[2017] UKUT 34 (TCC)

Appeal numbers: UT/2015/0094
UT/2015/0095

VAT – Builder's Block restricting deduction of input tax for certain items on a supply of a new dwelling – whether block, or further restrictions from 1984 and 1987, unlawful under EU law – meaning of "incorporates … in any part of the building or its site" – meaning of "ordinarily installed by builders as fixtures"

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

TAYLOR WIMPEY PLC **Appellant**

- and -

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

TRIBUNAL: MR JUSTICE WARREN
JUDGE ROGER BERNER

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 8 – 11 November 2016

Jonathan Peacock QC and James Rivett, instructed by PricewaterhouseCoopers LLP, for the Appellant

Andrew Macnab and Ewan West, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. These are the appeals of Taylor Wimpey Plc ("Taylor Wimpey") against two decisions of the First-tier Tribunal ("the FTT") (Judge Mosedale) which were released respectively on 12 June 2014 ("the First FTT Decision") and 12 February 2015 ("the Second FTT Decision").

2. The decisions concerned claims made by Taylor Wimpey, as representative member of its VAT group, for recovery of input tax incurred by Taylor Wimpey or members of the group during the period between 1 April 1973 and 30 April 1997 ("the Claim Period"). The claims related to the installation in new-built homes of (i) built-in ovens, (ii) surface hobs, (iii) extractor hoods, (iv) washing machines, (v) microwave ovens, (vi) dishwashers, (vii) washer driers, (viii) tumble driers, (ix) refrigerators, (x) freezers, (xi) fridge freezers and (xii) carpets and carpeting materials ("the Claim Items"). The claim is a *Fleming* claim, made on 30 March 2009, within the extended transitional limitation period for historic claims provided for by s 121 of the Finance Act 2008, following the decision of the House of Lords in *Fleming (trading as Bodycraft) v Revenue and Customs Commissioners*; *Condé Nast Publications Ltd v Revenue and Customs Commissioners* [2008] STC 324.

3. The amount of the claim is substantial. As things currently stand, the aggregate amount of input tax claimed is £51,179,177.59.

The basis of Taylor Wimpey's claim

4. Taylor Wimpey's claim raises issues of domestic and EU law, as well as factual issues. It concerns the effect, or effectiveness, of UK legislation, described as the Builder's Block, under which, in various legislative forms, input tax which would otherwise be deductible in respect of expenditure on goods incorporated in a new dwelling which is supplied by way of a zero-rated supply is rendered non-deductible.

5. The block, which was first introduced by the Input Tax (Exceptions) (No 1) Order 1972, with effect from 1 April 1973, applies only to goods which are incorporated into any part of the building or its site. It excludes (and so allows recovery of input tax in these respects) certain items, namely materials, builders' hardware, sanitary ware and other articles of a kind ordinarily installed by builders as fixtures (or, since 1 March 1995, ordinarily incorporated by builders in the building or site). But as a result of legislative changes, there have been introduced successive exceptions to those exclusions, thus blocking input tax recovery on certain specific classes of goods incorporated in the building, even where they are ordinarily installed as fixtures, or ordinarily incorporated in the building or site.

6. Thus, from 1 June 1984, by virtue of Article 2 of the Value Added Tax (Special Provisions) (Amendment) (No 2) Order 1984 ("the 1984 Order"), input tax was specifically blocked in relation to (a) finished or prefabricated furniture, other than furniture designed to be fitted in kitchens, (b) materials for the construction of fitted furniture, other than kitchen furniture, and (c) domestic electrical or gas appliances,

other than those designed to provide space heating or water heating or both. From 21 May 1987, by the Value Added Tax (Construction of Buildings) Order 1987 and its replacement, the identical Value Added Tax (Construction of Buildings) (No 2) Order (taken together "the 1987 Order"), a further specific block was introduced, this time for carpets or carpeting materials.

7. The legislation changed again with effect from 1 March 1995. The Builder's Block continued to apply to goods incorporated in any part of a building as described in the zero-rating schedule (Schedule 8 to the Value Added Tax Act 1994 ("VATA")), including a dwelling or its site, but not to building materials. The expression "building materials" was itself to be found in Schedule 8, and meant goods of a description ordinarily incorporated in a building (which included installation as fittings), other than goods of the specific descriptions already excluded (and thus blocked), with the exception of electrical and gas appliances designed to heat space or water (as before) and new exceptions (thereby affording input tax recovery) for such appliances to provide ventilation, air cooling, air purification or dust extraction and door entry systems, waste disposal units and machines for compacting waste, if intended for use in a building designed as a number of dwellings, burglar alarms, fire alarms, fire safety equipment and other appliances designed solely for the purpose of enabling aid to be summoned in an emergency.

8. We have set out in a schedule to this decision the text of the legislation on the Builder's Block as it applied from time to time in the Claim Period.

9. The arguments of Taylor Wimpey before the FTT, and which were essentially repeated and augmented in this appeal, were first that the Claim Items were not "incorporated" into the new-build homes, construing "incorporated" by reference to the English land law meaning of "fixtures", and secondly (and if wrong on the first argument) that the Claim Items were fixtures of a kind ordinarily installed by builders, and to the extent such items were nonetheless blocked from input tax recovery by way of specific exclusion from such recovery, the block was unlawful under EU law.

The FTT's decisions

10. The parties helpfully subdivided the Claim Items into three categories, as referred to by the FTT at [5] of the First FTT Decision. The first was low specification appliances, namely ovens, surface hobs and extractor hoods. The second, high specification appliances, covered all the other items, with the exception of the final category, carpets and carpeting materials.

11. In the First FTT Decision, addressing the domestic law issues, the FTT found first that all of the goods were incorporated in the building. It rejected Taylor Wimpey's submission that only something affixed to a building as a fixture could be incorporated in it. The FTT applied a literal reading of the legislation and a purposive approach to its construction. It concluded, at [298], that so far as goods were concerned, "incorporates" in the context of the legislation in relation to the Builder's Block meant incorporated such that the goods were part of the single zero-rated supply of the dwelling house. The FTT went on to find, at [302], that all the Claim

Items, as they were at the very least operational and attached to the houses' power supplies, were incorporated in the building. All those items were part of the zero-rated single supply (that having necessarily been part of Taylor Wimpey's case and HMRC having accepted that this was the case to the extent the items were "incorporated").

12. That conclusion meant, as a matter of domestic law, that the application of the Builder's Block depended on whether the Claim Items could be excluded from the block by being "ordinarily installed by builders as fixtures". The FTT considered first whether the Claim Items were fixtures. It considered the legal test, and the evidence it had received in relation to the Claim Items. It concluded, at [345], that all the items were fixtures, with the sole exception of "plugged in free standing white goods". It then went on to consider whether any of the Claim Items was "ordinarily installed" as a fixture.

13. The FTT concluded, on its view of the evidence before it, first, at [382], that low specification appliances only became ordinarily installed in the 1990s. That meant that they were at no time able to benefit from the exclusion to the Builder's Block: by the time they had become ordinarily installed, the block as it applied from 1984 specifically applied to such appliances. There was, however, one qualification, which the FTT explained at [383]. As a matter of HMRC practice, split level cookers (a low specification item) were able to benefit from the exclusion to the Builder's Block between 1975 and 1984. They were blocked, however, in 1984, when the administrative practice changed: they were not, the FTT found, at that stage ordinarily installed. By the time, on the FTT's findings, those goods had become ordinarily installed, the block specifically applied to those items.

14. As regards high specification appliances and carpets, on the evidence the FTT found that none of these Claim Items were ordinarily installed at any time in the Claim Period (First FTT Decision, at [381]).

15. As a matter of domestic law, therefore, the FTT held that Taylor Wimpey could not succeed in its claim. The Builder's Block applied to deny deduction for input tax incurred on all the Claim Items throughout the Claim Period. Although there was an administrative exception for split level cookers, it was accepted that VAT would have already been recovered under that practice, and so those items were not Claim Items during the period when that practice applied.

16. That brought the FTT to consider the lawfulness of the Builder's Block under EU law. Before the FTT, Taylor Wimpey did not seek to argue that the block was wholly unlawful. It argued instead that the changes to the block in 1984 and 1987, which specifically denied input tax deduction in relation to the specific items we have referred to at [6] above, were unlawful under EU law. The consequence, submitted Taylor Wimpey, was that input tax should be recovered on the Claim Items from the moment it was shown that they were ordinarily installed.

17. The effect in practice of that argument depends on the Claim Items which are found to have been ordinarily installed at some stage in the Claim Period. Taylor

Wimpey, of course, has argued that all the Claim Items qualify at different stages. But on the basis of the FTT's findings on that question, the only items to which this EU argument applied were the low specification items from 1990.

18. The basis of Taylor Wimpey's argument was that a block on input tax deduction could only be lawful under Article 17(6) of the Sixth Directive[1]. That had the effect, it was argued, that the block could not be extended after 1 January 1978. HMRC's submission in this regard was that the block was lawful under the "exemption with refund" provisions of Article 28(2) of the Sixth Directive in its original form and Article 28(2)(a) as inserted by Council Directive 92/97 (31 October 1992)[2], and so could be extended (effectively limiting the extent to which the UK's domestic rules derogated from the normal rules under the Sixth Directive).

19. The FTT rejected the position adopted by Taylor Wimpey. It held, at [413], that Article 17(6) did not apply to any refund granted in respect of a supply that is "exempt with refund", and that consequently there is nothing in Article 17(6) that would prevent the UK from expanding the scope of a block on exempt with refund supplies.

20. That did not mean that the FTT accepted HMRC's submission with regard to Article 28(2)(a). At [446], the FTT reasoned that, whilst Article 28(2)(a) permitted the zero-rating of new-build dwellings, it did so on the basis only that this was an exemption with refund. Items caught by the Builder's Block were liable to tax at 0% and were not entitled to refund of input tax. That, the FTT found, was not exemption with refund, but simply exemption. The FTT took the view, therefore, that the Builder's Block in its entirety was not authorised by Article 28(2)(a), and so was unlawful under EU law.

21. If the FTT had considered that view to have been critical to its decision, it would have been minded to refer the question to the Court of Justice of the European Union. It did not consider it critical for the following reasons. First, the FTT rejected Taylor Wimpey's argument that to the extent the Builder's Block was unlawful it should be disapplied and a deduction for input tax on the Claim Items allowed accordingly. The FTT instead found (at [452]) that, because of the Builder's Block, UK domestic law afforded exemption only (and not refund) with respect to the Claim Items. If Taylor Wimpey chose to rely on UK law it would obtain no refund. Furthermore, if Taylor Wimpey instead sought to rely on directly-effective EU law, the supply of the new building would be a standard-rated supply. There was

[1] Sixth Council Directive (77/388/EEC) of 17 May 1977, which came into force on 1 January 1978. Although the Sixth Directive has been superseded by the Principal VAT Directive (Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax), it was the Sixth Directive that applied for the relevant portion of the Claim Period.

[2] In this appeal, there is no material distinction between the two versions of Article 28(2). We shall refer only to the version from 31 October 1992, but that should be taken to include references to the original Article 28(2) as well.

accordingly, in either case, no right to exemption with refund with respect to the Claim Items.

22. Secondly, it rejected an argument that because the Claim Items were part of a single zero-rated supply, EU law did confer zero-rating on those items. The FTT found, at [455], relying on the judgment of the Court of Justice in *Talacre Beach Caravan Sales Ltd v Customs and Excise Commissioners* (Case C-251/05) [2006] STC 1671, that UK law had, by virtue of the Builder's Block, provided a tax position for the Claim Items which was separate from that of the house with which those items formed a single supply. The FTT reasoned that because the domestic law did not confer zero-rating on the Claim Items when they were part of a single supply, but conferred instead exemption, EU law would not have the effect that the Claim Items element of the supply was itself zero rated.

23. After considering further arguments of Taylor Wimpey, and rejecting them, the FTT summarised its conclusion at [471]. It concluded that, to the extent that the Builder's Block was unlawful, Taylor Wimpey could choose to rely on its position under UK law (with the result, according to the FTT's findings, that no input tax recovery would be available in respect of any of the Claim Items), or it could rely on EU law which, according to the FTT, would have the consequence that the supplies of the Claim Items would be standard rated.

24. That, as the FTT recognised at [472], would in principle entitle Taylor Wimpey to recover the input tax in respect of all of the Claim Items. However, that also gave rise to the question whether it could do so without offsetting the output tax on such standard-rated supplies against the recoverable input tax, given that the normal period in which HMRC could assess the output tax had long since expired.

25. That question was the subject of the Second FTT Decision. For that purpose, but subject to any appeals to this Tribunal, Taylor Wimpey treated its claim in March 2009 as an election to rely on its EU law rights to treat the supply of the Claim Items as standard rated and to reject the UK's treatment of the supplies as exempt. The FTT found that, as a matter of EU law, the standard-rated supply of the Claim items would give rise to a right to deduct but that, on the basis of the decision of the Court of Justice in *Minister Finansów v MDDP Sp z.o.o. Akademia Biznesu, Sp. komandytowa* (Case C-319/12) [2014] STC 699, the exercise of that right required an offset of the corresponding output tax. Because it was conceded by Taylor Wimpey that, on the assumption that its supplies of the Claim Items were standard rated, its output tax on those supplies would have exceeded its input tax recovery, the result was that Taylor Wimpey was not entitled to recover any of the input tax claimed.

Appeals to this Tribunal

26. It is from those two decisions of the FTT that Taylor Wimpey now appeals to this Tribunal, with the permission of the FTT itself in some respects, and with the permission of this Tribunal in certain others. The grounds of appeal are:

(1) *Ground 1*. Having identified the Builder's Block to be unlawful, the FTT erred in finding that the supplies of the Claim Items made by Taylor Wimpey would (looked at alone) be standard rated supplies with a right to recover input tax rather than zero rated supplies with a right to recover input tax.

(2) *Ground 2*. The FTT erred in finding that, following the matters addressed in relation to Ground 1, and in circumstances where (a) the provision of the Claim Items is a part of what would otherwise be a single zero-rated supply of a home and (b) there is no UK statutory limit on the scope of the relevant zero rate, the supply by Taylor Wimpey is nevertheless capable in part of being taxable at the standard rate as regards the Claim Items.

(3) *Ground 3*. In any event the FTT erred in finding that as a matter of general principle any right on the part of Taylor Wimpey to recover input VAT in respect of sums caught by the unlawful Builder's Block is a right to recover an amount net of an output VAT liability irrespective of national time limits.

(4) *Ground 4*. In the alternative, in the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that the Claim Items were all "incorporated" in the buildings for the purpose of the Builder's Block.

(5) *Ground 5*. In the alternative, in the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that the relevant Claim Items were not "ordinarily installed as fixtures" by builders in dwellings during the years in question.

(6) *Ground 6*. In the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that there is nothing in Article 17(6) of the Sixth VAT Directive to prevent the extension of the scope of the Builder's Block after 1 January 1978.

The lawfulness of the Builder's Block under EU law

27. As it is a threshold question the answer to which affects the other issues in these appeals, we start with the question whether the Builder's Block, or any extension to the Builder's Block, was lawful or unlawful as a matter of EU law.

28. On the accession of the UK to the EEC on 1 January 1973, the relevant VAT directives in force were the First Directive (Council Directive 67/227/EEC of 11 April 1967) and the Second Directive (Council Directive 67/228/EEC of 11 April 1967).

29. The First Directive, in its recitals, envisaged a staged approach to the harmonisation of turnover taxes within the Community, the first stage being the adoption by Member States of the common system of value added tax, "without an accompanying harmonisation of rates and exemptions". Article 1 required the Member States to replace their present systems of turnover taxes with the common system of VAT. Article 2 set out the principles of the system:

> "The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of goods and services, whatever the

> number of transactions which take place in the production and distribution process before the stage at which the tax is charged.
>
> On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components …"

30. Those objectives were taken further by the Second Directive, which was made on the same day as the First Directive. The iterative nature of the process continued to be recognised by acceptance on a transitional basis of differences between Member States, but by providing, in accordance with the recitals to the Second Directive, for the progressive abolition of those differences so as to ensure neutrality of competition between Member States. The tax was intended to be a broad-based tax, and exemptions and zero rates were to be strictly limited.

31. Article 10 of the Second Directive made provision for exemptions. Apart from special cases of the supplies of goods to places outside the Member State in question and associated services, and the provision of import services, Member States were themselves free, subject to consultation with the Commission under Article 16, to determine the "other exemptions which it considers necessary" (Article 10(3)).

32. Article 11 provided, generally, for deduction of tax invoiced on the supply to the taxable person of goods and services used by the taxable person for the purposes of his undertaking. However, Article 11(2) provided that VAT on goods and services used in non-taxable or exempt transactions was not deductible. Article 11(4) provided:

> "Certain goods and services may be excluded from the deduction system, in particular those capable of being exclusively or partially used for the private needs of the taxable person or of his staff."

33. Article 17 contained provision in relation to the transition from the then systems of turnover taxes to the common system of VAT. It included provision enabling Member States, again subject to consultation with the Commission, to provide for exemptions with refund of tax that would otherwise be non-deductible under Article 11(2). The last indent of Article 17 provided:

> "Member States may:
>
> …
>
> - provide for reduced rates or even exemptions with refund, if appropriate, of the tax paid at the preceding stage, where the total incidence of such measures does not exceed that of the reliefs applied under the present system. Such measures may only be taken for clearly defined social reasons and for the benefit of the final consumer, and may not remain in force after the abolition of the imposition of tax on importation and the remission of tax on exportation in trade between Member States."

34. The parties helpfully explained that the expression "reliefs applied under the present system" in the last indent of Article 17 referred to the reliefs then found in the national turnover tax systems, which were exemptions and special rates which represented a departure from the then norm of such taxation (see *EC Commission v United Kingdom* (Case C-416/85) [1988] STC 456, judgment at [2] – [4]). Although it is not entirely clear whether the comparator for this purpose was the former purchase tax regime in the UK, or the UK's new VAT system which was in place by 1 April 1973 (though the former seems more likely), the effect of the Second Directive was to permit the UK to maintain zero-rating reliefs that did not have the effect of making the footprint of the UK VAT system narrower than that of the former regime. The items which were zero-rated under the Finance Act 1972 had either been outside the scope of purchase tax (as was the case for new-build houses) or expressly not chargeable to or exempt from purchase tax (for example, builders' hardware, sanitary ware and other articles of kinds ordinarily installed by builders as fixtures, which were not chargeable to purchase tax under the Purchase Tax Act 1963, Sch 1, Part I, Group 11: see *F Austin (Leyton) Ltd v Customs and Excise Commissioners* [1968] 1 Ch 529, footnote 1.)

35. In relation to that part of the Claim Period to which the Second Directive applied (1 April 1973 to 31 December 1977), Taylor Wimpey's primary case is that while Article 17 authorised zero-rating, no part of that Article authorised the exclusion from deduction or refund found in the Builder's Block. Once the Member State had exercised its right under Article 17 to grant exemption with refund, it could not simultaneously remove that refund.

36. HMRC's position is that the Builder's Block is, and always has been, an integral part of the zero-rating system. It was authorised by, and compatible with EU law by reference to, the last indent of Article 17. Article 11 of the Second Directive is not relevant, and could not, as expressly provided by Article 11(2), in any event give Taylor Wimpey any EU law right to deduct where the inputs are used for the purpose of exempt output supplies.

37. The Sixth Directive came into force with respect to the United Kingdom on 1 January 1978. It provided, essentially, for a harmonised system of VAT throughout the Community, subject to the maintenance of certain transitional periods and derogations.

38. Article 13 provided for exemptions, including exemptions in the public interest (Article 13(A)). Material to these appeals is Article 13(B) which required Member States to exempt a list of transactions, including, at (g), "the supply of buildings or parts thereof and the land on which they stand, other than as described in Article 4(3)(a)". That reference, in Article 4, which dealt with "taxable persons", referred to the "supply before first occupation of buildings and the land on which they stand". Accordingly, unless exemption with refund, or zero-rating, were applied in relation to new builds, such supplies would not be exempt, but would be standard rated.

39. Article 17 made provision for the origin and scope of the right to deduct VAT. So far as material, Article 17(2) provided:

> "In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:
>
> (a) value added tax due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person …"

40. Generally, transactions which are exempt do not, because they are not taxable transactions, give rise to any right to deduct input tax. Article 17(3), however, provides some exceptions to that general rule. Accordingly, certain importations of goods are exempt with deduction or refund, as are exports outside the EU and certain international transactions where, for example, there are customs warehousing arrangements in place.

41. Article 17 also recognised the possibility of there being exclusions from the right of deduction of VAT, both existing and future. Article 17(6) provided:

> "Before a period of four years at the latest has elapsed from the date of entry into force of this Directive, the Council, acting unanimously on a proposal from the Commission, shall decide what expenditure shall not be eligible for a deduction of value added tax. Value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure, such as luxuries, amusements and entertainment.
>
> Until the above rules come into force, Member States may retain all the exclusions provided for under their national rules when this Directive comes into force."

42. The Sixth Directive included an array of transitional provisions. Article 28(2)(a), as subsequently inserted by Council Directive 92/77 (31 October 1992), concerned exemptions with refund, effectively allowing existing domestic rules in that respect to be maintained during a transitional period (which remains in force):

> "Exemptions with refund of the tax paid at the preceding stage and reduced rates lower than the minimum rate laid down in Article 12(3) in respect of the reduced rates, which were in force on 1 January 1991 and which are in accordance with Community law, and satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967, may be maintained."

43. The respective provisions of Article 17(6) and Article 28(2)(a) are material in these appeals. Put very briefly, and consistently with the respective positions adopted in relation to the Second Directive, Taylor Wimpey's case is that Article 28 cannot authorise the exclusion from deduction or refund found in the Builder's Block, and the Builder's Block is thus unauthorised. This is because, it is argued, a zero-rated supply is, under domestic law, a taxable supply so that the UK is then obliged to give effect to the fundamental aspect of EU law, namely deduction of tax paid at the earlier stage, or input tax. Further, Taylor Wimpey argues that, to the extent the Builder's Block is valid at all as a matter of EU law, it derives its validity from Article 17(6), thus restricting that validity to exclusions of deductibility of input tax in place under UK law at 1 January 1978 (so that the specific blocks introduced in 1984 and 1987

would be unlawful). By contrast, HMRC's case is that the Builder's Block derives its validity under EU law from Article 28(2)(a), and that Article 17(6) is not relevant. The FTT, as we have described, formed its own view that the Builder's Block was not valid at all, because it purported to create an exemption in relation to the affected goods, and not an exemption with refund.

44. The UK has provided, in what is now Group 5 of Schedule 8 VATA, for the zero-rating of the grant of a major interest in a building designed as a dwelling, and its site. To the extent that the Claim Items form part of a single supply with that grant, it is that provision which would give rise to the zero-rating as well of those items, and – subject to the Builder's Block to the extent that block is lawful – to the right to deduct attributable input tax.

45. The UK's rules on zero-rating are not the same as exemption with refund, in particular as they operate throughout the supply chain and not with respect only to the supply to the final consumer. The system has, however, been accepted as being essentially equivalent to exemption with refund within Article 28(2)(a). That was the position adopted by the European Commission, and accepted by the Court, in *EC Commission v United Kingdom* (Case 416/85) [1988] STC 456. In those infraction proceedings, a number of the UK's zero-rating provisions were challenged, including the zero-rating of construction of buildings, including the initial sale of new dwellings. It was argued by the Commission that the breadth of the UK's zero-rating in this respect, which encompassed private as well as local authority housing, was outside the scope of the "clearly defined social reasons" required by the last indent of Article 17 of the Second Directive. That argument was rejected by the Court, which accordingly upheld the UK's zero-rating in that respect.

46. As a general rule, supplies by a taxable person in the course of an economic activity are taxable supplies, and VAT is chargeable on those supplies. Correspondingly, and in accordance with the principle of neutrality of VAT, there is a right to deduct input tax attributable to those taxable transactions. The system of deduction enables the intermediate links in the distribution chain to deduct from their own taxable amount the sums paid by each to his own supplier in respect of VAT on the corresponding transaction (*Terra Bauberdarf-Handel GmbH v Finanzamt Osterholz-Scharmbeck* [2004] ECR I-5583, at [36]). The right to deduct input tax is an integral part of the VAT scheme and in principle may not be limited; it is subject only to such limitations as are permitted by derogations expressly provided for in the applicable directive. Any derogation from the principle of the right to deduct VAT must be interpreted strictly (*Lennartz v Finanzamt München III* (Case C-97/90) [1995] STC 514, at [27]; *Danfoss A/S and another v Skatteministeriet* (Case C-371/07) [2009] STC 701, at [26]).

47. An exception to that general rule is the system of exemptions. Under the Second Directive, prior to a harmonised system, it was for the Member States, subject to consultation, to determine what exemptions were necessary. The Sixth Directive set out a list of exemptions to be transposed into domestic law. In contrast to taxable supplies, and again in accordance with the neutrality principle, exemptions do not generally have a right of deduction of associated input tax. But as exceptions to the

general rule, exemptions are to be construed strictly (see *Skatteverket v PFC Clinic AB* (Case C-91/12) [2013] STC 1253, at [23]).

48. A further exception is the ability of Member States, through Article 17 of the Second Directive and Article 28(2)(a) of the Sixth Directive, to apply exemption with refund, including zero-rating, in order to enable effectively non-taxable transactions to benefit from deduction of associated input tax. As the Advocate-General (Kokott) said in *Marks & Spencer plc v Revenue and Customs Commissioners* (Case C-309/06) [2008] STC 1408, the right to deduct input tax in respect of exempt transactions, or zero-rated transactions (which are only notionally taxable transactions) had to be a specific feature of Article 28(2)(a) in order to derogate from the requirement, in Article 17(2) of the Sixth Directive, that the right to deduct applies only in respect of taxable transactions.

49. In *Marks & Spencer*, the issue before the Court of Justice concerned the claim for recovery of VAT wrongly accounted for on chocolate covered teacakes, which had over time been wrongly treated as biscuits (and thus as standard-rated supplies), but which should, under the domestic provisions, have been zero-rated. It was held (at [20] – [28]) that, first, Article 28(2) of the Sixth Directive did not provide a directly enforceable Community law right to have the supplies taxed at a zero rate. Community law did not require Member States to maintain exemptions with refund, and it was for the Member State alone to decide whether or not to retain a particular piece of legislation. Article 28(2) could be compared to a "stand-still" clause intended to prevent social hardship likely to follow from the abolition of exemptions provided for by the national legislature but not included in the Directive. It was pursuant to national law that the taxpayer could claim the exemption with refund of the tax paid at the preceding stage.

50. The Court held, secondly, at [32] – [36], that the maintenance of exemptions or of reduced rates of VAT is permissible only in so far as it complies with the principles governing the common system of VAT, including that of fiscal neutrality. Those principles may be relied upon by a taxable person against a national provision, or the application thereof, which fails to have regard to those principles.

51. Domestically, the question of the lawfulness or compatibility of the Builder's Block with EU law has been considered at the level of the VAT tribunal in *McCarthy & Stone PLC v Customs and Excise Commissioners* (13 May 1992; decision no 7752). In that case, certain items had been held by the tribunal to be articles ordinarily installed by builders of sheltered homes as fixtures, but that input tax was blocked because the items were domestic electrical appliances. The question before the tribunal was whether the inclusion of specific blocked items by the 1984 Order was unlawful by virtue of the Sixth Directive.

52. The company argued that the 1984 changes widened the exclusions from the right to deduct input tax, and that such a widening was not permitted under Article 17(6) of the Sixth Directive.

53. The tribunal found, at [36], that there was no necessary implication in the words of Article 17(6) of the Sixth Directive that a Member State is prevented from widening the class of exclusions from the right to credit for input tax in relation to transactions falling within the scope of exemptions with refund or, in the UK, zero-rated transactions. Its reasoning is essentially set out at [33]:

> "The source of any principle relating to deductibility will be in Article 17. The right to deduct in Article 17.2 in confined to the case of 'taxable transaction'. Zero-rated transactions (such as the grant of a major interest by a speculative builder to which the 1984 Order applies) are however, in the scheme of the 6th Directive, a class of 'exemptions with refund of tax'; consequently they are not covered by the mandatory direction in Article 17.2. Article 17.3 reinforces this. It in turn grants the right of refund of tax to certain transactions that are exempt under, inter alia, Article 15 (most of which are zero-rated under United Kingdom law). The inference must, therefore, be that in the absence of Article 17.3 there will be no right of deduction for those transactions because they were zero-rated or, in the 6th Directive terminology, exempt with refund of tax paid at the preceding stage. Article 17.6 which is expressed permissively appears therefore to be referring back to Articles 17.2 and 17.3, and is limited in its application. It allows Member States to retain exclusions from the right to deduct in the cases of taxable transactions (ie those taxed at positive rates) and to those specifically given the right of deduction by Article 17.3. It is also significant (as the Crown pointed out) that Article 17.2 by using the word deduct appears to be confined in its scope to the case of positive-rated transactions where there is in a real sense an output tax from which the related input tax can be deducted: it does not, however, go so far as to cover, and consequently mean that Article 17.6 covers, zero-rated transactions where there is no output tax from which the related input tax can be deducted."

54. The tribunal distinguished *Lennartz*, on which the company sought to rely, on the basis that that case was not concerned with exemptions with refund, but with taxable transactions.

55. The tribunal went on to consider whether, as regards the items in question, the 1984 Order produced a result that was compatible with the zero-rating system authorised by Article 28(2) of the Sixth Directive. Its reasoning, on which Mr Macnab placed particular reliance, was set out at [38] – [40]:

> "38. Article 28.2, as noted above, allows for derogation from the general rule of the 6th Directive (that all supplies, other than those on which Articles 13-16 confer exemption, are to be taxed at the positive rate with the right to deduct input tax). It authorises the zero rating system, as being a system equivalent to the system of exemption with refund permitted by the 2nd Directive. The words used 'exemption with refund … may be maintained' briefly described the systems covered by the derogation but they are in no sense designed to establish a comprehensive code.

> 39. Taking the United Kingdom zero-rating system for buildings as it existed on 31 December 1975, Article 3 of the 1972 Order (set out in paragraph 10 above) was an integral part of it. This provided that the consequence of a speculative builder making a zero-rated supply by granting a major interest in a building was for the builder to be excluded from the right to deduct the input tax incurred by him on non-standard fixtures. Thus at that time the description 'exemption with refund' did not appropriately cover the zero-rating system in the United Kingdom. The Tribunal does not, therefore, accept the Company's argument that the words 'with refund' must be taken literally with the result that the 1984 Order (which admittedly widened the class of transactions for which no repayment of tax is available) constitutes a further and unauthorised derogation.
>
> 40. The Tribunal considers that the 1984 Order, in just the same way as the 1972 Order, was a necessary annexure to the zero-rating system relating to buildings. To the extent that direct supplies of certain specified fixtures and fittings were themselves excluded from zero-rating under VAT Act 1973 Schedule 5 Group 8 Items 2 and 3, so it was necessary to make corresponding adjustments to the VAT Rules covering the grants by 'speculative builders' of major interests in buildings containing similar fixtures and fittings. To have introduced Note (2A) to Group 8 in 1984 without also introducing the 1984 Order would have produced an anomaly leading to opportunities for avoidance of tax. In the Tribunal's view Article 28.2 provides the framework for the zero-rating system in the United Kingdom and this framework covers the consequential rules such as the 1972 and the 1984 Orders required to produce a reasonably harmonious scheme. The substantive, albeit indirect, result of the 1984 Order was to secure the payment of VAT on non-standard fixtures such as domestic electric appliances: the speculative builder paid the tax but passed the burden on to the consumer who paid a correspondingly higher price. In that the respect the Tribunal has concluded that the effect of the 1984 Order has been, to adopt the contention put forward by the Crown, 'to move closer to the end result that would be achieved by the application of the normal rules laid down by the 6th Directive, and so to reduce rather than to enlarge the extent to which the national measures derogate from those rules.'"

56. The application of Article 17(6) of the Sixth Directive was considered by the Court of Justice in *Magoora sp. Z o.o. v Dyrektor Izby Skarbowej w Krakowie* (Case C-414/07) [2008] ECR I-10921, [2009] All ER (D) 117 (Jan) ("*Magoora*"). That case concerned restrictions on the deduction of input tax on purchases of fuel, where but for the restriction the input tax would have been deductible by reference to taxable transactions. In its original form, the restriction operated according to a mathematical formula derived from the authorised carrying capacity of a vehicle and the number of seats, but that was changed in 2005 to a restriction based on the authorised weight of the vehicle at issue.

57. The question, as reformulated by the Court, was whether Article 17(2) and (6) precluded a Member State from repealing the original restriction for vehicles used for a taxable activity and replacing them with measures laying down new criteria, and

whether it precluded the Member State from subsequently amending those criteria again so as to extend those restrictions. If the answer was affirmative, a further question was whether a taxable person was entitled to insist on the application of the original provisions.

58. The Court confirmed, first, that Article 17(6) is a stand-still provision allowing the retention of national exclusions from the right to deduct VAT which were applicable before the Sixth Directive entered into force. It also confirmed that, where the legislation of the Member State is amended to reduce the scope of existing exemptions, and thereby bring itself into line with the objective of the Sixth Directive, that legislation was covered by the derogation in Article 17(6) and is not in breach of Article 17(2). But if the effect of the new legislation is to increase the extent of existing exclusions, that is not covered by the derogation. The Court also went on to say, whilst in principle leaving the issue to the national court, that in the *Magoora* case the new law had extended the scope of the original restrictions.

59. At [44], the Court alluded to the remedy for an extension to which the Article 17(6) derogation did not apply. It stated that the domestic law fell to be interpreted, so far as possible with a view to achieving the results sought by the Sixth Directive, setting aside, if necessary, any contrary provision of national law.

60. With these authorities in mind, we turn to consider the lawfulness of the Builder's Block, and the 1984 and 1987 changes to it, as a matter of EU law.

61. In concluding (although, for the reasons given by the judge, not positively deciding) that the Builder's Block was "probably not authorised" by the Sixth Directive (First FTT Decision, [471]), the FTT formed the view that the block had the effect of applying, in respect of the relevant blocked items, not an exemption with refund but an exemption without refund, or put more simply an exemption. That, reasoned the FTT, was not authorised by Article 28(2)(a) of the Sixth Directive, nor by its predecessor, Article 17 of the Second Directive.

62. We do not agree with the reasoning of the FTT in this respect. First, we consider that the reference to refund in Article 17 of the Second Directive is to be read as including a partial refund of tax paid at that preceding stage. Article 17 is a widely drawn enabling provision giving Member States power to preserve the economic effect of reliefs previously available under "the present system", the meaning of which we have considered at paragraph 34 above. However, "the total incidence of such measures" [that is to say, reduced rates or exemptions with refund] must "not exceed that of the reliefs applied under the present system". It may well be that a Member State has a system of reliefs which would be reflected by providing for exemption with refund of tax in respect of some elements of the tax paid at the preceding stage (that is to say, input tax) but which, if refund of tax was granted in relation to all elements of the tax paid at the preceding stage, would exceed the existing reliefs. Just as the UK system of zero rating has been accepted as a valid system of providing for "exemption with refund" even though this system does not precisely reflect Article 17 of the Second Directive, so too we consider that zero rating with refund of tax paid at the earlier stage in respect of some, but not all, of the

elements of input tax paid at the earlier stage is to be seen as a valid reflection of the requirement that the total incidence of the measures implemented does not exceed the amount of the existing reliefs. Once it is accepted that there can be partial refund to reflect that requirement, we see no reason to restrict partial refund to those specific cases; instead, a Member State can restrict the elements of input tax which are to give rise to a right of refund. If that is correct so far as concerns the Second Directive, we consider that it is correct also in relation to the Sixth Directive. And see further at paragraph 71 below.

63. Secondly, although this is perhaps only a different, and longer, way of making the same point, we acknowledge the argument (without deciding its correctness) that, under the Second Directive, and subsequently the Sixth Directive, if the UK had purported to apply, as a matter of domestic legislation, an exemption to a class of goods outside the scope of Article 13, that would not have been permitted, by Article 28(2)(a) or otherwise. But that was not what the UK did. It merely restricted the extent of the refund in respect of input tax in relation to certain items of expenditure incurred in the provision of the building or land to which zero-rating was applied as a matter of UK law, the purpose of the legislation when drafted clearly being to ensure that there was no right of refund in relation to those items. As a matter of drafting, the starting point was to exclude refund in relation to "all goods" incorporated in a building. But there were exceptions to that exclusion for materials and the other items listed in the relevant domestic legislation from time to time. Materials, such as bricks and cement and sand (mixed to make mortar), once incorporated in a wall forming part of the building cease to have a separate identity for VAT purposes. No-one would say that there was a supply of bricks and cement and sand or indeed of a wall separate from the supply of the building. The bricks, sand and cement were, however, goods incorporated into the building and thus needed to be excepted from the Builder's Block if, as policy dictated, a refund of the VAT paid by the builder on those items should be made. Also excepted were items which would be provided in any dwelling - builder's hardware (e.g. door handles, door hinges, shelf supports, showers to name a few of the myriad items of conventional builder's hardware) and sanitary ware (both of which would be regarded as fixtures as a matter of English land law and form part of and pass with a transfer of the land and the building standing on it).

64. In our view, Article 17 of the Second Directive is to be construed as authorising the United Kingdom to provide a system of zero-rating of new-builds allowing refund of input tax in respect of the listed exceptions (builders materials etc) but denying refund in respect of other goods incorporated into the building. That system falls within "exemptions with refund … of tax paid at the preceding stage". This is not a surprising result. The reduced rates and exemptions with refund envisaged by Article 17 are permitted derogations from the ordinary requirements of the Second Directive (and subsequent Directives). As is submitted by HMRC, to restrict the extent of that derogation is not contrary to EU law but brings about a situation which more closely reflects the ordinary requirements of the Directives. Subject to a discrete argument about Article 17(6) of the Sixth Directive, we reach the same conclusion in relation to the Sixth Directive.

65. There is, we should point out at this stage, an added complication. It is now well-known, although it was not known at the time when the Builder's Block was first introduced, that goods which would appear to be the subject of a supply separate from the supply of the building itself can in some circumstances form part of a single supply with the building, and thus be zero-rated (or, in EU terms, exempt with refund) according to the principles in *Card Protection Plan Ltd v Customs and Excise Commissioners* (Case C-349/96) [1999] STC 270 ("CPP") and *Levob Verzekeringen BV v Staatssecretaris van Financiën* (Case C-41/04) [2006] STC 766 ("the *CPP* principles"). One might surmise that the draftsman of the original domestic legislation (the 1972 Order) did not have in mind the possibility that supplies of goods which had not been incorporated into the building would nonetheless take their VAT character (as zero-rated supplies) from the supply of the building itself.

66. Without at this stage considering (we do so later) how the concept of incorporation of items into the building and the concept of a single supply interact and inform each other, and in particular without addressing the argument that incorporation of an item means no more and no less than that there is a single supply, two matters are clear. First, to the extent that such items are incorporated in the building, the Builder's Block, if valid, excludes refund of the input tax paid on items within the Block; secondly, to the extent that such items are not incorporated in the building, the Builder's Block is of no relevance.

67. It is possible (depending on the outcome of the incorporation issue) that the Claim Items, or some of them, (i) are incorporated in the building and also (ii) are prima facie the subject of a supply separate from that of the building but drawn into the orbit of zero-rating by application of the *CPP* principles. The FTT held (at [453] - [456]) that, on the basis of the judgment of the Court of Justice in *Talacre Beach Caravan Sales Ltd v Customs and Excise Commissioners* (Case C-251/05) [2006] STC 1671, the effect of UK law is to confer exemption on the supply of all of the Claim Items (the FTT having held that all of the Claim Items were incorporated). The FTT was here using "exemption" in contra-distinction to a zero-rated supply. It was not using "exemption" in the sense in which it is used in the expression "exemption with refund" in Article 28(2)(a) of the Sixth Directive where it includes the UK system of zero-rating. We do not agree with the conclusion of the FTT.

68. *Talacre Beach* concerned an express exclusion in respect of removable contents from the UK zero-rating for caravans. It was argued that the sale of the caravan and its contents was a single indivisible supply which should be subject to zero-rating as a whole. That argument was rejected by the Court of Justice. The fact that, under EU law, a single supply is, as a rule, subject to a single rate of VAT does not preclude some elements of that supply from being taxed separately, where only such taxation complies with the conditions imposed by Article 28(2)(a) of the Sixth Directive (*Talacre Beach*, judgment at [24]).

69. *Talacre Beach* is concerned with the primacy of the domestic rules that comply with the Article 28(2)(a) derogation over the effect of the application of the EU concept of single supply. On that footing it could not be argued that the single supply concept itself could override the Builder's Block. The Builder's Block has the

necessary specific language to provide different tax treatment of a single supply which includes the relevant items. That language, however, does not create a separate exempt supply of those items; it merely restricts the effect of zero-rating which would otherwise apply by virtue of the single supply. It would require specific language to create an exemption in relation to a particular element of a single supply that would otherwise be zero-rated (*Colaingrove Ltd v Revenue and Customs Commissioners* [2015] STC 1013, at [44]). It would not be possible, consistently with EU law, for the UK to legislate for exemption for an element which, on its own, would be a standard-rated supply. The Builder's Block does not, contrary to the reasoning of the FTT, identify a different tax treatment for individual elements of the composite zero-rated supply of the building. Instead of that single zero-rated supply giving rise to full recovery of input tax, only limited recovery is permitted, by excluding input tax referable to certain elements of that single supply. That limited recovery was, as we have found, permitted under both Article 17 of the Second Directive and Article 28(2)(a) of the Sixth Directive.

70. By contrast with the position of the caravans and removable contents in *Talacre Beach*, in this case the UK law does not seeks to remove the relevant items (that is, items which are brought within zero-rating only by application of the *CPP* principles) from the scope of the zero-rated supply. Indeed, that the items which are not in any event part of the building itself form part of a zero-rated supply with the sale of the new dwelling is the very premise of the Builder's Block in relation to those items; if the items did not form part of such single supply their supply would be standard-rated, and input tax deduction would follow in the normal course. Accordingly, the Builder's Block cannot be construed so as to create a separate exempt supply of the relevant items. What it does is to provide only partial input tax recovery in relation to the single supply which comprises the building and the relevant items which would otherwise be separate supplies. *Talacre Beach* makes clear that, if separate taxation of an element of a single supply complies with the Article 28(2)(a) conditions, it is not precluded by EU law. Equally, therefore, a partial refund of input tax in relation to a supply that is exempt with refund (or zero-rated) which, as we have found, is authorised by Article 28(2)(a), is not precluded by EU law.

71. We should add a few further comments on Taylor Wimpey's case. We do not accept, as Mr Peacock argued, that the general structure of outputs and inputs under the Sixth Directive (or the Second Directive before it) mandates that exemption with refund can only permit full refund (including full refund for all items drawn into the single zero-rated supply) and not partial refund. We do not consider that any support for that proposition can be derived from the reference by Advocate General Sharpston in footnote 16 to [36] of her opinion in *Danfoss* to zero-rated supplies giving rise to a right to deduct. That is merely descriptive of the typical case of a zero-rated supply, and does not countenance either the relevant domestic law or the facts and issues in this case.

72. Nor does the description of the Article 28(2)(a) derogation by Advocate General Kokott in *Talacre Beach* assist Mr Peacock's argument. Much of what the Advocate General said at [18] – [23] of her opinion is also descriptive of the VAT system

generally and the Article 28(2)(a) derogation in the context of the UK's zero-rating. At [24], the Advocate General said this:

> "Article 28(2)(a) of the Sixth Directive permits only the maintenance of national exemptions which are *in accordance with Community law*. This condition, expressly included in the Directive only in 1992, can only be understood as meaning that the national rules must be consistent with the requirements of Community law *in other respects*, thus inasmuch as art 28 does not itself permit derogations, as for example in the case of the rate of tax or the right to deduct."

73. That is not authority for a proposition that exemptions with refund must be consistent with the general right to deduct that derives from Article 17 *et seq* of the Sixth Directive. It points clearly in the opposite direction. The reference to the right to deduct (as with the rate of tax, which is applicable to the derogation for reduced rates which is also provided by Article 28(2)(a)) is not to a requirement of Community law with which the national law must be consistent, but to the derogation in Article 28(2)(a), which leaves the right to deduct in respect of exemptions with refund as a matter of national law, subject always to principles of Community law such as that of fiscal neutrality.

74. We further reject Mr Peacock's specific argument under this head that having adopted a system of zero-rating in relation to the supply of new-builds, the UK must allow deduction of all input tax which would be allowed if the supply had been standard rated. This argument is to the effect that, even if the Builder's Block could have been validly introduced by the adoption of a system of exemption with partial refund, this was not what was done; instead, the UK chose to introduce zero-rating with the result that the supply was a taxable supply which carried with it a full right to deduction or refund. We disagree. The UK system of zero-rating was accepted as valid by the Commission, the Advocate General and the Court of Justice in *EC Commission v United Kingdom* (see above at paragraph 45), by reference to the "exemption with refund" exception. The fact that the UK's domestic law treats a zero-rated supply as a taxable supply (in order to provide for input tax refund under domestic law) does not make such a supply a taxable supply under EU law. There is accordingly no right to a refund or deduction of input tax under EU law. Such a right, if it exists at all, can only be derived from UK domestic law. If that domestic law excludes that right, as it does by means of the Builder's Block, there is no route under which Taylor Wimpey can claim full deduction as of right.

75. We conclude therefore that there is nothing in Article 17 of the Second Directive or Article 28(2)(a) of the Sixth Directive that requires an exemption with refund to be exemption with full refund. The extent of the refund is a matter of national law, subject always to general principles of EU law. In that respect, a restriction on the right of refund to the extent that the zero-rated supply encompasses items that would, were they separate supplies, be taxable supplies at the standard rate, tends towards fiscal neutrality, rather than against it, a point of importance in relation to those of the Claim Items (all of them according to the FTT) that are brought within zero-rating only by application of the *CPP* principles.

76. In our judgment, therefore, the Builder's Block, as originally enacted in the 1972 Order (and then in the 1977 Order), was not contrary to the scope of the exemption with refund derogation, either that in Article 17 of the Second Directive or that in Article 28(2)(a) of the Sixth Directive. Article 17 was a transitional provision which recognised the gradual move from individual turnover tax systems of the Member States, in the UK of purchase taxes, towards a harmonised VAT system, and allowed Member States the latitude to apply their own exemptions with refund, so long as that did not restrict taxation beyond what had been the case under the former domestic system. Article 28(2)(a), by contrast, was a stand-still provision, which aimed to draw a line on the introduction of new exemptions with refund by providing for a more limited derogation for domestic systems of exemption with refund, originally with respect to domestic provisions in force at 31 December 1975, and following amendment in 1992 for those in force on 1 January 1991. It was evidently intended to preserve those domestic systems to the extent they were in accordance with Community law.

77. Contrary to the view adopted by the FTT, the Builder's Block did not provide exemption for the specified items, and so did not contravene Community law in that respect. Restricting a right of input tax deduction in relation to the single zero-rated supply by reference only to the specified items, as provided by the Builder's Block, but leaving the zero-rated supply with refund otherwise than to that extent, complied both with Article 17 of the Second Directive and with Article 28(2)(a) of the Sixth Directive. In those circumstances it is clear from *Talacre Beach* that the block is not precluded by Community law.

78. That leaves the question whether the changes to the Builder's Block that were made in 1984 and 1987, thus introducing additional specific blocks, were in accordance with Community law. Mr Peacock argued that Article 17(6) of the Sixth Directive applied to the right to deduct in respect of a zero-rated supply as it applied to taxable transactions, and thus precluded any extension of restrictions of the right to deduct after 1 January 1978. We do not agree, for the following reasons.

79. First, as the FTT observed, consistently with *McCarthy & Stone*, the right to deduct in Article 17 of the Sixth Directive is confined to taxable transactions and certain specific transactions referred to in Article 17(3). As we have described in paragraph 74, we agree with the FTT that the expression "taxable transactions" in this context is confined to transactions which are taxable as a matter of EU law, and does not encompass a zero-rated transaction which, although taxable under UK law (in order that the input tax deduction can be applied in respect of a zero-rated supply), is under EU law not a taxable transaction, but one that is exempt with refund by virtue of the derogation. Article 17(6) is part of Article 17, and can have no application outside of transactions that are taxable transactions as a matter of EU law or those in respect of which deduction or refund is specifically provided by Article 17(3).

80. Secondly, that feature of Article 17 had the consequence, as Advocate General Kokott explained in her opinion in *Marks & Spencer*, at [27], that the right to deduct in respect of exempt with refund, or zero-rated, transactions had to be incorporated into Article 28(2)(a); it could not derive from Article 17 of the Sixth Directive.

81. Thirdly, although principles of Community law apply to domestic provisions for which derogated authority is afforded by Article 28(2)(a), such as the principle of fiscal neutrality, the right to deduct in respect of exemption with refund or zero-rating provisions having effect under Article 28(2)(a) derives not from any such general principle or any other provisions of the Sixth Directive, such as Article 17. That is clear from a proper understanding of the opinion of Advocate General Kokott in *Talacre Beach*, at [24], to which we referred at paragraph 72.

82. We thus reject Mr Peacock's arguments on the effect of Article 17(6) of the Sixth Directive. It is Article 28(2)(a) that now provides the necessary legal basis under EU law for the Builder's Block, which was formerly provided by the last indent of Article 17 of the Second Directive. *Magoora* has no application in this respect. Unlike *Magoora*, this is not a case of Article 17(6) applying to preclude an extension of a restriction on a right to deduct which is provided by Article 17. It is Article 28(2)(a) that applies, and that Article operates to preserve existing systems of exemption with refund at the relevant date and to preclude only extensions to the right of exemption with refund. The restriction on a right to deduct input tax in respect of the single zero-rated supply by reference to particular items that are included within the scope of that supply cannot be regarded as an *extension* of exemption with refund; it is a *restriction* on the right to exemption with refund. That is particularly clear where the input tax relates to items that are brought within the zero-rated single supply according to *CPP* principles, but which, if supplied separately, would be standard-rated supplies.

83. The changes made by the 1984 and 1987 Orders, which added to the list of items for which an input tax deduction would not be permitted, irrespective of whether the items were ordinarily installed by builders as fixtures, were not, for the reasons we have given, precluded by Article 17(6). Nor were they precluded by any principle of EU law. The changes were, as the tribunal in *McCarthy & Stone* held, in our view rightly, an integral part of the zero-rating system relating to new dwellings. A restriction on the right of deduction or refund of input tax for the items in question, when those items were excluded from an output tax liability solely by reference to the single zero-rated supply of which they formed part, moved closer to fiscal neutrality on which the system of deduction is based, and thus brought the system more in line with the objective of the Sixth Directive. That, as indicated by *Magoora* in a different context, must be considered to be covered by a derogation, in this case in Article 28(2)(a).

84. We conclude, therefore, that the restricted right to deduction or refund of input tax which is provided by the Builder's Block was, when introduced, an element of the derogated system of zero-rating permitted by Article 17 of the Second Directive and accorded with Community law. That remained the case when it was permitted to continue in place by means of the derogation in Article 28(2)(a) of the Sixth Directive. The restrictions on deductibility of input tax which apply by virtue of the Builder's Block, including those introduced by the 1984 and 1987 orders, are not unlawful as a matter of Community law.

85. In consequence of that conclusion, we are not concerned with the effects of unlawfulness of the Builder's Block. It follows therefore that no question arises as to whether Taylor Wimpey must elect for the application of UK law or the direct effect of EU law. It is not necessary for us to consider what the position would be if we had held that the Builder's Block, or any part of it, was unlawful as a matter of EU law. Although that question was addressed at some length by the FTT, it is not one on which, in the circumstances, it would be appropriate for us to express a view. We should not, however, be taken to have accepted either the conclusion of the FTT in that respect, or its reasoning.

Reference to the Court of Justice

86. We have considered whether the question of the lawfulness of the Builder's Block is one that we should refer to the Court of Justice. We have concluded that it is not. Having examined the relevant authorities of the Court of Justice, we consider that the question is one that we have been able to resolve with complete confidence. Although Mr Peacock urged us to consider whether a reference would be appropriate on this issue, we have decided that no reference is necessary in this case.

The Builder's Block: were the Claim Items "incorporated" in the building?

87. The FTT took the view, at [301] of the First FTT Decision, that the Builder's Block would apply to anything attached to the dwelling by any means, including anything merely plugged or plumbed in, but only if it was part of a zero-rated supply. To the extent, therefore, that the Claim Items were part of a single supply (and it was a necessary part of Taylor Wimpey's case that they were), and were at the very least operational and attached to the power supply of the dwellings, the FTT found, at [302], that they were incorporated in the building for the purpose of the Builder's Block.

88. That finding, argued Mr Peacock, is wrong in law. Each of the Claim Items retained its separate identity: a fridge, oven or washing machine would be replaced or upgraded over time, and there could be no suggestion that any of the Claim Items were permanently incorporated into the fabric of the building. Mr Peacock's argument before us, as it was before the FTT, was that the concepts of "incorporation" and "installation as a fixture" are co-extensive and that for an item to be incorporated into a building or site in the sense required by the Builder's Block it must be attached to land (or property) so as to become part of the land or property in the sense of becoming a fixture.

89. In this regard, Mr Peacock referred us to a case in the VAT tribunal, *Rialto Builders Ltd v Customs and Excise Commissioners* (12 December 1973, decision no 53). That case concerned gas and electric fires that had been installed in dwellings built for sale. It was accepted both that the articles in question were fixtures, and that they were incorporated in the relevant buildings. The question of incorporation did not therefore arise for determination, but the tribunal nonetheless remarked that "It is not clear to us how an article could be 'incorporated' in part of a building … without becoming a fixture." There was, however, no argument on that point. The tribunal

here must have had in mind articles which retain their identity. A brick incorporated into a wall of a building is clearly not a fixture; rather it forms part of the building.

90. Mr Peacock also relied on another decision of the VAT tribunal, *Rainbow Pools London Ltd v Revenue and Customs Commissioners* (18 August 2008; decision no 20800). In that case the issue was the application of the Builder's Block to two items, an electrically-powered, fully-retractable and insulated swimming pool cover and a moveable tiled floor to an indoor swimming pool that could be set at various heights (or depths) so as to form part of the floor of the room (the pool thus disappearing) or the floor of the pool at varying depths.

91. The principal issue in *Rainbow Pools* was whether the items in question were "building materials" within Note (22) of Group 5 of Schedule 8 VATA by reason of being, in relation to any description of building, "goods of a description ordinarily incorporated by builders in a building of that description". It was accepted by the tribunal, at [25], that the retractable covers were "incorporated" in the structure of the pools to which they were attached, and at [30] that the moveable floors were attached to the pools even though they moved, and thus passed the test of being incorporated into the building.

92. Neither *Rialto Builders* nor *Rainbow Pools* is of much assistance on the issue of incorporation. The question of incorporation was not argued, but was conceded, in *Rialto Builders*, and the remarks of the tribunal, without the benefit of argument, are of little value. Nor is the fact that in a particular case, such as *Rainbow Pools*, an item that might be argued to be a fixture was held, having regard to the degree of its attachment, to be incorporated in a building lead to the conclusion that it is only such items that can be so incorporated. That question was not addressed in *Rainbow Pools*.

93. The classic exposition of the English land law on fixtures is that set out by Blackburn J, giving the judgment of the Exchequer Chamber of the Court of Common Pleas, in *Holland v Hodgson* (1871-72) LR 7 CP 328, at pp 334-335, where he said:

> "There is no doubt that the general maxim of the law is, that what is annexed to the land becomes part of the land; but it is very difficult, if not impossible, to say with precision what constitutes an annexation sufficient for this purpose. It is a question which must depend on the circumstances of each case, and mainly on two circumstances, as indicating the intention, viz., the degree of annexation and the object of the annexation. When the article in question is no further attached to the land, then by its own weight it is generally to be considered a mere chattel; see *Wiltshear v. Cottrell*, and the cases there cited. But even in such a case, if the intention is apparent to make the articles part of the land, they do become part of the land: see *D'Eyncourt v. Gregory*. Thus blocks of stone placed one on the top of another without any mortar or cement for the purpose of forming a dry stone wall would become part of the land, though the same stones, if deposited in a builder's yard and for convenience sake stacked on the top of each other in the form of a wall, would remain chattels. On the other hand, an article may be very firmly fixed to the land, and yet the circumstances may be such as to shew that it was never intended to be part of the land, and then it does

> not become part of the land. The anchor of a large ship must be very firmly fixed in the ground in order to bear the strain of the cable, yet no one could suppose that it became part of the land, even though it should chance that the shipowner was also the owner of the fee of the spot where the anchor was dropped. An anchor similarly fixed in the soil for the purpose of bearing the strain of the chain of a suspension bridge would be part of the land. Perhaps the true rule is, that articles not otherwise attached to the land than by their own weight are not to be considered as part of the land, unless the circumstances are such as to shew that they were intended to be part of the land, the onus of shewing that they were so intended lying on those who assert that they have ceased to be chattels, and that, on the contrary, an article which is affixed to the land even slightly is to be considered as part of the land, unless the circumstances are such as to shew that it was intended all along to continue a chattel, the onus lying on those who contend that it is a chattel."

94. The question to be answered in the land law context is whether the item in question is to be considered as part of the land or as a chattel. That is not the same question as that posed by the legislative framework of the Builder's Block, which uses the term "incorporated" in the building. Although we accept that that question may involve consideration of concepts of degree and object of annexation, it is not the same as the land law question, and must be answered in its own context.

95. Clearly, "incorporates" is not the same as "installed as fixtures". Many items (or "goods" to use the word adopted in the legislation) will be incorporated in a building without being fixtures. We have given the example of a brick; but the same goes for a large number of the components of a building, from roof timbers to foundation concrete, from pipes to electrical wiring. It would therefore have been insufficient to except from the Builder's Block only fixtures ordinarily installed by builders since goods such as materials would clearly be incorporated in the building but, equally clearly, would not be fixtures; the exception of materials was therefore necessary.

96. The exceptions from the original Builder's Block (under the 1972 Order and repeated in later Orders up to 1995) were, it seems to us, an attempt to capture the core elements which ordinarily go to make up, or are consumed in the construction of, a building and which become part of the building. The excepted items in the list, preceding fixtures ordinarily installed by builders, are clearly all types of item which form core elements in that class (although, exceptionally, an item might be a material although not commonly used). The last item in the list - "fixtures ordinarily installed by builders" - is similarly to be seen as identifying a class of items incorporated in a building which form core elements of the building and become part of the building.

97. But that is not to say that an item which is not a fixture - and which does not become part of the land as a matter of land law but instead remains a chattel - is therefore necessarily excluded from the concept of incorporation. This possibility is expressly recognised in the iteration of the Builder's Block contained in the 1995 Order where for the purposes of Note (22), the incorporation of goods in a building includes their installation as fittings. The draftsman clearly considered that an item

might be installed as a fitting without thereby becoming a fixture: fixtures are not expressly mentioned in the 1995 Order because, on any view, a fixture is "incorporated" in the building within the meaning of that Order.

98. As to "installation as fittings", we do not consider that the word "fitting" has any legally established meaning. It means, in substance, no more than a chattel somehow attached to the building where the degree of attachment is not sufficient, on the facts of the particular case, to constitute the item as a fixture. In the 1995 Order there is, of course, an express provision which brings items installed as fittings into the concept of "incorporation". For our part, we do not think that that is to stretch the concept incorporation. And just as the express provisions of the 1995 Order do not stretch the concept of incorporation, so too, it is a perfectly natural use of the word "incorporates" in earlier iterations of the Builder's Block to include within its concept the installation of a chattel as a fitting. It will be necessary, in a given case, to consider whether something has been installed as a fitting, or whether it is a mere chattel, but we consider that assistance may be derived from considering the question not solely from the perspective of whether something may be described as “a fitting”, but whether it is *installed* as such. If something requires installation, that will, in our view, often be an indication that it falls to be considered to be a fitting.

99. Our view is that “incorporates” has the wider meaning which we have just considered and is not, contrary to Mr Peacock’s submission, restricted in its application to items of the type included in the list of exceptions. It follows from that, as Mr Macnab submitted, that the change in 1995, by which the exclusion from the Builder’s Block (subject to specified items being blocked) from one that depended on the item being ordinarily installed as a fixture to one that applied when the item was ordinarily incorporated in the building, operated in principle as a relaxation of the Builder’s Block. For instance, items ordinarily installed as fittings (but not so as to become fixtures) would not – unless specifically blocked – be blocked under the 1995 changes, but would have been blocked before.

100. That broader approach to the meaning of “incorporates” is also supported as a matter of purposive construction. It is, in our judgment, evident from the statutory scheme, first that the Builder’s Block was relevant only where the item in question was part of the zero-rated supply of the dwelling, and secondly that the block was intended to be excluded only in respect of certain items (subject to exceptions) that were either integral to the building, or “core” in the sense of either being ordinarily installed as fixtures or, from 1 March 1995, ordinarily incorporated in a building.

101. The purpose of the Builder’s Block is to block recovery of input tax on all components of a building other than the excepted, core, items. It would be inconsistent with this purposive approach to construe the Builder’s Block in a way that would exclude items installed as fittings from being regarded as incorporated in the building, with the result that such fittings would be zero-rated as part of the single supply with the dwelling and the input tax on those fittings would be recovered. That would have the consequence, at least prior to 1 March 1995, that installed fittings would have the benefit of recovery of input tax, but fixtures which were not “core” in the sense of not having been ordinarily installed by builders would not benefit from

recovery. Adopting a purposive approach to the construction of "incorporated", we find that the expression cannot be limited to fixtures, but must include items installed as fittings before as well as after the 1995 Order.

102. That, we consider, is the extent of the meaning of "incorporates". The statutory test is whether an item is incorporated in the building or its site; the test is not whether the item is included in the sale of whatever it is that is sold or to be sold. And so this issue of attachment must likewise be tested by reference to the physical relationship between the item and the building and not by an intention to include the item in the sale of the building and its site. We do not accept that the meaning of that expression is co-extensive with what is part of the single zero-rated supply. The tests, on *CPP* principles, of what is a single supply for VAT purposes, do not depend on any notion of incorporation in other elements of the supply. Although that would be a relevant factor, it would be but one of a range of factors that would fall to be considered.

103. It is not necessary in this decision for us to examine the *CPP* principles in any detail. It is sufficient, to illustrate that those principles are not co-extensive with any question of incorporation, if we refer to the key principles as summarised by the Upper Tribunal (Judges Sinfield and Gort) in *Honourable Society of Middle Temple v Revenue and Customs Commissioners* [2013] STC 1998, at [60]:

> "The key principles for determining whether a particular transaction should be regarded as a single composite supply or as several independent supplies may be summarised as follows:
>
> (1) Every supply must normally be regarded as distinct and independent, although a supply which comprises a single transaction from an economic point of view should not be artificially split.
>
> (2) The essential features or characteristic elements of the transaction must be examined in order to determine whether, from the point of view of a typical consumer, the supplies constitute several distinct principal supplies or a single economic supply.
>
> (3) There is no absolute rule and all the circumstances must be considered in every transaction.
>
> (4) Formally distinct services, which could be supplied separately, must be considered to be a single transaction if they are not independent.
>
> (5) There is a single supply where two or more elements are so closely linked that they form a single, indivisible economic supply which it would be artificial to split.
>
> (6) In order for different elements to form a single economic supply which it would be artificial to split, they must, from the point of view of a typical consumer, be equally inseparable and indispensable.
>
> (7) The fact that, in other circumstances, the different elements can be or are supplied separately by a third party is irrelevant.

> (8) There is also a single supply where one or more elements are to be regarded as constituting the principal services, while one or more elements are to be regarded as ancillary services which share the tax treatment of the principal element.
>
> (9) A service must be regarded as ancillary if it does not constitute for the customer an aim in itself, but is a means of better enjoying the principal service supplied.
>
> (10) The ability of the customer to choose whether or not to be supplied with an element is an important factor in determining whether there is a single supply or several independent supplies, although it is not decisive, and there must be a genuine freedom to choose which reflects the economic reality of the arrangements between the parties.
>
> (11) Separate invoicing and pricing, if it reflects the interests of the parties, support the view that the elements are independent supplies, without being decisive.
>
> (12) A single supply consisting of several elements is not automatically similar to the supply of those elements separately and so different tax treatment does not necessarily offend the principle of fiscal neutrality."

104. We consider it is clear that, depending on the circumstances, it might be possible, applying *CPP* principles, for an item to be part of a single supply of the dwelling and yet be outside the meaning of "incorporated" in the building. But we are equally clear that, applying a purposive construction, both fixtures and items installed as fittings will be so incorporated.

105. It follows that we do not agree with the FTT when it said, at [298], that so far as goods are concerned, "incorporates" means incorporated such that they are part of the single zero-rated supply of the dwelling. As the FTT recognised, "incorporates" is a more physical test than that for a single supply. The two tests are not the same. Although the Builder's Block can be relevant only if the item in question is part of a single supply of the dwelling, the test for the application in principle of the Builder's Block does not require any enquiry into whether the item was part of a single supply; the sole test is that of incorporation.

106. We accept, as the FTT did, at [243], that since 1973 Parliament, in enacting on the one hand the zero-rating provisions for the supply of construction services and related goods (originally in Items 2 and 3 of Group 8 of Schedule 4 FA 1972, and now to be found in Items 2 and 4 of Group 5 of Schedule 8 VATA) and on the other the provisions for the granting of a major interest in a new dwelling by the person constructing it, intended there to be a broad symmetry between the two. The different cases are conveniently described as contract builders and speculative builders. In the case of contract builders, zero-rating is restricted to the same range of items as are excluded from the Builder's Block in the case of speculative builders.

107. That does not however mean, as Mr Macnab argued, that "incorporated" should be construed as referring to everything that would be part of the single supply of the dwelling. Purposive construction can go only so far, and cannot give rise to a construction that cannot be borne by the words of the statute.

108. In the case of contract builders, the test for zero-rating of the related goods has, until 1995, focused on builder's hardware, sanitary ware and other articles of a kind ordinarily installed by builders as fixtures, excluding from time to time the same specific items expressly included within the Builder's Block. No test of incorporation was required to be met. Even following the 1995 changes, in the case of contract builders the test of incorporation of the building materials was a test for inclusion of the materials in the zero rate, not an exclusion. By contrast, in the case of the Builder's Block, incorporation in the building has been a pre-condition for exclusion from input tax recovery.

109. In the case of contract builders, zero-rating has at all times been applied to goods related to the construction services by a discrete zero-rating provision. It has never been material to that zero-rating whether the goods were, or were not, supplied as part of a single supply with the construction services themselves. It has only been since 1995 that an incorporation test has been introduced for builder's hardware, but there is still no single supply test.

110. It follows, in our view, that there is nothing in terms of the construction of the Builder's Block that can be derived from the broad symmetry between the tax treatment of contract and speculative builders. In particular, there is no basis on which that symmetry can lead to a conclusion that in the block "incorporates" is co-extensive with inclusion in the single zero-rated supply of the dwelling. The expression "incorporates in any part of the building or its site" is inapt to describe every case where an item would be regarded as part of the single supply of the dwelling.

111. In our judgment, therefore, the test of incorporation is not determined by reference to the English land law of fixtures, nor by whether the item is part of the single zero-rated supply for VAT purposes. An item will be incorporated in a building if it is a fixture, and also if it is installed as a fitting. That does not depend on nice distinctions of land law, and whether something is part of the land. Nor does it involve an enquiry into whether the item is part of the single supply of the dwelling, either because it is part of the building or on *CPP* principles; that is a pre-condition for the Builder's Block becoming material in a given case, but it does not determine the application of the block.

112. That leaves the question of the criteria that should be applied in order to determine if an item, which is not a fixture, is installed as a fitting. The test must be such as to be consistent with the statutory language of incorporation in a building. Without setting a prescriptive test, there must in our view be a material degree of attachment to the building, albeit less than the degree of annexation required for something to be a fixture. In our judgment mere attachment to an electricity supply by a removable plug is not, on its own, sufficient for the item to be regarded as

installed as a fitting, or incorporated. Some other feature or features of installation is necessary, whether by housing the item in a particular structure, or by fixing the item in a manner designed to be other than temporary either to a physical part of the structure or to a supply of electricity, gas or water or means of ventilation or drainage.

Were the Claim Items incorporated in the building?

Fixtures

113. The FTT made findings with respect to whether the Claim Items were fixtures. First, at [326], the FTT found that to the extent that white goods were merely plugged in, or plugged in and attached to the water supply and drains, they could not be fixtures. Secondly, at [327] – [331], to the extent that white goods were wired in and attached by screws to the carcass of the kitchen units and/or the work surface and/or a kitchen unit door or (in the case of the hood) to the kitchen wall, there was a sufficient degree and object of annexation, such that those white goods would be fixtures.

114. The FTT went on to find, in relation to carpets, that the fitted carpets that formed part of the Claim Items were fixtures. In doing so the FTT declined to follow the Court of Appeal in *Botham and others v TSB Bank plc* (1997) 73 P&CR D1. In that case the Court considered a wide range of items, including relevantly to this appeal white goods in the kitchen, namely an oven, dishwasher, extractor, hob, fridge and freezer, kitchen units and work surfaces, including a fitted sink, and fitted carpets cut to size and kept in place by gripper rods. The kitchen units, work surfaces and sink were held to be fixtures, but the white goods were not, even though they were wired and plumbed in. The fitted carpets were also held not to be fixtures.

115. With regard to the fitted carpets, those were considered alongside curtains and blinds. The Court took the view that the carpets were attached to the building in an insubstantial manner, there was no intention to effect a permanent improvement to the building and the removal of the carpets would have no effect, damaging or otherwise, on the fabric of the building. It was not a case where carpet or carpet squares had been affixed to a concrete screed in such a way as to make them part of the floor.

116. The FTT took the view that it was entitled to depart from the judgment of the Court of Appeal because the facts were different. It was significant, reasoned the FTT, that in *Botham v TSB* Roch LJ had taken the view that fitted carpets were not installed by builders, whereas in Taylor Wimpey's case they were so installed. The FTT also took its own view, though it appears without any evidence, that a fitted carpet is cut to size, fitted by expert fitters with tools and held down by gripper rods nailed to the floor, and that it would have the necessary degree of annexation to qualify, in principle, as a fixture. The FTT then went on to find that because Taylor Wimpey intended the carpets to pass with the dwelling, that was a sufficient intention, or object of annexation, for the fitted carpets to qualify as fixtures.

117. We do not agree. In our judgment, the FTT erred in law in this respect. It was not open to it to find that fitted carpets, held by gripper rods as in *Botham v TSB*, had the requisite degree of annexation, when *Botham v TSB* had decided to the contrary.

The FTT appears to have considered it material that the gripper rods themselves were nailed to the floor, but that is not material to the degree of annexation of the carpets themselves. The Court of Appeal concerned itself instead with the ease at which the carpets could be lifted off the gripper rods. That was the appropriate test, and by failing to adopt it, the FTT erred in law. The only conclusion available to the FTT was that the fitted carpets were not fixtures.

118. Apart from the error in respect of the fitted carpets, we consider that the FTT's conclusions with respect to the other items were consistent with *Botham v TSB*. In particular, the FTT was careful to draw a distinction between white goods that were merely plumbed or wired in (holding, as in *Bolton v TSB*, that those Claim Items were not fixtures) and those which were fixed by screws, for example to the kitchen units or the wall, which the FTT held were fixtures. Those conclusions were open to the FTT, and there is no error of law in those respects.

Installed fittings

119. We are unable, without further submission, finally to determine the extent to which those Claim Items that were not fixtures should be classified as installed fittings so as to meet the test of incorporation in the building. Our view essentially is that, from the list of Claim Items, the only items that will be neither fixtures nor installed fittings will be white goods that are free-standing and attached to the building by means only of a removable plug or other temporary attachment to the mains services, in circumstances where the equipment is of its nature portable in the ordinary course.

120. Without making any findings in relation to the Claim Items themselves, it would be expected, for example, that a built-in oven, a surface hob (to the extent they were not fixtures), an extractor hood, a wired and plumbed-in washing machine and a wired and plumbed-in dishwasher would all be installed fittings. Stand-alone washer driers and tumble driers would likewise be installed fittings if either they were attached in a non-temporary manner to ventilation or were installed in a location with some reasonable expectation of permanence, in the sense of the expected working life of the appliance. If the latter criterion were met, the same would apply to refrigerators, freezers and fridge freezers, and to microwave ovens. It is only if such items are essentially free-standing and properly regarded as portable, even if attached to the mains, that they would not qualify as fittings, but would be mere chattels, and thus outside the meaning of "incorporated" for the purpose of the Builder's Block. An example would be a microwave oven that is simply placed on the kitchen work surface, and which is plugged in for use. Finally, fitted carpets would clearly be fittings.

121. As we say at the end of this decision, we invite the parties to seek to agree the position by reference to the guidance we have given on the meaning of installed fitting, but failing agreement we shall hear further argument.

Ordinarily installed as fixtures/ ordinarily incorporated

122. Having decided that the Builder's Block is lawful as a matter of EU law, the consequence is that, in so far as the Claim Items were incorporated in the buildings, the question of the application of the block, except in the case of the specified items from time to time, depends on whether those Claim Items, or any of them were "ordinarily installed as fixtures", or (since 1995) "ordinarily incorporated by builders in a building of that description" (including, in the latter case, installation as fittings).

123. We start with the question of principle, namely what is meant by "ordinarily installed". The FTT held, at [353], that to satisfy this test an item did not have to be invariably installed, but that items would be ordinarily installed if they were usually or commonly installed when the homes were built. On that basis, the FTT concluded, at [369], that if an item was installed as standard by house builders then it was ordinarily installed within the meaning of the Builder's Block.

124. In our judgment, the proper focus must be on the language of the provision, which applies a test of ordinariness of the installation or incorporation in a building. The question is not a new one: it was considered as long ago as 1968 in *F Austin (Leyton) Ltd* by reference to corresponding provisions under the Purchase Tax Act 1963. Two questions arose in that case. The first, with which we are not concerned, was whether a fixed and built-in dressing table was "furniture" within the relevant statutory meaning. The second was whether a unit of that nature was "ordinarily installed by builders as a fixture".

125. The provision at issue in *F Austin (Leyton) Ltd* – Group 11, Sch 1 to the 1963 Act – bore similarity to the exceptions to the Builder's Block, in that it grouped together builder's hardware, sanitary ware and other articles of kinds ordinarily installed by builders as fixtures. Given the similarity, it is worth referring fully to the analysis given by Stamp J at pp 538 – 539:

> "As a matter of the ordinary meaning of the English language, the word 'ordinarily,' in my view, governs the whole of the rest of the phrase 'installed by builders as fixtures' and does not serve to distinguish articles installed ordinarily as fixtures from those which are installed by builders but not as fixtures. To fall within the category described, the articles must be both of a kind ordinarily installed by builders and of a kind ordinarily installed by builders as fixtures. Nor, in my judgment, does the word 'ordinarily' serve to distinguish articles ordinarily installed by builders as fixtures from articles ordinarily installed as fixtures by persons who are not builders. The word "ordinarily" when read in conjunction with the opening words "builders' hardware, sanitaryware and other articles of kinds" and the concluding words 'as fixtures' indicate, in my judgment, that what is meant by the words 'ordinarily installed by builders' is that they are ordinarily installed in the course of building - articles which one would expect a builder to instal as fixtures in the ordinary way and without any special instruction. The articles which are specifically spoken of are clearly articles which one would expect a builder to instal as fixtures as a matter of course because a builder when performing his

> function of building ordinarily instals them. A prospective purchaser viewing a house and finding no pipes, basins, baths, cisterns or water closets would, I venture to think, express surprise that such articles were not there, and he would do so because these articles are of kinds ordinarily installed by builders as fixtures. But if he said to the builder following him round 'Why are there no fitted dressing tables?' the surprise would, I venture to think, be on the other side, and the question might appropriately be answered by the builder by some such remark as 'Builders in this country do not at present ordinarily instal articles of that kind as fixtures' and if the impertinent visitor remarked 'But I have been looking at some houses up the road where the builder has installed dressing tables as fixtures,' the builder might, I think, patiently and, in my judgment, correctly reply 'That is still today exceptional though the time may come when all furniture is ordinarily installed as fixtures.' That day is, in my judgment, still before us. As I have indicated, I am assisted to the conclusion to which I have come on this part of the case by the consideration that the phrase in question is part of a longer description of articles which comprise articles of a kind which a builder does ordinarily instal and does ordinarily instal as fixtures - e.g., builders' hardware and sanitaryware - and if the latter part of the phrase is not to be construed as ejusdem generis with builders' hardware and sanitary-ware, it would at least derive colour from those terms. But the whole description is of a genus, namely articles which a builder would instal as fixtures."

126. That the judgment of Stamp J in *F Austin (Leyton) Ltd* is as relevant in the VAT context as it was to purchase tax is apparent from the later case, in 1982, of *Customs and Excise Commissioners v Smitmit Design Centre Ltd* [1982] STC 525. In that case the issue did not concern the Builder's Block, but the analogous provisions for zero-rating for contract builders. Having referred at length to the above passage from Stamp J's judgment, Glidewell J (at p 531b) made it clear that to equate "ordinarily" with "invariably" would be to apply too rigid a test, saying that "ordinary" means in the ordinary way, and suggesting other synonyms of "commonly" or perhaps "usually".

127. We respectfully agree that, as a matter of language, "ordinarily" means something that is not invariable, and it must permit of exceptions. But that does not mean that it must be confined to those cases where the installation is so prevalent that it is only in exceptional cases that it would not be carried out. That too would be too rigid a test. Something will be ordinarily installed or incorporated, in our judgment, unless its installation or incorporation would be out of the ordinary, uncommon or unusual. The test, we consider, is whether the installation or incorporation of the item by builders is at the relevant time commonplace or not out of the ordinary.

128. On the other hand, we do not consider that merely because the installation or incorporation of a particular item has a quality of recurrence that permits it to be described as not exceptional, that will be sufficient to meet the degree of prevalence required to satisfy a test of ordinariness. Doing something merely more commonly or more usually than on an exceptional or isolated basis does not render that something as ordinarily done. There is a range of activity between something that is exceptional

or an isolated occurrence and something that is ordinary. It cannot be enough, as the tribunal in *Rainbow Pools* appears to have thought, that the mere fact that swimming pools are sometimes included in luxury dwelling houses means that they must be regarded as ordinarily installed in such houses.

129. In our judgment, for an item to be ordinarily installed, the prevalence of its installation must be greater than that it is not exceptionally installed, and greater than merely sometimes installed. However, we do not consider that ordinariness can be equated with likelihood, and we disagree therefore with the FTT when it said, at [369], that ordinary means no more than that the item in question is more likely to be installed than not. Furthermore, we would not ourselves adopt the synonym of "usually" as suggested by Glidewell J in *Smitmit*; we consider that the meaning of ordinarily is closer to commonly, an expression also referred to by Glidewell J.

130. There is no bright-line test. The test, in our view, is one of ordinariness or commonness, which does not require that there be any industry standard (though clearly, if there were, that would be material factor), or that the items would be installed in most dwellings. It is, in the end, a matter of judgment, having regard to the evidence as to the relative frequency of installation by builders of the item in question at the material time.

131. The question then is to what extent it is necessary to identify any particular class of buildings by reference to which the ordinariness of installation or incorporation falls to be tested. The FTT took the view, at [359], that prior to the 1995 changes "ordinarily" had to be measured against all dwellings, and that from 1 March 1995 the comparison was with the applicable description of building out of the four types identified by the FTT as within Group 5 of Schedule 8 VATA (namely, those designed as a dwelling, those designed as a number of dwellings, those intended for use solely for a relevant residential purpose and those intended for use for a relevant charitable purpose).

132. The comparator question has been considered in a number of decisions of the VAT tribunal. In *McCarthy & Stone*, as we have described, the case concerned certain domestic electrical appliances installed in sheltered homes as fixtures. The approach of the tribunal, which was accepted by the Commissioners in that case, was to regard sheltered homes as a distinct category against which the ordinariness of the installation could be tested. The tribunal did not adopt a test which looked at all dwellings and which did not distinguish between types of dwelling, such as sheltered homes (see *McCarthy & Stone Plc*, decision no 7014; 1992).

133. In *Rialto Homes Plc*, the tribunal was focused on the several descriptions of building described, from 1995, in Group 5 of Schedule 8 VATA. It decided, at [23], that the relevant comparator was with buildings "designed as a dwelling or a number of dwellings". It was incorrect to confine attention to the particular development in question and to ask simply whether the trees and shrubs were ordinarily incorporated in developments of that kind. The correct approach, according to the tribunal, was to look at the building of new houses in general.

134. A different approach was adopted by the tribunal in *Rainbow Pools*. That case again concerned the position following the 1995 changes, and the descriptions of building contained in Group 5. The tribunal held, at [21], that "any description of building" included, as a discrete category, a luxury dwelling house. The tribunal reasoned that both high-rise flats and luxury dwelling houses could be separate descriptions of building, and that the relevant descriptions in Note (22) to Group 5 could not be confined to the various generic categories of building referred to in Group 5.

135. In *Rainbow Pools* the tribunal had particular regard to a list of items accepted by HMRC as being "ordinarily incorporated" in a building or its site, as set out in Notice 708. We were shown that notice (June 2007 version), which does include, at para 13.8, a list of such items which, in relation to dwellings, includes air conditioning, saunas, lifts and hoists and indoor swimming pools (other than diving boards and other specialist equipment). The tribunal in *Rainbow Pools* drew particular attention to the inclusion in that list of air conditioning, saunas and swimming pools, which it associated with luxury dwelling houses, rather than with dwelling houses in general.

136. We agree with the FTT that the tribunal in *Rainbow Pools* was wrong to identify a discrete category of luxury dwellings. Even following the 1995 changes, and the reference to "any description of building", the legislation is focused on the way a building would be described as a building, and not on the relative quality of the end-product. There is for this purpose no proper distinction between luxury homes and other less luxurious dwellings.

137. We do not consider that it can have been the intention of Parliament at any time to require a test of ordinariness to be measured by reference to all buildings. That would have the effect, which we consider could not be right, that a range of buildings would be included in the comparative exercise in respect of which installation of an item as a fixture could in some cases be universal and in others rare or unheard-of. If, as we consider to be the case, the purpose of the Builder's Block is to allow deduction of input tax for what might be regarded as core items in a building, it cannot have been the intention to exclude an item that was core to the particular type of building in question merely on the ground that it was not core to a number of other types of building that bear no relationship to the particular supply in question. It would, for example, have the illogical result that lifts, which are ordinarily installed in high-rise apartment blocks, could not satisfy that test with regard to dwellings in general, and so input tax incurred on such lifts in such an apartment block would (contrary to HMRC's practice) be blocked.

138. In our view the proper comparator in the case of any buildings is buildings which most closely accord with the use of the building in question. Thus, a building designed for a single family unit will be compared, for the purpose of determining the ordinariness of the installation as fixtures (or, from 1 March 1995, fittings) with single dwelling houses. A flat or apartment in a block of several storeys will be compared with buildings designed as multiple dwellings. Maisonettes will be compared with maisonettes. Sheltered homes, as in *McCarthy & Stone*, are to be compared with

other such buildings. That in our view is the case both prior to and from 1 March 1995. There is no reason to consider that the March 1995 changes in wording, by including specific reference to "buildings of that description" was intended to change the law.

139. We should add that we do not agree with the FTT that the question whether an item was ordinarily installed or incorporated is to be measured as at the date of the legislation or the date of a legislative change (First FTT Decision, [367] - [368]). It is clear that the legislation is looking at the state of affairs from time to time, and that the question whether items are ordinarily installed or incorporated will change over time. The issue with which the Builder's Block is concerned is the deduction of input tax. It is the time that right arises that is the relevant time at which the question whether an item is ordinarily installed or incorporated must be determined.

140. We do not consider that an increase, as a matter of fact, in items that are ordinarily installed in dwellings would amount to an increase in the scope of the UK's zero rate, and would thereby be unlawful. In our judgment, there is no increase in the scope of a zero rate merely because certain items that, of their nature, failed to qualify for zero rating according to the conditions attached by the domestic law as at the relevant date for a derogation, later come into the scope of the zero rating by satisfying those conditions. The stand-still operates by reference to the effect of the relevant provisions at a conceptual level. Nor in any event can there be an increase in a zero rate merely on account of the fact that items that are not themselves zero-rated have zero-rating applied to them by reason of being part of a single zero-rated supply (*Colaingrove*, at [45]).

Outstanding issues

141. Although we have made findings on a number of issues of principle, including that the Builder's Block is lawful as a matter of EU law and that the changes made to the block in 1984 and 1987 were also lawful, and that whether the Claim Items were incorporated in the buildings depends on whether they were fixtures or were installed as fittings, a number of issues remain to be resolved with respect to the particular facts and circumstances of this case.

The "incorporation" issue

142. As we have said, the question whether Claim Items that were not fixtures were instead installed fittings remains open, although we hope that the guidance we have given will be helpful in resolving that question. The parties should seek to agree the position for the relevant items, having regard to our findings as to the criteria to be applied in that respect. If it is not possible to agree, we shall hear further argument.

The single supply/multiple supplies issue

143. To the extent that the Claim Items were not fixtures and may also be found not to meet the test of being installed fittings, so that there are Claim Items that are found not to have been incorporated in a building for the purpose of the Builder's Block,

with the result that there can be no restriction on input tax deduction in those respects, there will be a further question. The acceptance by HMRC, before the FTT and repeated before us, that if the Claim Items were "incorporated" in a building they would be part of the single zero-rated supply, would not apply. We heard some argument on the single/multiple supply issue, but we need make no determination at this stage. That will be necessary only to the extent that items may be found (or agreed) not to be either fixtures or installed fittings. If that is the case, the supply question will be addressed more productively if it focuses on the particular items in question at the material time.

The offset issue

144. Moving further into the realm of speculation, if Claim Items are found not to have been "incorporated" in a building, and are then found to have been the subject of a separate standard-rated supply, at that stage it will be necessary to consider whether the input tax deduction that would then be due should be offset by the output tax that ought to have been accounted-for on such a supply, notwithstanding that HMRC would be out of time for raising an assessment for such output tax. That was the subject of the Second FTT Decision, although in the different context of the Builder's Block being unlawful and Taylor Wimpey relying on the direct effect of EU law, and that direct effect having been held by the FTT to be that the relevant supplies were standard rated.

145. We heard argument on the issue of offset in that context. On the basis of our findings the context for that issue, were it to arise at all, would be rather different, namely that there were separate standard-rated supplies without any need to rely on direct effect. Given that the issue only arises at all to the extent Claim Items are found both not to have been "incorporated" in a building and to have been the subject of a separate standard-rated supply, it would not be appropriate for us to make any findings in that respect at this stage. We shall do so only if the issue becomes material to our final determination in respect of any of the Claim Items.

The ordinarily installed issue

146. To the extent that the parties agree, or we decide, that the Claim Items were incorporated in the building (by reason of being fixtures or being installed as fittings), there will remain the question whether any of them were excluded from the Builder's Block by being, first, ordinarily installed as fixtures (before 1 March 1995) or ordinarily incorporated (including ordinarily installed as fittings) from 1 March 1995, and secondly, not specifically brought back into the Block.

147. For such Claim Items there are only a limited number that, even if those items were ordinarily installed as fixtures or ordinarily incorporated by builders in the building (as relevant), could in principle qualify under the Builder's Block for an input tax deduction. Those items are:

(1) White goods up to 1 June 1984 (when domestic electrical and gas appliances, other than those designed to provide space heating or water heating

or both, were specifically blocked from input tax deduction), but again only to the extent they are fixtures.

(2) From 1 March 1995, only those electrical and gas appliances that could qualify for input tax deduction by reason of providing ventilation, air cooling, air purification or dust extraction (such as extractor hoods).

Although a specific block with respect to carpets and carpeting materials was introduced only from 21 May 1987, before that date the fitted carpets in this case were, as we have found, installed as fittings and were not fixtures. Accordingly, they could not have been ordinarily installed as *fixtures* prior to 21 May 1987 and could not therefore at any time have been excluded from the Builder's Block.

148. In relation to the white goods, to the extent they were incorporated in the building, the question that remains is whether any of them were ordinarily installed as fixtures or ordinarily incorporated by builders in the applicable dwellings at the material times. The FTT made findings of fact in that regard, concluding, at [369] – [383], that none of the Claim Items were ordinarily installed in the 1970s or 1980s, and that in the 1990s low specification items (ovens, surface hobs and extractor hoods) were ordinarily installed but that the other white goods (high specification items) were not. If that were right, it would only be the extractor hoods from 1 March 1995 that could qualify for input tax deduction, and as the FTT noted in the First FTT Decision, at [20], Taylor Wimpey had recovered input tax on cooker hoods from 21 July 1994.

149. However, Taylor Wimpey disputes the FTT's findings of fact, arguing that its findings were such that no person judicially and properly instructed could have come to (*Edwards v Bairstow* [1956] AC 14) and/or which were controverted by the only evidence before the FTT (*Georgiou v Customs and Excise Commissioners* [1996] STC 463). At the hearing before us, we decided that Taylor Wimpey's case on the FTT's findings of fact should be left to one side until after we had considered, and reached conclusions on, the questions of principle at issue in this appeal. That would enable the parties to consider to what extent further argument should be heard on the factual questions.

Direction

150. In light of the conclusions we have reached on those questions of principle, we invite the parties to seek to agree the position. To the extent they are unable to agree, the parties should inform the Tribunal within one month of the date of release of this decision of those aspects of the appeal and those of the FTT's findings of fact that remain in issue. In that event the Tribunal will make further directions for the final determination of this appeal.

Application for permission to appeal

151. As this appeal has not yet been finally determined, we direct that the time for applying for permission to appeal will not start to run until final determination by the Tribunal

MR JUSTICE WARREN

UPPER TRIBUNAL JUDGE ROGER BERNER

RELEASE DATE: 7 February 2017

SCHEDULE

Builder's Block: UK legislation

The Input Tax (Exceptions) (No 1) Order 1972 (1972 No 1165)

1 April 1973

3. Where a taxable person constructing a building for the purpose of granting a major interest in it or in any part of it incorporates in any part of the building or its site which is used for the purposes of a dwelling goods other than materials, builder's hardware, sanitary ware or other articles of a kind ordinarily installed by builders as fixtures, tax on the supply or importation of the goods shall not be deducted by him as input tax under section 3 of the Finance Act 1972.

The Value Added Tax (Special Provisions) Order 1977 (1977 No 1796)

1 January 1978

8. Where a taxable person constructing a building for the purpose of granting a major interest in it or in any part of it incorporates in any part of the building or its site which is used for the purposes of a dwelling goods other than materials, builder's hardware, sanitary ware or other articles of a kind ordinarily installed by builders as fixtures, tax charged on the supply or importation of the goods shall be excluded from any credit under sections 3 and 4 of the [Finance Act 1972].

The Value Added Tax (Special Provisions) Order 1981 (1981 No 1741)

1 January 1981

8. Where a taxable person constructing a building for the purpose of granting a major interest in it or in any part of it incorporates in any part of the building or its site which is used for the purpose of a dwelling goods other than materials, builder's hardware, sanitary ware or other articles of a kind ordinarily installed by builders as fixtures, tax charged on the supply or importation of the goods shall be excluded from any credit under sections 3 and 4 of the [Finance Act 1972].

The Value Added Tax (Special Provisions) (Amendment) (No 2) Order 1984 (1984 No 736)

1 June 1984

8.-(1) Subject to paragraph (2) below where a taxable person constructing a building for the purpose of granting a major interest in it or in any part of it incorporates in any part of the building or its site which is used for the purpose of a dwelling, input tax on the supply or

importation of the goods shall be excluded from any credit under sections 14 and 15 of the Value Added Tax Act 1983.

(2) Paragraph (1) above shall not apply to materials, builder's hardware, sanitary ware or other articles of a kind ordinarily installed by builders as fixtures except –

(a) finished or prefabricated furniture, other than furniture designed to be fitted in kitchens;

(b) materials for the construction of fitted furniture, other than kitchen furniture; and

(c) domestic electrical or gas appliances, other than those designed to provide space heating or water heating or both.

The Value Added Tax (Construction of Buildings) Order 1987 (1987 No 781)

21 May 1987

3. Article 8 of the Value Added Tax (Special Provisions) Order 1981 shall be varied –

(a) by inserting in paragraph (1) after the words "taxable person constructing a building" and before the words "for the purpose of granting a major interest in it", the following words –

"or effecting works to any building, in either case"

(b) by inserting in paragraph (2) after sub-paragraph (c) the following sub-paragraph –

"(d) carpets or carpeting materials".

The Value Added Tax (Construction of Buildings) (No 2) Order 1987 (1987) No 1072

25 June 1987

3. Article 8 of the Value Added Tax (Special Provisions) Order 1981 shall be varied –

(a) by inserting in paragraph (1) after the words "taxable person constructing a building" and before the words "for the purpose of granting a major interest in it", the following words –

"or effecting works to any building, in either case"

(b) by inserting in paragraph (2) after sub-paragraph (c) the following sub-paragraph –

"(d) carpets or carpeting materials".

The Value Added Tax (Input Tax) Order 1992 (1992 No 3222)

1 January 1993

6.—(1) Subject to paragraph (2) below where a taxable person constructing a building or effecting works to any building, in either case for the purpose of granting a major interest in it or in any part of it, incorporates goods in any part of the building or its site which is used for the purpose of a dwelling, input tax on the supply, or acquisition or importation of the goods shall be excluded from any credit under section 14 of the [Value Added Tax Act 1983].

(2) Paragraph (1) above shall not apply to materials, builders' hardware, sanitary ware or other articles of a kind ordinarily installed by builders as fixtures except—

(a) finished or prefabricated furniture, other than furniture designed to be fitted in kitchens;

(b) materials for the construction of fitted furniture, other than kitchen furniture;

(c) domestic electrical or gas appliances, other than those designed to provide space heating or water heating or both;

(d) carpets or carpeting materials.

The Value Added Tax (Input Tax) (Amendment) Order 1995 (1995 No 281)

1 March 1995

6. For article 6 [of the Value Added Tax (Input Tax) Order 1992], there shall be substituted –

"6. Where a taxable person constructing, or effecting any works to a building, in either case for the purposes of making a grant of a major interest in it or any part of it or its site which is of a description in Schedule 8 to the [Value Added Tax Act 1994], incorporates goods other than building materials in any part of the building or its site, input tax on the supply, acquisition or importation of the goods shall be excluded from credit under section 25 of the Act."

The Value Added Tax (Construction of Buildings) Order 1995 (1995 No 280)

1 March 1995

2. For Group 5 of Schedule 8 to the Value Added Tax Act 1994 there shall be substituted –

"**GROUP 5 – CONSTRUCTION OF BUILDINGS, ETC.**

Item No

1. The first grant by a person –

(a) constructing a building –

(i) designed as a dwelling or a number of dwellings; or

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

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

…

Notes:

…

(22) "Building materials", in relation to any description of building, means goods of a description ordinarily incorporated by builders in a building of that description, (or its site), but does not include –

(a) finished or prefabricated furniture, other than furniture designed to be fitted in kitchens;

(b) materials for the construction of fitted furniture, other than kitchen furniture;

(c) electrical or gas appliances, unless the appliance is an appliance which is –

(i) designed to heat space or water (or both) or to provide ventilation, air cooling, air purification, or dust extraction; or

(ii) intended for use in a building designed as a number of dwellings and is a door-entry system, a waste disposal unit or a machine for compacting waste; or

(iii) a burglar alarm, a fire alarm, or fire safety equipment or designed solely for the purpose of enabling aid to be summoned in an emergency; or

(iv) a lift or hoist;

(d) carpets or carpeting material.

(23) For the purposes of Note (22) above the incorporation of goods in a building includes their installation as fittings.