – if there are no such elements the principle applies and the two supplies should be taxed in the same way.

77. As regards the second of these components – the elements of the domestic regime to be tested for significant influence on consumer choice – we do not consider that it is possible to do that in this case at a high level of generality. There is a wealth of ways in which a building reconstruction may fail Note 4: some of them will have no affect on consumer choice, others may have a significant effect on a particular comparable supply. It is thus not possible for us to say whether compliance with Note 4 will affect consumer choice. In our view therefore the test must be conducted by reference to the particular circumstances of the supply in question: asking whether those retained features which breached the Note 4 requirements would significantly affect the choice between a flat in this building and a comparable supply.

78. That brings us to the identification of a comparable supply: the identification of a supply which is identical or similar from the point of view of the consumer and meets the same needs of a consumer.

79. It seems to us that the purchase of a flat is a highly idiosyncratic activity: consumers may reject or seek possible dwellings for a number of reasons: layout, location, views, architectural style, age, size or even decoration The need for a dwelling will not be the only significant influence on the choice of a typical consumer. People move house not because they want a dwelling but because they want a *different* dwelling, and it is features other than the fact that what they buy is a dwelling which motivate their choice,

80. For most consumers – for the typical consumer – some of these needs or influences will not be significant. Very few will require only flats which are painted red. But for others, location, layout, size and style will "have a significant influence on the choice of the consumer". We do not think that whether or not the building is listed will have a significant influence on the choice of a typical consumer, although the style of the building will. The retention of a Michelangelo ceiling will affect the typical consumer's choice, the retention of hidden floor slabs or a useful internal wall will not.

81. We note that in *Rank* the ECJ (at [58]) regarded matters such as minimum and maximum stakes and the chances of winning as factors potentially relevant to whether two supplies of betting were comparable because they were likely to have a considerable influence on a consumer's choice. Matters such as layout, style, aspect and size will play an important role in the choice of a dwelling. A mansion in Hampshire does not meet the same needs as a flat in Docklands. This is not to say that there may be cases where comparable dwellings may be identified, but simply to say that that may not always be the case.

82. In this case we were not shown any evidence that there were other flats which might meet the same needs as RSGH, and, given the importance to a consumer of views, size, layout and style, we were not convinced that there were real examples which met the same needs for a typical consumer as a flat in RSGH.

83. In *LIFE* Arnold LJ referred to *Solleveld* C-443/04 & 444/04 in which the CJEU had considered whether a distinction drawn in a member state's legislation between supplies by medical practitioners with and without certain qualifications breached fiscal neutrality. It held that it did so only if the practitioners had qualifications which ensured the same level of care as those benefitting from the state's exemption. In that case medical care by a physiotherapist and a psychotherapist were at issue. In such a case the needs of a customer are readily identified; in the case of the purchase of a flat the needs of a consumer are more wide ranging..

84. In *Rank* the ECJ said that "the actual existence of competition between two supplies of service does not constitute an independent and additional condition for infringement of the principle of fiscal neutrality if the supplies in question are identical or similar". That means that we do not need evidence of competition, but it does not mean that we can conclude that a flat in RSGH is similar to another without either evidence of the other's existence or the actual knowledge of the tribunal of a similar flat. We had no such evidence or knowledge.

85. As a result we cannot conclude that there were similar flats whose sales were treated differently. On this basis we do not find that the principle of fiscal neutrality was infringed.

86. If we are wrong in this conclusion then we should conduct either (i) a comparison with a theoretical flat sharing those characteristics of a flat in the RSGH which we consider would significantly influence the choice of a typical consumer (such as layout, aspect and size) but without the retained elements which breached Note 4, or (ii) merely ask whether, for a typical consumer, the retained elements were a significant feature of the decision to buy a flat in RSGH. To both these questions we would return the same answer, namely that the grand entrance hall, stairs, the associated entrance corridors and the Queen's Room would have had a significant influence on a purchaser's choice. On this basis we would find that the fiscal neutrality principle was not breached in relation to the supply of the flats in the RSGH.

87. We should mention one other argument which was not raised by the parties but which gave us some concern after the hearing. It related to those flats in respect of which zero rating was agreed[3] by HMRC on the basis that, since they were constructed in an area which had not been used as residential accommodation for 10 years, they were, by virtue of Note (7) to Group 5, to be regarded as the conversion of a non-residential part of a building, and so qualify for zero rating under Item 1 Group 5.

88. It seemed to us to be likely that at least some of these flats were comparable to some of those other flats in RSGH which were converted from residential accommodation and would meet the same needs of a typical consumer. Thus at first sight there appeared to be a breach of fiscal neutrality on the basis of the text in *Rank.* However, *s*ince the point was not argued we do not address it any further other than to say that, as "fiscal neutrality may be envisaged only as between competing traders" (see *Commission v Sweden* C 480/10 para 17 and paras 49 and 51 *Marks & Spencer* C 309/06) and RHD sold both types of flat, this did not appear to be a breach of that principle.

Balfon Tower

89. On our interpretation of the provisions of Group 6 and our understanding of the reconstruction of Balfon Tower, the work there undertaken would not qualify as a substantial

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[3] see footnote 2 to para [6]

reconstruction for the purposes of Group 6 because the internal floor slabs were non de minimis features which were substantially retained in the reconstruction.

90. In *Rank* the CJEU said (at [64]) that the fact that the fiscal authorities had treated supplies by other suppliers as exempt in contravention of domestic legislation did not permit a taxpayer making similar supplies to rely on the principle of fiscal neutrality to claim exemption for his supplies.

91. As a result we conclude that the treatment afforded to the Balfon Tower redevelopment does not assist RHD's case.

Proportionality

92. The principle of proportionality is one of EU law which requires that measures adopted by community legislatures and implemented by their courts "do not exceed the limits of what is appropriate and necessary to attain" the legitimate objectives of the legislature (para [50] *HMRC v GMAC (UK) PLC* [2016] EWCA Civ 1015 citing *Viamex* C 37/06 & 58/06).

93. The objects of legislation enacted in compliance with a Directive include the underlying objects of the Directive (*HMRC v Trinity Mirror* [2015] UKUT 421 (TCC) at [57-59]).

94. Article 110 PVD permits member states to continue with zero rating which was in force at 1 January 1991 if that zero rating was in accordance with Community law and adopted for clearly defined social reasons. This permission is expressed by Art 109 as a temporary measure pending the adoption of a uniform community code for the taxation of inter-community trade.

95. *Norbury Developments v CCE* C 136/97 concerned the permission given by Art 28(3)(b) of the Sixth Directive to continue to exempt land supplies. The CJEU said at [20] that the abolition of such exemption was an objective pursued by Art 28(4). Art 110 is the successor of Art 28(2) which was also subject to Art 28(4). Seems to us that the eventual abolition of the non-harmonised zero rating permitted by Art 110 is similarly an objective of the Directive.

96. Mr Watkinson does not dispute that domestic exemptions must comply with the Proportionality principle but he says that given the margin of appreciation allowed to a member state and the Directive's object of abolishing non harmonised exemptions, it has no effect.

97. Miss Shaw says that even though Group 6 is a derogation, the UK must ensure that its provisions are necessary and proportionate to the attainment of the objectives of the legislature. She says that those objects are to alleviate the burden on owners of listed buildings, to protect the national heritage and to promote home building or ownership. She says that the effect of Note 4, if it prevents the retention of interior features even where they are necessary to the structural integrity of that building, is not a proportionate or necessary response to these objectives.

98. Note 4, she says, derogates from the width of Item 1 and does not further the objectives of providing housing, protecting heritage or alleviating the burden on the owners of listed buildings. It does not even put listed buildings in a similar position to new buildings which retain a single or double façade because the removal of internal structures may jeopardise external walls or be impossible. It offers no incentive to preserve internal listed features. Nor, she says, is it proportionate to align listed buildings with non-listed buildings since such alignment does not reduce the financial burden on owners of listed buildings.

99. It seems to us that it is not correct to read Item 1 as providing a relief authorised by the Directive and Note 4 as derogating therefrom. The provisions must be read together, and indeed that is the effect of section 96(9) VATA. Thus what is to be considered is whether the

derogation consisting of the zero rating of the sale of dwellings resulting from the reconstruction of a listed residential building which has left intact only the external walls and other external features "does not exceed the limits of what is appropriate and necessary to attain the objects legitimately pursued by the legislature".

100. So far as concerns the change to the legislation in 2012, it seems to us that the removal of zero rating on alterations to listed buildings and the abolition of the 60% test in Note 4 accord with the underlying purpose of the directive of the abolition of non-harmonised exemptions (including zero rating).

101. Miss Shaw relies on *GMAC* which concerned, inter alia, the provisions of the VAT Act in relation to relief for bad debts. The Directive required the taxable amount to be the amount of consideration received by the trader. That was supported by the first paragraph of Art11C(1) which, in accordance with that principle, defined cases in which member states were required to reduce the taxable amount; those cases included non-payment and were cases where the consideration for the supply turned out to be less than expected. Then the second paragraph of Art 11C(1) gave member states a power to derogate from that treatment in the case of non-payment where non-payment might be difficult to establish or temporary. In *Goldsmiths* the CJEU had said:

> "18. The power to derogate, which is strictly limited to the latter situation [where non-payment might be difficult to establish or temporary] is based on the notion that in certain circumstances non payment of consideration may be difficult to establish or temporary. It follows that the exercise of that power must be justified if the measures taken…are not to undermine the object of fiscal harmonisation pursues by the Directive."

102. This language in our view addresses whether the domestic derogation is drawn unjustifiably widely in the light of its objectives; it is concerned to restrict national measures to those which do not disturb fiscal harmonisation except where justified by the authority of the derogation power.

103. In *GMAC* the UK's domestic provisions derogated from the obligation to treat the VATable amount as the amount actually received. That derogation was held by the Court of Appeal to be unjustified because it was of such a nature that it exceeded the authority given by the directive because it was not proportionate to the permitted aims and was therefore too wide.

104. In relation to Group 6 the question raised by the proportionality principle is, in our view, not whether the provision is too narrow, but whether it is unjustifiably broad. What has to be justified is its width, not whether it is too narrow. On that basis the principle cannot avail RSH.

105. If we are wrong in this conclusion, the provision would remain to be tested against the Directive's objective of the abolition of non-harmonised provisions and the domestic aims of the legislation. In conducting that exercise the test to be adopted is whether the measure adopted is "manifestly inappropriate (see *GMAC* [51]) or, put another way, devoid of reasonable foundation.

106. We agree that one of the social aims of the legislation in Group 5 and Group 6 was to make new dwellings cheaper or increase housing stock. Group 5 goes further than making new housing built on a non-residential site cheaper by extending zero rating to the demolition and rebuilding of housing. That is then extended in Group 5 and Group 6 by extending the zero rating to a building where all that is left of the original building is at most a couple of walls or, respectively, a shell. This gives an incentive to provide residential accommodation rather than non-residential accommodation in such buildings and does not appear manifestly inappropriate to the social objective of encouraging the provision of housing.

107. Miss Shaw referred to the objective of relieving the financial burden on the owners of listed buildings. This was the objective of Group 6 identified by Lord Nicholls in his dissenting judgement in *Zielinski Baker*. Lord Walker, with whom the remainder of their Lordships agreed, referred to this objective only obliquely in his reference to the protection of listed buildings, which purpose he regarded as "less clearly articulated". That was in relation to the pre 2012 legislation.

108. We are not able from the material surrounding the 2012 legislation or that legislation after amendment to identify the relief of the financial burden on owners of listed buildings as an object of the reformed legislation. Indeed, the new provisions give, like the pre 2012 provisions, no relief to the owner of a listed building on the costs it must incur in maintaining it. Since 2012, relief is afforded only to the consumer of the supply of a new dwelling of the right sort. It seems to us that if this purpose of relief to the owner was less clearly articulated before 2012 it was absent thereafter.

109. There was little in the precursor material to the 2012 legislation to suggest a well-defined policy of preserving heritage. The statement in the consultative document (see [50] above) that listed buildings would be put on a similar position to new buildings retaining one or two facades suggests to us a policy of recognising the importance of the exterior of listed buildings, but we cannot spell out from it, or from the nature of the language of Item 1 and Note 4, a policy wider than that. And that policy is manifestly subordinate to the policy of promoting housing. It does not seem to us that the provisions of Group 5 are manifestly inappropriate to that aim.

110. We conclude that the principle of Proportionality does not avail RHD.

Conclusion

111. We dismiss the appeal

Rights of Appeal

112. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 13 AUGUST 2021