[2014] UKUT 0083 (TCC)

Appeal number FTC/43/2013

VAT - zero rating - whether a building designed as a dwelling built in grounds of existing house was an annexe to existing building - yes - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

STEPHEN COLCHESTER

Appellant

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Judge Greg Sinfield
Judge Edward Sadler

Sitting in public in London on 11 December 2013

The Appellant in person

Amy Mannion, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Mr Stephen Colchester appeals against the decision of the First-tier Tribunal ("the FTT") released on 4 January 2013, [2013] UKFTT 45 (TC), ("the Decision"). Mr Colchester had appealed to the FTT against a decision of the Respondents ("HMRC") that the construction of a new building in the grounds of his house, Yew Tree Cottage ("the Cottage"), was chargeable to VAT at the standard rate. Mr Colchester had contended that the construction should be zero rated under Item 2 of Group 5 of Schedule 8 to the VAT Act 1994 ("VATA") as the construction of a building designed as a dwelling.

2. The FTT decided that the new building was designed as a dwelling but that it was also an annexe to the Cottage. Note (16)(c) to Group 5 of Schedule 8 to the VATA provides that the construction of a building does not include the construction of an annexe to an existing building. Accordingly, the construction of the new building did not qualify as a construction of a building for the purposes of item 2 of Group 5 and was chargeable to VAT at the standard rate.

3. Mr Colchester appealed to this Tribunal. He contended that the FTT erred in law in the Decision in holding that the new building was an annexe. That is the only issue in this appeal. Before the FTT, HMRC had conceded that the new building consisted of self-contained living accommodation but sought to argue that it did not comprise a building designed as a dwelling because it did not satisfy conditions (c) and (d) of Note (2) to Group 5. The FTT decided that it did satisfy those conditions and that, accordingly, the new building was a building designed as a dwelling. HMRC did not seek to appeal that decision

4. For the reasons given below, we have decided that Mr Colchester's appeal against the Decision must be dismissed.

Facts

5. The parties agreed a statement of facts for the hearing before the FTT. The FTT set out the facts at [5] to [9] of the Decision. The relevant facts for this appeal, drawn from the facts found by the FTT and documents before it, are as follows.

6. Mr and Mrs Colchester live in the Cottage. In 2010, they applied for planning permission to construct a building described in the planning application as "a replacement garage/guest annex" in the grounds of the Cottage. A document headed "written justification" submitted to the planning authority stated:

> "At present the front door opens directly into the dining room with no appropriate space for coats, boots and dogs. This means that mud trails into the heart of the house and, as the stairs also open directly into the dining room, both the ground and first floor suffer temperature loss when the front door is opened. The tented ceilings on the first floor and the general lack of space elsewhere means *(sic)* that there is no traditional storage in the house. There is also no practical utility room

> and no space for guest accommodation. The existing garage has impractical 2m wide doors, is unsightly and out of keeping with the character of the house.
>
> …
>
> The proposed works provide a practical solution to the house's current shortcomings in a sympathetic manner which will enhance the character of the house and its surroundings."

7. The planning authority granted consent. The planning consent did not prohibit the separate use or disposal of the new building and there was no covenant prohibiting such separate use or disposal. The existing garage was demolished and the new building was constructed on the same site. The new building was completed in accordance with the planning consent in 2011. It was physically separate from the Cottage. The ground floor of the building contained a central garage space with a workshop running the length of the garage on one side and a store room on the other. At the rear of the garage was a utility room, with space and plumbing for a sink, washing machine and tumble dryer, and a lobby area with stairs to the first floor. The first floor provided what the planning application described as "guest accommodation … [which] would also double up as a study". There was also a toilet and shower room at the top of the stairs. HMRC agreed that the new building constituted self-contained living accommodation.

8. The builders originally charged VAT at the zero rate on the construction of the new building. In 2012, HMRC decided that the goods and services supplied in the course of the construction of the new building were chargeable to VAT at the standard rate. Mr Colchester, who was an interested party because of his apparent liability to pay the VAT, appealed to the FTT.

Legislation

9. Section 30(2) of the VATA provides that a supply of goods or services of a description specified in Schedule 8 is zero rated. Item 2 of Group 5 of Schedule 8 to the VATA describes the following supply:

> "The supply in the course of the construction of
>
> (a) a building designed as a dwelling or number of dwellings or intended for use solely for a relevant residential purpose or a relevant charitable purpose …"

10. By virtue of section 96(9) of VATA, Schedule 8 must be interpreted in accordance with its notes. Note (16) to Group 5 of Schedule 8 provides as follows:

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

11. Although the provisions of Note (2) to Group 5 were not the subject of Mr Colchester's appeal to this tribunal, certain of his submissions related to the scope of Note (16) if a building is designed as a dwelling for the purposes of Note (2). It may therefore be helpful to set out Note (2) which is as follows:

> "(2) A building is designed as a dwelling or a number of dwellings where in relation to each dwelling the following conditions are satisfied
>
> (a) the dwelling consists of self-contained living accommodation;
>
> (b) there is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling;
>
> (c) the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision; and
>
> (d) statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent."

Case law

12. The leading authorities on the meaning of annexe for the purposes of Group 5 of Schedule 8 to the VATA are two decisions of the High Court which both relate to the same appellant and supplies. Mr and Mrs Cantrell operated a nursing home which consisted of two units, in separate buildings, accommodating patients with different needs. Having obtained planning consent, Mr and Mrs Cantrell demolished an existing building at their nursing home and built a new one to house elderly severely mentally infirm patients. The new building was completely self-contained. It abutted an extension ("the New Barn") to the other unit's building at one corner; a fire door, which was for emergency use only, connected the two units. HMRC considered that the construction of the new building was standard rated as the enlargement of or an extension or annexe to an existing building. Mr and Mrs Cantrell appealed to the VAT and Duties Tribunal which held that the new structure was an enlargement and might also be an annexe. Mr and Mrs Cantrell appealed to the High Court.

13. In *Cantrell and another (t/a Foxearth Lodge Nursing Home) v Customs and Excise* [2000] STC 100 ("*Cantrell No 1*"), Lightman J held that the Tribunal had made a material mistake of fact and had taken into account extraneous and irrelevant considerations. He remitted the matter for a rehearing. In his judgment, Lightman J observed, at [4] of the judgment, that the question was one of fact, not law, to be determined by applying a two stage test as follows:

> "The two stage test for determining whether the works carried out constituted an enlargement, extension or annexe to an existing building is well established. 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 … 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. It is necessary to examine the pre-existing building or buildings and the building or buildings in course of construction when the supply is made. What is 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, the uses for which they are physically capable of being put and the functions which they are physically capable of performing. 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 potential for use inherent in the building or buildings."

14. Lightman J remitted the case to the VAT and Duties Tribunal with the guidance at [12] that:

> "… regard must be only to the physical character of the buildings in course of construction at the date of the relevant supply and that the subjective intentions on the part of Mr and Mrs Cantrell as to their future use, their subsequent use and the terms of the planning permission regulating their future use are irrelevant, save only in so far as they throw light upon the potential use and functioning of the buildings."

15. In its second decision, the Tribunal found that the new building was an annexe and dismissed the appeal. Mr and Mrs Cantrell appealed again to the High Court. In *Cantrell and another (t/a Foxearth Lodge Nursing Home) v Customs and Excise (No 2)* [2003] EWHC 404 (Ch), [2003] STC 486 ("*Cantrell No 2*"), Sir Andrew Morritt V-C defined annexe in Note (16) to Group 5 of Schedule 8, at [16] – [17] of the judgment, as follows:

> "The reference to an 'annexe' in Note (16) when compared with the references to 'enlargement' of or 'extension' to the existing building introduces a different concept. Thus they may be physically separate so that the connection between the two is by way of some other association. But the Tribunal seems to have thought that any association is enough. In my view that cannot be right. If there were a sufficient association between building A and building B, on the Tribunal's conclusion each would be an annexe of the other. So to hold would ignore the plain inferences to be drawn from the use of the word 'annexe'.
>
> An annexe is an adjunct or accessory to something else, such as a document. When used in relation to a building it is referring to a supplementary structure, be it a room, a wing or a separate building."

16. Sir Andrew Morritt observed, at [20] of the judgment, that:

> "The judgment of Lightman J was directed primarily to the conclusion of the Tribunal in their first decision that the Phase I works constituted the enlargement of the New Barn. In that context, and in the context of an extension, I understand and agree that the relevant considerations are those which arise from the comparison of physical features of the existing building before and after the works in question. But in the case of an alleged annexe the requirement that such a construction should be an adjunct or accessory to another may require some wider enquiry. It is unnecessary to reach any concluded view on that question to decide this case."

17. The reason why Sir Andrew Morritt considered that it was not necessary for him to reach a concluded view on the issue of whether a wider inquiry was necessary in *Cantrell No 2* is made clear in the next paragraph of the judgment. At [21], Sir Andrew Morritt said:

> "It is clear from the quotations of the Tribunal's findings I have set out … above and from the plans and photographs put before the Tribunal and me that there is nothing in the physical features of the building … to suggest that it was an adjunct of or accessory to the New Barn so as to be an annexe to the New Barn. Neither contiguity, common ownership nor inclusion in the building complex as a whole does so. If it is legitimate to look more widely than the purely physical characteristics then the medical requirements for the separation of [one] unit from [the other] unit show clearly that the latter is in no sense an adjunct of or accessory to the former."

FTT's decision

18. The FTT (Judge Alison McKenna and Mr Tym Marsh) decided that the new building was an annexe to the Cottage. In doing so, the FTT followed the guidance given by Sir Andrew Morritt in *Cantrell No 2*. The FTT set out its reasoning on this issue at [26] and [27] of the Decision as follows:

> "26. However, in following the decision of the Vice-Chancellor in the second *Cantrell* appeal we note that, when looking at the case of an alleged annexe, we are entitled to look beyond the mere functionality of the new building. In making the 'wider enquiry' contemplated by the Court in that case, we have considered the functional relationship between the existing dwelling and the new building and taken into account the justification for the new building provided to the planning authority as described … above. We reject the Appellant's submission that, when considering the characteristics of an annexe, we are limited to assessing the functionality of the new building only.
>
> 27. This was a case in which the entire rationale for seeking planning consent was based upon the enumerated shortcomings of the existing dwelling and the need to provide additional facilities in a new building, to be in common ownership and use. The new building was specifically designed to be in keeping with the main dwelling and was said to enhance not only the amenities but also the character of the main dwelling. We find that, as a matter of fact, the new building is a supplementary structure, an adjunct or accessory to the main house.

> There is, in our view, a functional connection between the new building and the main house sufficient to render it an annexe. The new building is designed to meet the deficiencies of the main house and to operate in conjunction with it. We therefore find that the new building falls within the meaning of an annexe, using the ordinary meaning of that term, and so engages note (16)(c)."

19. Having found, as a fact, that it was an annexe to the Cottage, the FTT concluded, at [28] of the Decision, that the construction of the new building was excluded by Note (16)(c) from being the "construction of a building"' for the purposes of Group 5 of Schedule 8 of the VATA and dismissed Mr Colchester's appeal.

Submissions

20. Mr Colchester submitted that the FTT's reasoning in the Decision was wrong in three respects, namely:

(1) the FTT was wrong to take into account Mr Colchester's purposes or intentions in submitting the planning application when considering whether the new building was an annexe;

(2) the FTT failed to apply the correct objective tests when considering whether the new building was an annexe; and

(3) the FTT was wrong to conclude that the new building was an annexe having concluded that it was a building designed as a dwelling within Note (2) to Group 5.

Discussion

21. In relation to the first criticism, Mr Colchester said that the terms of the Written Justification document submitted with the planning application were irrelevant and should not have been taken into account by the FTT in reaching its conclusion. He relied on the following passage from [4] of the judgment of Lightman J in *Cantrell No 1*:

> "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 potential for use inherent in the building or buildings."

22. Mr Colchester stated that the FTT sought to escape the precedent set by Lightman J by reference to [20] of the judgment of Sir Andrew Morritt in *Cantrell No 2* which the FTT quoted at [17] of the Decision. Mr Colchester criticised the FTT for omitting the final sentence of [20] of *Cantrell No 2* which says:

> "It is unnecessary to reach any concluded view on that question to decide this case."

23. Mr Colchester submitted that the final sentence of [20] of *Cantrell No 2* showed that Sir Andrew Morritt adopted and applied Lightman J's approach. We regard this submission as unsustainable. Reading [20] and [21] of *Cantrell No 2* together, it is

clear that Sir Andrew Morritt considered that there was no need for a wider enquiry where there was nothing in the physical features of a building to suggest that it was an adjunct or accessory to another and thus an annexe. He did not make a wider enquiry in *Cantrell No 2* because he did not need to do so. Sir Andrew Morritt did not rule out the need for a wider enquiry in cases where the position is less clear than it was in *Cantrell No 2* but rather accepted that it may be necessary in such cases. Because he did not need to undertake a wider enquiry in *Cantrell No 2*, Sir Andrew Morritt's observations on this point are obiter dicta. Nevertheless, we consider that they indicate an approach in relation to the issue of whether a structure is an annexe which is clearly correct and should be followed where the physical features of a building in themselves do not clearly lead to a conclusion as to whether or not it is an annexe. The status of the new building in this case was not as clear as in *Cantrell No 2*. We consider that the FTT adopted the correct approach to determining whether the new building was an annexe of the Cottage when it undertook a wider enquiry, ie considered matters other than the physical characteristics and functionality of the new building only.

24. Mr Colchester submitted that even if Sir Andrew Morritt's words did allow of the possibility of a wider enquiry, they did not negate Lightman J's categorisation of the terms of planning permissions, motives and intended or subsequent actual use as irrelevant. We do not accept this submission. Sir Andrew Morritt made it clear that Lightman J was primarily concerned in *Cantrell No 1* with the issue of whether or not the new building in that case was an enlargement. That is the context in which Lightman J's comments should be read. We consider that matters such as motive and intention can have no bearing on whether a structure is an enlargement of or an extension to an existing building instead of being a separate building. Such an issue clearly turns on purely physical characteristics. In the case of an annexe, however, it may not be possible to determine whether a structure is an adjunct or accessory to another purely on the basis of the physical characteristics of the original building and the physical characteristics of the building or buildings resulting from the construction works. In our view, Lightman J's comments in *Cantrell No 1* do not exclude the possibility of a wider enquiry in cases where the issue is whether the works comprise the construction of an annexe to an existing building, and that issue cannot be clearly determined by reference to the physical features of the relevant structures. Even if we were wrong in our understanding of Lightman J's comments, we consider that the wider enquiry approach suggested by Sir Andrew Morritt in *Cantrell No 2* is the correct approach in such cases.

25. Mr Colchester contended that if a wider enquiry were needed, which he did not accept, then the FTT had erred by considering irrelevant factors such as the intended use of the new building as indicated by the Written Justification document. We consider that the FTT in this case properly considered evidence that was relevant to the issue of whether the new building was an adjunct or accessory to the Cottage. In our view, such evidence includes, in addition to the physical characteristics of both structures which may or may not be determinative of the issue, the matters identified by Lightman J in *Cantrell No 1* as illuminating the potential for use inherent in the building, namely "the terms of planning permissions, the motives behind undertaking the works and the intended or subsequent actual use". Where the physical features do

not provide (as they did in *Cantrell No 2* but did not do in this case) a clear indication of whether or not a structure is an annexe, it is necessary to conduct a wider enquiry and consider matters such as the planning permission and intended use of the new building in order to determine its status.

26. Mr Colchester's second criticism of the Decision was that the FTT had failed to apply the correct objective criteria when considering whether the new building was an annexe. In summary, Mr Colchester submitted that a number of factors showed that the new building was designed as a dwelling within the meaning of Note (2) to Group 5 of Schedule 8, as the FTT found to be the case, and contended that a building which is a dwelling within Note (2) cannot be an annexe.

27. Mr Colchester contended that, as both the Cottage and the new building were dwellings neither could be an annexe of the other, and thus it followed that, having concluded that the new building was a building designed as a dwelling within Note (2) to Group 5, the FTT was wrong to find that it was an annexe of the Cottage. Mr Colchester relied on [16] of *Cantrell No 2*, as authority for the proposition that, where two buildings are of the same type, eg dwellings, neither can be an annexe of the other. We think that submission does not accurately reflect what Sir Andrew Morritt said in [16] of *Cantrell No 2*. He said that, where there are two buildings, to hold that each was an annexe of the other ignored the plain inferences to be drawn from the use of the word 'annexe'. In our view, Sir Andrew Morritt meant that the word 'annexe' carried the connotation that one of the two buildings is necessarily the adjunct or accessory to the other which is the principal building. He did not say that, where there are two buildings, one cannot be an annexe to the other. That is clear from the fact that one of the examples of a supplementary structure that Sir Andrew Morritt gave in [16] of *Cantrell No 2* was a separate building. We consider that to be equally true where the two buildings have the same function, for example where both are dwellings. The question in such cases is not whether two buildings are separate dwellings but whether one dwelling is an adjunct or accessory to the other. In our view, the new building was clearly an adjunct or accessory to the Cottage because, notwithstanding it was a building designed as a dwelling, it created a garage and guest accommodation that was to be used with or for the better enjoyment of the Cottage. It is, in Sir Andrew Morritt's phrase, a supplementary structure to the Cottage.

28. Mr Colchester also submitted that any other interpretation would lead to the anomalous result that a dwelling that was a separate annexe and standard rated would be zero rated if it was attached to the existing dwelling by virtue of Note (16)(b) and thus an enlargement or extension. The FTT found, at [25] (and having regard to HMRC's concession that the building consisted of self-contained living accommodation), that the new building met the conditions in Note (2) and was therefore a building designed as a dwelling. HMRC do not challenge that conclusion and we do not need to revisit it. Mr Colchester's submission to us overlooks the fact that the FTT found that, even though the new building was designed as a dwelling, it was an annexe to the Cottage. The FTT's finding on that point would, inevitably, be the same if the new building were attached to the Cottage and thus its construction would still be excluded from zero rating by Note (16)(c).

29. Mr Colchester also referred us to HMRC's guidance in Notice 708 Buildings and Construction (October 2013). He accepted that such guidance was not law but submitted that it reflected HMRC's view of the law which supported his interpretation. Section 3.2.6 states

> "An annexe can be either a structure attached to an existing building or a structure detached from it. A detached structure is treated for VAT purposes as a separate building. The comments in this section only apply to attached structures.
>
> "There is no legal definition of 'annexe'. In order to be considered an annexe, a structure must be attached to an existing building but not in such a way so as to be considered an enlargement or extension of that building.
>
> …
>
> The annexe and the existing building would form two separate parts of a single building that operate independently of each other."

30. Mr Colchester submitted that HMRC's guidance in Notice 708 was that a building that was not attached to an existing building was not an annexe. We agree that the wording of Section 3.2.6 of Notice 708 is, at best, confusing. Having stated that an annexe can be either an attached or detached structure, section 3.2.6 states "to be considered an annexe, a structure must be attached to an existing building". Although the section states that its comments only apply to attached structures, we consider that it does not make sufficiently clear (at least, to Mr Colchester and to us) that a detached structure, which is treated for VAT purposes as a separate building, may also be an annexe and section 3.2.6 could confuse a reader not familiar with guidance contained in the case law on this subject. HMRC guidance cannot, in any event, override the law. In *Cantrell No 2*, Sir Andrew Morritt clearly stated that an annexe need not be physically attached when he said, at [16], that annexes "may be physically separate so that the connection between the two is by way of some other association". In this case, the FTT found as a fact that the new building, a detached structure, was an annexe of the Cottage.

31. In conclusion, we consider that the FTT applied the correct approach to determining whether the new building was an annexe. The FTT's decision that the new building was an annexe to the Cottage was a finding of fact. That finding of fact was entirely in accord with the evidence before the FTT. On the basis of that finding of fact, the FTT could only have held that the construction of the annexe was not the construction of a building for the purposes of Group 5 of Schedule 8 to the VATA and thus was not chargeable to VAT at the zero rate but at the standard rate.

Decision

32. For the reasons set out above, we dismiss Mr Colchester's appeal against the Decision.

Greg Sinfield

Judge of the Upper Tribunal

Edward Sadler

Judge of the Upper Tribunal

Release date: 28 February 2014