[2017] UKUT 253 (TCC)

Appeal number: UT/2016/0154

VAT — building work — substantial but not complete demolition of existing dwelling and construction of new dwelling on site — VATA Sch 8 Group 5, Items 2 and 4 — Notes (16) and (18) — whether FTT correct to conclude that existing building had ceased to exist — no — appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

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

- and –

J3 BUILDING SOLUTIONS LTD **Respondents**

Tribunal: Hon Mr Justice Mann
Judge Colin Bishopp

Sitting in public in London on 8 June 2017

Hui Ling McCarthy, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Will Byrne, counsel, instructed by Kenneth M Barrow & Co, for the Respondents

DECISION

Introduction

1. This is an appeal from the Decision of the First Tier Tribunal ("FTT") released on 10 May 2016 in which the FTT allowed an appeal of the taxpayer against the refusal by HMRC to allow certain construction work carried on by the appellant at 82, Moor Lane North, Gosforth, Newcastle-upon-Tyne to be zero-rated. The VAT in issue was £40,069.00.

2. The facts can be briefly stated. The property in question comprised a coach house with some modern flat-roofed extensions, and a limited amount of un-built-on land. The coach house had been used as a residential dwelling. The plans for its redevelopment which were implemented involved demolishing the coach house and the extensions save for the northern and western exterior walls and part of the southern exterior wall. The retained walls were stripped of their plaster on the inside and new walls were erected inside the old north wall with a membrane between the new and old walls in order to prevent the ingress of water. A new eastern wall was constructed, together with part of the southern wall which was built so as to join up with the retained part of the southern wall. Parts of the overall building were increased in height, and the footprint of the overall building (including the former extensions) was increased. It is the VAT involved in carrying out those works that is now in issue.

3. Before us Miss Hui Ling McCarthy appeared for HMRC; Mr Will Byrne appeared for the respondent taxpayer.

The law and the legal points arising

4. The question which arose below and which arises on this appeal is whether or not the taxpayer is entitled to treat its supplies as zero-rated. That turns on whether or not the supplies fall within Group 5 of Schedule 8 to the Value Added Tax Act 1994 ("the Act") which sets out what supplies are zero-rated. The only parts of that extensive Schedule which are relevant are as follows:

> "2. The supply in the course of the construction of –
>
> (a) A building designed as a dwelling…
>
> of any services related to the construction other than the services of an architect, surveyor or any person acting as a consultant or in a supervisory capacity.…
>
> 4. The supply of building materials to a person to whom the supplier is supplying services within item 2 or 3 of this Group which include the incorporation of the materials into the building (or its site) in question."

5. The provisions of the Schedule are supplemented by Notes which, despite their title, have full legislative force (having been added by subordinate legislation over the years). The relevant notes are Notes 16 and 18:

> "(16) For the purposes 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;…

(18) A building only ceases to be an existing building when:

(a) Demolished completely to ground level; or

(b) 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 or similar permission."

6. The point which arises on this appeal turns on the interaction between those three provisions. It was not disputed that the supplies in question would fall within the wording of Items 2 and 4 (and thus be zero-rated) if that wording stood alone – they were supplies in the course of construction of a building designed as a dwelling. However, the contention of HMRC is that the works are taken out of zero-rating because they fall within the description of one or more of the nouns contained in Note 16(a), and in particular HMRC contends that the works were an "alteration" within the meaning of the Note. The respondent taxpayer says that the works fall within none of those descriptions and therefore they are not taken outside the scope of Items 2 and 4.

7. One further fact needs to be added at this stage. It will be seen that Note 18 seems to define how a building ceases to be an "existing building" for the purposes of the statutory provisions. A building achieves that by virtue of a complete demolition. As a matter of fact there was no complete demolition in the present case – some walls remained. However, if what is left of a building consists of no more than a single or double façade which is required by planning permission then the retention of those walls will not prevent the situation being viewed as one in which the building was in fact totally demolished, and thus will not prevent it ceasing to be an "existing building". The FTT considered whether or not the facts of the present case fell within that deemed complete demolition even though its reasoning rendered such a decision unnecessary. The FTT found as a fact that the retained northern and western walls were not retained as a condition of any statutory planning consent (see paragraphs 117-118), and they also found as a fact that a third wall (the part southern wall) was also retained. Those findings of fact were not challenged by the respondent. In those circumstances the conditions referred to in Note 18(b) were not fulfilled. The result of that is that parts of the original building remained and it was not demolished completely to ground level, and it was not deemed to have been demolished. HMRC submits that that state of affairs means that the "existing building" subsisted throughout the entire building process, that is to say the existing building continued to subsist for the purposes of considering zero-rating. The taxpayer's case is that despite the provisions of Note 18 and the findings of fact to which we have just referred, there nonetheless came a point of time later when the "existing building" ceased to exist as a result of the works that were carried out. That issue lies at the heart of the dispute between the parties.

The FTT's Decision

8. The FTT were hindered in their deliberations on the matter by the fact that, very surprisingly, case law going to the central point in issue was not cited by either side. It was only when the members went away and did their own researches after the hearing that it appeared that there were potentially relevant authorities on which the FTT ought

to have been addressed. Having discovered those authorities the FTT did not call for further submissions, but made up their own minds on the basis of those authorities.

9. The first section of the FTT's Decision is taken up with a consideration of the policy behind the relevant parts of the zero-rating regime and how the zero-rating provisions ought to be construed. We do not think it necessary to set out any of that material or to consider it ourselves. It then turned to "The case law on Note 16". It considered in some depth the case of *HMRC v Astral Constructions Limited* [2015] UKUT 21 (TCC). That was a case involving a purported "enlargement or extension", and not one of the works referred to in Note 16(a). They considered that the case was authority, binding on the FTT, "that a 'new build' (i.e. construction within Item 2 of the Group that does not come within any of the operations in Note 16) does not need to be a wholly new structure, i.e. one on a green field or brown field site that falls clearly within the policy of the Group as envisaged by the ECJ."

10. The FTT then went on to consider prior cases which they considered to have a bearing on the meaning of the word "reconstruction". They referred to *Wimpey Group Services Limited v Commissioners of Customs and Excise* [1988] STC 1, *Commissioners of Customs and Excise v Marchday Holdings Limited* [1997] STC 272 and *Commissioners of Customs and Excise v London Diocesan Fund* [1993] STC 369. The FTT noted at paragraph 54 of their Decision that all those three appeals related to periods before Note 18 was added to the statute (in 1995) and acknowledged:

> "They were therefore construing 'reconstruction' of an 'existing building' without any legislative gloss on the latter term."

11. Having considered some more facts the FTT set out "our conclusion on Note 16". They concluded at paragraph 63:

> "Mindful that we are told that the question that we have to decide is one of fact and degree, a jury question as was said in *Marchday*, we find, on the basis of our findings of fact as to what the old building consisted of and what was done after demolition, and the differences between them, that the works here were the construction of a building designed as a dwelling which was not the reconstruction of an existing building."

12. It is clear that the FTT at this point were basing their Decision on the sort of reasoning appearing in *Marchday* in which (as will appear) judges and tribunals approached the question of whether or not works were alterations or reconstructions of an "existing building" as some sort of overall assessment involving comparing the before and after state of affairs, and without the application of a provision such as Note 18, because that Note was not then in force.

13. At paragraph 66 and 67 the FTT concluded:

> "66. Nor do we think that what was done can possibly be described as an alteration of an existing building. Demolition is not alteration, and the only parts not demolished were not altered. We repeat Stuart-Smith LJ's remark in *Marchday* on alteration:
>
> > '…somewhere along that line it is possible to say, the original building has ceased to exist, what is being done cannot be sensibly or realistically described as an alteration of it…'

> In our view we can say that what was done here cannot realistically or even sensibly be described as alteration of the old building.
>
> 67. As a result the appellant succeeds. We do not strictly need to consider whether Note 18 can affect our conclusion. But in deference to the submissions of both parties and in case it is found that we were wrong to come to the conclusion we did as to the meaning of 'reconstruction' and 'alteration' and their application to the facts of this case, we have considered Note 18. We have found ourselves in an uncomfortable position in relation to Note 18, so it may be as well that consideration of it is not vital to our Decision."

14. The FTT then did indeed go on to consider:

> "Note 18: What does it do?"

Having set out some explanatory notes and an extract from Budget News Release 5/94 (probably inadmissible for the purposes of construing the Act), they then set out an extensive passage from the decision in the *London Diocesan Fund* case, from which they came to the conclusion that the apparent purpose of the provision was to give a developer or builder the certainty that if, but only if, in the course of the works the existing building was demolished to ground level, then the entire works would be zero-rated. However, the FTT concluded that Note 18 could not have that effect in the present case bearing in mind the background case law. At paragraph 83 the FTT concluded:

> "It is clear from the tenor of the Decision that the UT [in *Astral*] assumes that Note 18 has a wider scope than we do, and we note that *Astral* is about a Note 16(b) case, but even with these caveats it seems to us that it must follow from what the UT says that Note 18 does not say what is or is not a reconstruction, nor does it mean that all work done on a site that is not completely demolished to ground level (as our site was not) must be regarded as reconstruction etc and not a new build."

15. The FTT then turned their attention to whether or not, if Note 18 might be relevant, there was a deemed demolition as described in Note 18(b). This is where they came to the conclusion that the northern and western walls were not façades that were required to be retained by a planning or similar permission, and in any event there was a third wall (part of the southern wall) which would mean that too many walls had been retained if what was left of the original building was to fall within paragraph (b) of Note 18.

16. In all those circumstances, the FTT allowed the appeal of the taxpayer.

The flaw in the FTT's reasoning

17. HMRC submitted that this approach was flawed because it failed to bring in Note 18 in its proper place in the construction of the three relevant provisions of Schedule 8. We agree with this submission. It is plain that the FTT considered Note 16 without reference to Note 18, only then turning to the latter. That is apparent from paragraph 67 of the Decision, which summarises the position of the FTT, but it is also apparent from the FTT's prior reliance on old authority which preceded that paragraph. It is important to understand how the older authorities worked and how Note 18 has affected the position arising from them.

18. This is most clearly demonstrated by the decision in *Marchday*, on whose reasoning the FTT in this case, and the Upper Tribunal in *Astral*, placed considerable reliance. In that case the VAT tribunal and the courts had to consider whether extensive works to a former building, which retained some bits and pieces of the former building, fell within the then equivalent of Note 16. The decision of the VAT Tribunal, which was ultimately upheld, was set out at p 276-7 of the report:

> "the question which we must ask ourselves is whether the work done by [the company] at No. 44/52 Banner Street amounted to the conversion, reconstruction, alteration or enlargement of the existing building, in the sense in which these words are commonly used *or whether the end result is a new building.* We must compare the end result with the building as it was … If what might otherwise be described as conversion, reconstruction, alteration or enlargement *is so extensive that the building is essentially a new building, then Note (1A) does not apply."* [The emphasis is that of Stuart-Smith LJ in the Court of Appeal.]

19. That analysis was essentially upheld by the High Court and the Court of Appeal. At p 278d Stuart-Smith LJ agreed with the finding of the judge below, who had said:

> "[Counsel's] position entails the proposition that the continuity of the pre-existing building's identity is not at all the touchstone for the proper application of the note. The difficulty with this argument, in my judgement, is not only that it fails to give due weight to the expression 'existing building', but also that it fails to confront the very sense of the four nouns used in the note – or at least three of them. The words 'conversion', 'alteration', and 'enlargement' seem to me to connote a state of affairs in which the building upon which such works are done necessarily remains after they are done. One cannot sensibly ascribe any of these three descriptions to a case where the old building is, in effect, destroyed by the works in question. As a matter of language in each of the three implies the contrary. If a building has been converted, altered, or enlarged, it has plainly not been destroyed; it continues to exist there it may have been substantially transformed." (p278b-d)

20. Thus the exercise in that case, and in preceding cases, involved considering whether or not the existing building had ceased to exist by reference to the works themselves. That is a different intellectual exercise from that which now has to be carried out in the presence of Note 18. Note 18 provides its own answer as to whether or not the existing building continues to exist (subject to the qualification in paragraph (b)). It has become the sort of touchstone to which the first instance judge referred in the passage just cited. A *Marchday* type enquiry is no longer relevant as such. One has to approach Note 16 with the effect of Note 18 firmly in mind because it tells the reader what an "existing building" is. The Decision shows that the FTT failed to do that, but that they instead embarked on the evaluative approach which Note 18 precludes.

21. That the FTT were carrying out that exercise without bringing in Note 18 at the correct stage in the reasoning is apparent from the heading to the part of their Decision starting at paragraph 63 –

> "Our conclusion on Note 16."

Paragraph 67 (set out above) also makes clear what the approach of the FTT was. That is an erroneous approach. It ought not to have reached a conclusion on Note 16 without considering Note 18 as well. Considering it afterwards is not the same thing.

22. We therefore have to reconsider the question with all three relevant provisions considered at their appropriate place in the inquiry.

23. There is little difficulty about Items 2 and 4. The works involved in this case were clearly works of construction. What has to be considered is whether or not the works were the conversion, reconstruction or alteration of an existing building for the purposes of Note 16. It is those emphasised words which were not given proper effect by the FTT.

24. The words "existing building" are defined in Note 18. On the facts of this case there remained an existing building at all times. The pre-works building stood, and it was not demolished completely to ground floor level. What remained did not fall within Note 18(b), so there was an existing building at all times.

25. So it then becomes necessary to consider whether what was done amounted to conversion, reconstruction or alteration of *that existing building*. Those words cover a lot of metaphorical ground. The word "alteration" in particular is capable of having a wide meaning, as acknowledged by Stuart-Smith LJ in *Marchday:*

> "In my opinion the word alteration probably has the widest meaning, and may well encompass conversion in the sense I have indicated and enlargement. But the scale of alteration may be almost infinite. At one end one could have what would be regarded plainly as de minimis, for example to change of a door handle. At the other there may be virtually nothing left of the original building. Somewhere along that line it is possible to say, the original building has ceased to exist, what is being done cannot be sensibly or realistically described as an alteration of it. That was the approach of the tribunal in this case; my judgment is more correct in law." (p279a-b).

26. Neither side dissented from the proposition that "alteration" is a word capable of a wide meaning. We think that once one considers the words "conversion, reconstruction or alteration" in the context of relatively small (but not de minimis) remaining parts of the former building it is not possible to imagine any works done which would not fall within one or other of them, particularly "alteration". Mr Byrne himself, for the respondent, accepted that those three words taken together would cover the entire field of works that might be done, and we think that that concession was rightly made. If there is a degree of artificiality about it then that flows from the inbuilt artificiality in deeming the continued existence of a building of which in fact little remains.

27. We observe in passing that we have quoted that paragraph from the judgment of Stuart-Smith LJ in its entirety in the interests of completeness. At first glance it might be thought that the penultimate sentence might also apply to the present case, and if it did then it might be thought that it would take the present case outside Note 16, as the respondent avers. However, it must be noted that Stuart-Smith LJ was considering a generalised concept of an existing building and acknowledging that, purely conceptually speaking, it might be possible to say that an existing building had ceased to exist, so that there was nothing left which could be altered. That approach, however, is no longer possible in the light of Note 18. Note 18(a) provides that the existing building continues to exist absent complete demolition, and para (b) sets out the only permissible exception. The Note therefore supplants any conceptual considerations and provides the framework for considering Note 16.

28. That provides the answer to this appeal. There remained an existing building and it was incorporated into the new structure. That was an alteration, so Note 16 operates to exclude the supplies from the zero-rating that would otherwise be generated by Items 2 and 4.

29. As we have observed, there is nothing in the older cases which is inconsistent with this because they were considering a different situation absent Note 18. It is worthy of note that Stuart-Smith LJ in *Marchday* seemed to have envisaged that Note 18 would make a difference. At the end of his judgment he said (p280b-d):

> "The law has now been changed by statute. The Finance Act 1989 abolished zero-rating in relation to the construction of buildings other than those designed as dwellings. In relation to dwellings, note 18 of Group 5 of Sch 8 to the Value Added Tax Act 1994 (introduced by the Value Added Tax (Construction of Buildings) Order 1995, SI 1995/280, with effect from 1 March 1995) provided that a building only ceases to be an existing building when it is demolished completely to ground level. Although this is subject to an exception in note 18 (b) where the facade is left standing as a condition of planning consent."

30. To our eyes that demonstrates that Stuart-Smith LJ rightly considered that the change in the law had changed the effect of the zero-rating provisions by specifying, rather than leaving it as a matter of judicial impression, the circumstances in which an existing building had ceased to exist.

31. We turn now to *Astral*, on which the FTT apparently placed quite a lot of reliance while acknowledging that it was an enlargement/extension case and not an alteration/reconstruction case. It was a case which applied Schedule 8 as it now is, with Note 18. In *Astral* the relevant works were substantial additions to the site of a redundant church. Ancillary buildings were taken down, leaving just the original church. Additional "wings" (the word used in the decisions in that case) were added so as to form three sides of a new square, with the church forming the fourth side, connected to wings by brick and glass walkways at ground and first floor levels. The question in that case was whether the works were an "enlargement of, or extension to, an existing building" within Note 16 so as to remove the zero-rating that would otherwise be conferred by Item 2. The FTT and Upper Tribunal held that they were not, so that Item 2 applied. In arriving at that conclusion they both said it was appropriate to apply the approach in *Marchday,* considering whether the works were an "alteration or enlargement of the original building in the sense in which those words are commonly used, or whether the end result is a new building" (*Marchday* at p 380, cited in *Astral* at p 1047j). HMRC had submitted that the introduction of Note 18 meant that that test was no longer appropriate and that the test did not now require one to consider whether the church retained its identity (that was determined by Note 18) but whether the existing building was enlarged or extended.

32. That submission was rejected:

> "57. We do not accept Ms Mitrophanous' submission that Note (18) to Group 5 of Sch 8 of the VATA has made the fact and degree test, as propounded in *London Diocesan Fund* and *Marchday Holdings* and applied in *Cantrell No 1* and *Cantrell No 2*, irrelevant in this case. Note (18) defines when a structure ceases to be an existing building. It does not say what is or is not an extension or enlargement. Note (18) does not mean that all work, no matter how extensive, done on the site of a building that is not completely demolished to ground level must be regarded as an

> enlargement or extension. We do not accept that the word 'any' in Note (16)(b) affects our conclusion on this point. We consider that 'any' cannot be construed as applying to treat all works in relation to a building that has not been completely demolished to ground level as enlargements or extensions. That would be to place too much weight on the word 'any' and not enough on 'enlargement' and 'extension'."

33. The FTT in the present matter expressed the view that *Astral* and the earlier cases identified above, which were considered in *Astral*, established the binding proposition that:

> "… the question whether particular works are within Note 16 or not is a question of fact."

34. So far as *Astral* itself is concerned the FTT in the present case determined the proposition which they considered was derived from that case, and which was binding on the FTT, was this:

> "44. The proposition established in *Astral* which is binding on us is that a 'newbuild' (ie construction within Item 2 of the Group that does not come within any of the operations in Note 16) does not need to be a wholly new structure, i.e. one on a greenfield or brownfield site that falls clearly within the policy of the Group as envisaged by the ECJ."

35. In our view that takes *Astral* a little too far, and in any event *Astral* is distinguishable from the present case. What *Astral* decided was that it was open to a tribunal to consider whether works fell to be treated as an enlargement or extension to an existing building, or something going beyond that. It does not go to the question which arises in this case, which relates to limb (a) of Note 16 ("conversion, reconstruction or alteration"), not limb (b). The reasoning of *Marchday*, which depends on an inquiry as to whether the original building can be said to be a still "existing building" has now clearly been displaced by Note 18 in those circumstances. The deemed persistence of the "existing building" answers the question whether or not the works done on site are in the nature of reconstruction or alteration (or conversion) because, as Mr Byrne conceded, the works can have no other character given the persistence of the building. That persistence does not necessarily answer the question in the same way if what is under consideration is whether something is an extension or enlargement. One still has to go on to consider, in a real way, whether the works fairly fall within that category. That is the sort of jury question which arose in *Astral*. But it is one which arises in relation to enlargement and extension in a way which does not apply to reconstruction and alteration.

36. We therefore consider that *Astral* does not provide an answer to the question which arises in the present matter, and insofar as the FTT found that it did then it erred in that respect as well. It is distinguishable.

37. In HMRC's application for permission to appeal it sought to argue that *Astral* was wrongly decided. That submission was also made by Miss McCarthy at the hearing before us, though she put it at a lower level, preferring to distinguish it instead. We do not have to say whether we think *Astral* was wrongly decided, and express no view on the topic. We prefer to say it can be distinguished, leaving an attack on the decision itself (which HMRC decided not to mount in the *Astral* case itself via a further appeal to

the Court of Appeal, as they conceded on the permission to appeal application) to come in another case if HMRC persists in its view.

Conclusion

38. It follows from the above reasoning that we allow the appeal in this matter. It was a condition of the grant of permission to appeal to the Upper Tribunal that HMRC would not seek any costs against the respondent, so we anticipate that there will be no costs or other ancillary questions with which we will have to deal, but if there are they will have to be the subject of a separate application.

Hon Mr Justice Mann **Judge Colin Bishopp**

Upper Tribunal Judges

Release date: 21 June 2017