[2017] UKFTT 0206 (TC)

# TC05694

**Appeal number: TC/2014/06086**

***VALUE ADDED TAX - Zero rating – construction of buildings - whether a supply and consideration – yes - whether zero rating could apply to supplies of construction services prior to the discharge of a condition of planning when condition removed after commencement of but before completion of works – yes - timing of application of Note 2 of Group 5 Schedule 8 VATA - whether over declared and overpaid VAT reclaimable – yes - Sections 1, 4, 5, 30, 35, 49 and 80 Value Added Tax Act 1994 ("VATA") – Appeal allowed.***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**QUITIE LIMITED** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE W RUTHVEN GEMMELL WS**
**MEMBER: EILEEN SUMPTER, WS**

**Sitting in public at George House, Edinburgh, on 1 February 2017**

**Zizhen Yang, Barrister, instructed by KPMG, for the Appellant**

**Mrs Sharon Spence, Officer of HMRC, for the Respondents**

DECISION

## Introduction

1. Quitie Limited ["QL"] appealed against (1) a decision by HMRC issued on 10 March 2014 and upheld on review on 9 May 2014 adjusting QL's VAT return for the 10/13 period and a VAT assessment under Section 73 VAT Act 1994 ("VATA") for the same period which increased QL's net VAT liability to HMRC by £305,478.15 on the grounds that the zero rating could not apply to supplies of construction services that were made before the date on which a Section 75 planning condition was discharged, on 2 August 2013 ("the 2014 decision") and (2) against a rejection by HMRC of a Section 80 claim on 16 January 2017 on the grounds that, at the time of the supply, the building was not designed as a dwelling, as defined in Note 2 of Group 5, Schedule 8, VATA ("the Section 80 claim").

2. QL made an application for the appeals against the 2014 decision and the Section 80 claim to be combined which was not objected to by HMRC. The Tribunal granted the application.

3. HMRC made an application that the formerly agreed Statement of Facts should be amended principally in relation to the removal of the references to there being a loan from Charles Buchanan Ritchie ("CR") to QL. The Tribunal granted the application.

4. QL made an application that HMRC be barred from arguing there was an agreement between CR and QL. QL claimed this had not been part of HMRC's case until the production of their Skeleton Argument; that HMRC have not set out when the agreement was, when it was made and when it was accepted and that the issue had arisen late in the day and caused prejudice to QL. The Tribunal noted the objections but considered that any evidence in relation to this would present itself during the hearing and, accordingly, the application was refused.

5. Evidence was given by CR, aged 69, who was the sole shareholder of QL and a director of QL, along with his wife and daughter-in-law. CR was a credible witness.

6. The issues before the Tribunal were whether QL was entitled to a VAT credit or to have its VAT liability for £305,478.15 set aside. QL say there was either no supply or if there was a supply it was zero rated. HMRC say that there was a supply and it was not zero rated.

## Legislation

See Appendix 1.

## Cases Referred To

See Appendix 2.

7. QL also trading under the name of the Tufted Duck Hotel and using the same VAT registration number, purchased on 16 March 2007 land and buildings on the site of the Tufted Duck hotel, close to the village of St Combs, Aberdeenshire, Scotland, for a consideration of £375,000. CR had been born in and brought up near this village. The land was on the coast of Aberdeenshire and faced the North Sea.

8. On 17 April 2009 QL made a planning application to the Aberdeenshire Council for a dwelling house ("the House") to be built on the land that it had acquired. Planning permission was granted by the Council on 26 April 2011 but only following the Council and QL entering into an agreement under Section 75 of the Town and Country Planning (Scotland) Act 1997. The first clause of that agreement provided as follows: –

*"(FIRST) in the event of the Second Party (QL) wishing to dispose of the site (in which the dwelling house is to be constructed) it will be disposed of only as part of the disposal that also includes the buildings forming the Tufted Duck Hotel…"* ("the section 75 condition").

9. During the course of 2010, QL contracted with the Lovie Construction Ltd ("Lovie") to act as the main contractor in relation to the building of the house. Lovie then issued invoices annually to QL, which were paid in arrears, following the completion of the works invoiced. QL also received services and building materials from other suppliers in relation to the construction of the House.

10. On the invoices issued to QL in December 2011 (1st Claim for work to date £300,000) and December 2012 (2nd Claim for work to date £750,000), Lovie charged no VAT on its supplies, believing that those supplies were zero-rated as they related to a residential property. After receiving the December 2012 invoice, QL was advised by its then VAT adviser that those supplies should be standard-rated because of the existence of the section 75 condition. On the basis of that advice, QL asked Lovie to issue a VAT invoice for the supplies already made. Lovie issued a VAT-only invoice on 30 April 2013, for the amount of £210,000, which was paid by QL.

11. QL's then VAT adviser subsequently advised QL to issue an invoice to CR for the value of the supplies that QL had received to date from Lovie and other suppliers. The invoice was said to be needed for QL to recover the VAT on supplies received by it.

12. On the basis of that advice, QL issued an invoice to Mr Ritchie on 30 April 2013 for the sum of £1,527,390.73, plus VAT of £305,478.15, representing the total costs incurred by QL up to 11 April 2013 on the construction of the House. The total amount was identified on the invoice as being paid by way of credit against "City Ledger – Mr Charles Ritchie".

13. It was anticipated that QL would transfer the House to CR at an appropriate time in the future, either as a partly built construction or as a completed property.

14. QL accounted for the VAT stated in the 30 April 2013 invoice by including it as output tax in its VAT return for the prescribed accounting period ending 30 April 2013 ("the 04/10 Period"), and has paid that amount to HMRC.

15. On 28 June 2013, QL made an application to the Council to discharge the section 75 condition that the House could not be sold separately from the buildings forming the Tufted Duck Hotel and the condition was discharged by the Council on 2 August 2013.

16. On 30 September 2013, again on the advice of its then VAT adviser, QL issued a credit note to CR for the amount of £305,478.15. The advice given to QL was that the purported supply identified on the April 2013 invoice should, following the discharge of the section 75 Condition, be recognised as a zero-rated supply.

17. QL accounted for the credit note in its VAT return for the prescribed accounting period ending 30 October 2013 ("the 10/13 Period") by reducing the output tax in that period by the amount of £305,478.15 explaining that VAT had been charged by QL because the House, the dwelling, "did not initially conform within the conditions of a 'qualifying dwelling' by reason of planning restrictions" and that they had "credited the output VAT charged to the new owner in respect of payments to date".

18. Further invoices were issued by Lovie to QL in December 2013, December 2014, and January 2016; no VAT was charged in those invoices.

19. Between November 2013 and March 2014, QL's then tax adviser and HMRC engaged in a course of correspondence, in which HMRC stated that zero-rating could not apply to supplies of construction services relating to the House that were made before the date on which the section 75 condition was discharged, ie, 2 August 2013.

20. On 27 January 2014 QL's tax adviser wrote to HMRC setting out the background to why the credit note issued by QL to CR should be accepted by HMRC. The letter stated "Our client has, in addition to its normal activities in operating a hotel, undertaken the construction of a new house on land to be transferred to Mr Ritchie. Accordingly it subcontracted out the various services and supplies required. When the work commenced it was found that the planning permission was such that a restriction meant the dis-application of zero-rating. Thus VAT at the standard rate was charged and accounted for."

21. The letter continued, "Subsequently, on appeal, the planning restriction was withdrawn and the new dwelling met the conditions of a qualifying dwelling. In the meantime and since QL could not bear the costs, an 'interim' fee was issued to Mr Ritchie on which VAT was charged. Following the withdrawal of the restriction, a credit note was issued in respect of VAT and this is a matter we are now discussing… In any case there appears no loss to the Revenue as presumably Mr Ritchie would be able to make a claim under the DIY Scheme upon completion."

22. On 10 March 2014, HMRC issued a decision adjusting QL's VAT return for the 10/13 Period, and a VAT assessment for the same period ("the 2014 Decision"). The

effect of the 2014 Decision was to increase QL's net VAT liability to HMRC by £305,478.15. QL has paid the assessed amount to HMRC.

23. On 24 March 2014, QL requested a review of the 2014 Decision. On 9 May 2014, HMRC issued its decision on review, upholding the assessment on the basis that the document from the Council notifying the discharge of the section 75 condition did not appear to be backdated to the date of the original planning application. QL subsequently approached the Council to ask that the discharge be treated as being effective from an earlier date, which request was refused.

24. On 31 January 2016, QL's board of directors resolved to transfer the House to CR and his wife. On the same day, the agreement to transfer the House was entered into by QL as the seller and Mr and Mrs Ritchie as the purchasers. Full legal title to the House was transferred on 20 June 2016.

25. Consideration for the transfer was the total cost to QL of constructing the House, including the cost of the land on which it is built, and was satisfied by CR writing off loans owed to him by QL. The amount of loans so written off included the amount identified on the 30 April 2013 invoice.

26. By a letter dated 8 June 2015, QL made a claim to HMRC to recover over declared and overpaid VAT of £305,478.15 for the 04/13 Period ("the Section 80 Claim") and QL repeated the claim in a letter dated 7 December 2016.

27. HMRC rejected the Section 80 Claim on 16 January 2017. The reason given was as follows:

> "[…] at the time of the supply the building was not designed as a dwelling as defined in Note 2 of Group 5, Schedule 8, VAT Act 1994. The removal of the planning restriction prior to completion means that supplies up to the time of its removal are not in respect of a building designed as a dwelling and are not eligible for the zero rate."

28. CR gave evidence that he had set up QL to manage and corral the finances, by which he meant to keep funding in "one pot", for the construction of the properties. CR explained that he had many projects running simultaneously and this was his way of working. He confirmed that construction services were carried out on his behalf by QL and stated that there was an expectation, but not an agreement, that the House would be transferred to him and his wife, once it had been completed.

29. CR confirmed that QL, of which CR was a director, were managing all the construction and various contractors in relation to the House because, ultimately, this would pass to him and his wife.

30. CR explained that on receipt of the invoice dated 30 April 2013 from QL it had been written off by means of a loan. CR stated that he made loans of £6 million to QL for the construction of properties on the site, including the House. He stated that QL managed the construction services which were carried out for QL who only had the

money to pay for them because they obtained the money from CR as a loan. CR confirmed that indirectly the work was carried out for CR and his wife and he had appointed QL to oversee the construction of the House and handle the payments.

31. CR referred repeatedly to an "understanding" that the House would be transferred to him and his wife but he explained that there was no agreement and certainly no written agreement in the sense, as CR saw it, that an agreement would be in writing, or as he put it "set in stone" and an "understanding" was a more flexible arrangement.

32. Reference was made to letters written by QL's then VAT adviser which stated that the building, the House, was being built "for you" which referred to an agreement between QL and CR in relation to design and build. CR stated that there was an understanding about that but that there was no written agreement. CR confirmed that he employed an architect to design the House and told the architect what he wanted and that he was on site checking that the builders were following what the architect had specified.

33. CR confirmed that there was never any question that the House would ultimately belong to him and his wife provided they both survived to the completion of the building of the House. CR emphatically denied that there was any agreement between him, and his wife, and QL, that the House would be transferred to him and until 2016 there was only an expectation on CR's part that the House would, in time, be transferred to him to hold in his own name. An agreement was only recorded in QL's board minutes on 31 January 2016.

34. CR confirmed that he had paid the April invoice by writing it off against loans on the basis that he had spent "a fortune making the site". This was needed, CR explained, to fortify the part of the site on which the House was to be built and required 267 steel piles to create a sound foundation. CR explained that this was simply to make the site suitable for a building and was, in his view, lost money as this type of expense could not be, and would not be, recoverable if the house had been sold. In other words, whereas the house would have a value, the costs of making the site appropriate on which to build it would not be realised in that value.

35. CR explained that he had done this because he had been born and brought up near the site and that he so wished to live there that he knew he would have to write off the cost. The writing off of the loan was as a result of advice received from CR's then tax adviser to the effect that if he did not write off the loan, QL would be in financial difficulties. CR said that it was his practice to normally follow the advice of his advisers,

36. QL had then issued an invoice for services received from Lovie to enable QL to recover VAT. CR said that QL had asked him for the money and he had paid QL so that QL could pay the invoice to Lovie.

37. CR was asked if he would normally pay an amount of money such as £1.5 million without any loan documentation and CR advised that he would not but that he had

done so in this instance because this was something controlled by him and his wife and there were no other third parties.

38. With the agreement to transfer the house to CR by QL on 31 January 2016, the price agreed for the sale of the house was set at the cost price to QL and not the market value, which was much lower. To meet the purchase price CR stated that he wrote off loans owed to him by QL up to the amount of the total cost of the house, including the cost of the underlying land on which it was built.

39. CR stated that he had only paid off the April 2013 invoice because QL's adviser had told QL at the time, that the invoice was necessary to allow it to recover the VAT on supplies received by it. CR confirmed that if he funded something for £6 million it was done in the expectation of something and that something included that eventually the House would belong to him and his wife.

40. HMRC referred to an email from QL's then tax adviser dated 19 December 2013 as follows: – "QL operate as a hotel (The Tufted Duck) and Mr C Ritchie is a director of the business. Mr Ritchie decided he would like to build a new house on land owned by and adjacent to the hotel. It was agreed that the land would be transferred to him. To facilitate the construction of the dwelling it was agreed verbally that QL would take on the role of contractor and would incur the costs etc and would effectively provide the construction of the new dwelling. QL has staff and office facilities which made this a practical solution to the project….. The transfer of the land to Mr Ritchie is currently being drafted by the solicitor. The agreement between QL and Mr Ritchie is a design and build one, however because of the close relationship, it was felt there was no need to commit the agreement to writing. However, that can obviously be done if you require it for any reason".

41. HMRC also referred to a letter from QL's tax adviser dated 24 March 2014 which stated "the payments which the client (CR) has made to date have been seen as part of payments towards this overall supply and were necessary to meet funding requirements. The client has not taken possession of the house as yet so although the value charge to him was based on certain costs, the supply was in fact related to the final qualifying house".

**Submissions by QL**

*No underlying supply*

42. QL say that they are entitled to a credit of £305,478.15 or to have the 2014 Decision set aside such that its VAT liability to HMRC is reduced by the same amount because it had accounted for £305,478.15 as output tax in the 04/13 Period when it was not output tax, because there was no underlying supply, and, if not, their Section 80 claim succeeds. Alternatively, if the Tribunal find that there was an underlying supply, that it was zero rated.

43. QL say that it is clear from Sections 1(1)(a), 4(1) and 5(2)(a) of VATA and Article 2.1 of the Principal VAT Directive ("PVD") that VAT is only chargeable where there is a supply for a consideration. "Supply" is not defined in the VAT

legislation and the word should be given its ordinary meaning. They refer to the *Carlton Lodge Club* case which concerned a payment by subscription members' club who claimed that the club owned the drink it supplied and it was not a supply of goods and services because the drink was "released by other members of their share in the drink and so represented the consideration and therefore no VAT was due". The court held that it was a supply and that the definition was not limited to the supply of goods and services by way of sale.

44. QL say that they did not furnish CR with anything whereas in *Carlton Lodge Club* each member received a drink. CR had no interest in the house before and after he paid the invoice and only QL had an interest and did not furnish or serve CR with anything.

45. They say that there was no underlying supply because QL had issued the 30 April 2013 invoice only because it had been advised to do so. Notwithstanding the description on that invoice, there was in fact no contract or agreement at the time for QL to furnish or to serve CR with anything in relation to the House.

46. It was not possible for there to have been a supply in the 04/13 Period from QL to CR as CR had no interest in the House or the land on which it was built until 31 January 2016 and refer to Section 2 of the Requirements of Writing (Scotland) Act 1995 which requires a written document to create or transfer a real right in land.

47. When CR wrote off loans to QL in the amount set out in the 30 April 2013 invoice that was not, in any way, a consideration for a supply. In order for payment to be a consideration for a supply there must be a direct link between the supply and payment; there must be a reciprocal performance; a *quid pro quo* and not a *quid cum quo*.

48. QL made reference to the *Tolsma* case which concerned the player of a barrel organ on a public highway in the Netherlands who solicited voluntary donations from passers-by but also knocked on doors at houses and shops to ask for payment. He was assessed to VAT by the Netherlands tax authorities. The European Court of Justice held that for Mr Tolsma to be supplying services for a consideration required a direct link between the service provided and that "the consideration received and that the supply of services is effected 'for consideration' only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient".

49. QL also made reference to the *Church Schools* case which involved the relationship between two charitable companies who had a close ownership relationship and each held shares in the other. One company, the foundation, granted a lease of the properties to the other, the company, at a market rent and at the same time arrangements were made for cash surpluses to be transferred from the company to the foundation as grants.

50. These grants were assessed to VAT. The court held that although there was a legal relationship between the foundation and the company there was no direct link between the execution of the building works, which had been partly financed by the grants, and the grants. Similarly QL say that the development of the House is not a supply for services for the loan being written off, the supply is made with the loan, which is then written off.

51. QL say that when CR wrote off the loans to QL, in respect of the 30 April 2013 invoice, that was not a consideration as it bore no direct link to and was not made in return for anything furnished or served by QL. As there was no agreement between them, any write off was a voluntary release for which CR received nothing in return and is consistent with the write-offs subsequently being avoided and the same loans written off in 2016 as consideration for the House.

52. The voluntary release was purely motivated by a concern that QL should not be put in financial difficulties. QL say that talk about agreements and references to correspondence is a "red herring". The only question is why CR wrote off the loans and the answer is QL's perceived or actual financial difficulties.

53. As there was no underlying supply, the £305,478.15 accounted for by QL as output tax in the 04/13 period was not in fact output tax due. As such, pursuant to Section 80(1) VATA, HMRC are liable to credit QL with that amount.

*Zero rated supply*

54. In the alternative, QL say that if there was a supply it could only have been a supply of construction services and/or building materials in the course of the construction of the House and was zero rated as the conditions set down at Note (2) (c) to Group 5 of Schedule 8 VATA are fulfilled.

55. QL say that HMRC, while asserting a supply by QL to CR in the 04/13 Period, they have failed to identify the nature of that asserted supply.

56. QL state that whether or not a building under construction is "designed as a dwelling" is to be determined after its completion. All four conditions in Note (2) must be satisfied at the same time and this is apparent, not least, from the phrase "the following conditions *are* (QL's emphasis added) satisfied" in Note (2) and the use of the word "and" between sub-paragraphs (c) and (d).

57. QL say that the earliest time at which all four conditions are capable of being satisfied at the same time is on completion of the building for the following reasons:-

(1) Each condition must be satisfied by "the dwelling" and "the dwelling" does not exist until building works have been completed;

(2) Each of the conditions (a) to (c) is framed in the present tense, eg "consists" not "will consist", and is only capable of being satisfied at a time when the dwelling exists. It is only once the building is complete that one is able to

determine whether or not it "consists" of self-contained living accommodation; and

(3) Condition (d), whether the construction or conversion *has been* (emphasis added) carried out in accordance with [statutory planning] consent, "can only be determined can also only be ascertained when the building is complete".

58. QL further say that there is nothing unusual about a change in circumstances resulting in a subsequent change to a VAT liability and that HMRC's interpretation is open to abuse as it may be possible to create a situation before completion and benefit from zero rating but which might fail to meet the appropriate criteria when the building is actually completed, such as becoming a commercial development.

59. QL cite the Upper Tribunal decision in *Shields* as authority that where a building is constructed, the question of whether or not it is "designed as a dwelling" within the meaning given in Note (2) is to be determined after the construction has been completed. This case was concerned with the claim under the DIY Builders Scheme for a refund of VAT incurred on the construction of a new dwelling.

60. The building in question was subject to an occupancy condition in the planning permission which the Upper Tribunal found had been a prohibition within the meaning of Note (2)(c). Construction was completed in 2009, a Section 35 claim was made in 2011 and the occupancy condition was removed in 2012.

61. The Tribunal stated "whether or not Mr Shields was entitled to recover VAT incurred in the construction of the dwelling under Section 35 VATA must be considered in the light of the fact that when the construction or conversion has been carried out and the claim is made." QL say this is entirely consistent with and supports their approach and is also entirely consistent with the purpose of Group 5 which is to facilitate home ownership for the population, specifically for the benefit of a final consumer such as CR.

62. QL say that it further follows, therefore, when a supply is made before building is completed, the supply may be determined zero rated when the building works are completed and that is the position with the House. All four conditions in Note (2) were satisfied and, accordingly, the supply at the 04/13 Period was zero rated. HMRC are, therefore, wrong to contend that the four conditions could be satisfied before completion of the building.

63. In any event, the consideration for the supply in the 04/13 period was reduced in the 10/13 period when the Section 75 condition was discharged and when HMRC accepted that all four conditions in Note (2) were met. QL correctly accounted for that reduction in consideration in its VAT return for the 10/13 Period under Regulation 38.

64. QL say that in terms of the PVD and its predecessor, zero rating must, *inter alia*, be adopted for clearly defined social reasons and for the benefit of the final consumer ("the Directive Requirements").

65. The Directive Requirements were interpreted and applied in the *UK* case which also related to the zero rating provisions in Group 8 of Schedule 5 to the Value Added Tax Act 1983 in relation to any building or any civil engineering work which the European Commission objected to. The European Court of Justice held that construction of industrial and commercial businesses and community and civil engineering works were not activities for the benefit of the final consumer.

66. Accordingly, the UK Government amended the VAT legislation to provide that zero rating applied to supplies relating to "a building designed as a dwelling or a number of dwellings". The purpose of the zero rating provisions, therefore, is to facilitate home ownership for the population for the benefit of a final consumer such as CR who cannot pass on any tax burden.

67. QL, say that HMRC's position impedes homeownership, by placing a tax burden on and correspondingly increasing the cost to a final consumer.

68. If QL had issued an invoice to CR after the discharge of the Section 75 condition, it would be zero rated. There was no supply to CR in 04/13 as nothing was supplied or furnished to CR who had no interest in the property. The loan written off was not for any supply; it was written off on advice of QL's adviser to ensure that it did not suffer adverse consequences.

69. Even if there was a close connection, it did not matter that the write-off was for a particular purpose; it did not matter that the write-off would eventually benefit CR. The question is what was the payment for, to which the answer is that it was not for a supply, see *Church Schools*, and not for a supply in this case.

70. QL say there is a distinction between the different legal entities of CR and themselves and that there is a corporate veil which distinguishes the *Carlton Lodge Club* case.

71. QL say that the expense of "making the site" was a supply to QL from Lovie and not a supply by QL. All CR did was provide finance by writing off a loan on the advice of his then tax adviser and it is not unusual for directors to write off loans and these do not need an agreement.

72. QL say that there was no supply in return for CR writing off the loan in April 2013.

73. They say that HMRC refer to Item 2 in Schedule 8 of the Group in support of their case but say that it is self-evident from that Item that the supply cannot be determined until the building is complete because this Item uses the words "the supply in the course of the construction of" when referring to both services related to construction and the supply of building materials.

74. QR says that the cases relied upon by HMRC, other than *Shields and Michael James Watson*, provide no authority as to deciding when the conditions are satisfied and are of no value.

75. They refer to the decision in *Michael James Watson* and to the submission put forward by HMRC, which was accepted by the Tribunal, which says "Note 2 (c) cannot have been satisfied by the appellant at the relevant time (see *Lamming*) and goes on to refer to a planning qualification being outwith Note 2 (c) and/or (d) legally impermissible because (i) as at the relevant time of works completion Note 2 (c) was not capable of being satisfied by reason of the….". This, they say, supports their submission that a claim cannot be made until the works are completed.

76. A copy of the case of *Lamming* was not produced at the hearing but subsequently sent to the parties and to the Tribunal at the Tribunal's request.

77. If the Tribunal find that there is a supply, the rating is applied at completion, which is the earliest time when all four conditions can be fulfilled at the same time, see *Shields*, in keeping with the purpose of Group 5 as analysed in the *UK* case.

**Submissions by HMRC**

78. HMRC say that there is tangible and contemporaneous written evidence that an agreement existed between QL and CR and there was a supply, taxable at the standard rate pursuant to Section 5(2)(a) VATA. QL's tax adviser wrote on 19 November 2013 in relation to the VAT credit claim on the return for the period 10/13 that QL was acting as contractor in respect of the construction of a substantial new dwelling which did not initially conform to the conditions of a "qualifying dwelling" due to planning restrictions. The letter stated that QL had "credited the output VAT charged to the new owner in respect of the payments today".

79. Similarly by email dated 19 December 2013 QL's same tax adviser wrote to HMRC saying "CR decided he would like to build a new house on land owned by and adjacent to the hotel… To facilitate the construction of the dwelling it was agreed verbally that QL would take on the role of contractor and will incur the costs etc and would effectively provide the construction of the new dwelling".

80. HMRC refer to a further email by the same author of 27 January 2014 which stated "we note that you have not accepted that QL should have issued a credit note to its client Mr Ritchie. Our client has, in addition to its normal activities and operating a hotel, undertaken the construction of new house on land to be transferred to Mr Ritchie".

81. Again the same author wrote to HMRC requesting their views on the viability of "the owner" making an application to recover VAT in relation to the construction using the DIY Scheme.

82. HMRC say that the written evidence from QL's adviser, coupled with the fact that QL raised invoices and credit notes to CR, which CR paid, is incontrovertible proof that there was an agreement between QL and CR to construct and supply the property and land to CR.

83. Accordingly, HMRC struggled to understand why QL is now arguing that no supply from QL to CR took place. HMRC say that the "loans" were in fact payments

linked directly to the supply of construction services made by QL and that there is accordingly a direct link between the service provided by QL and the consideration received from CR which is in accordance with the meaning of supply as provided for in Section 5(2)(a) VATA.

84. HMRC cite the case of *Apple and Pear Development Council* where it was held that "the concept of the supply of services effected for consideration within the meaning of Article 2(1) of the Sixth Directive presupposed the existence of a direct link between the service provided and the consideration received."

*The Note 2(c) issue*

85. HMRC say that the Section 75 condition is a prohibition against separate disposal and creates a binding functional relationship between QL's dwelling and the Tufted Duck Hotel.

86. They say that Note (2) Group 5 Schedule 8 provides that the building is "designed as a dwelling" where specific conditions are satisfied and the requirements of Note (2)(c) provide that a building is designed as a dwelling if either separate use or separate disposal is not prohibited by the terms of any covenant or statutory planning consent.

87. HMRC rely on the Upper Tribunal case *Richard Burton*, where the Tribunal found the planning consent condition imposed a prohibition from separate use (so that no refund was due under the DIY scheme). The condition in the planning application was that "the occupation of the dwelling shall be limited to a person solely or mainly employed or last employed in Park Hall Lake Fishery or a widow or widower of such a person or, any resident dependants".

88. The Upper Tribunal referred to the judgement in *Shields* as an authority for the proposition that "a condition of planning permission for a dwelling that requires it to be occupied by a person who works at a specified location prohibits the use of the dwelling separately from the specified location".

89. HMRC say that the Upper Tribunal in *Richard Burton* found that the limitation in the condition was sufficiently mandatory and clearly defined terms to be capable of amounting to a prohibition

90. HMRC say that the section 75 condition imposes a similarly mandatory and clearly defined prohibition being the disposal of the property separate from the Tufted Duck Hotel and therefore it fails the test of Group 5.

91. They say that even if the planning condition does not preclude the "separate use" of the property, if QL do not meet one or other of the conditions in Note 2(c) then the property does not qualify as one designed as a dwelling. HMRC say that prohibition of a "separate disposal" is sufficient that the property does not qualify as one designed as a dwelling. HMRC say that they are supported in this view by *Richard Burton* and *Shields.*

92. The prohibition was in place at the relevant time the supplies were made and accordingly as separate disposal was prohibited at the relevant time, the construction services were supplied and therefore there is no zero rating to the supplies.

93. HMRC referred to the decision of *Michael John Watson* where the appellant tried to recover VAT through the DIY Builders' Scheme on a building where planning permission had been granted for a self-contained dwelling, albeit one that could not be used separately from an existing dwelling. The taxpayer submitted a retrospective [second] planning application and the offending condition was removed, albeit at a date some six months later than the completion of the dwelling. The First-tier Tribunal rejected the appeal, finding that "at the relevant time of works completion" the zero rating criteria was not capable of being satisfied as "Note (2)(d) required the particular works to have been undertaken before and not after the event of a [second] grant of the planning permission".

94. HMRC say that the raising of the tax invoice to CR dated 30 April 2013 by QL in respect of the construction works and the interim payments, described by QL is loans in respect of the construction work under the basic tax point rules.

95. These rules state that VAT is to be accounted for when a supply is made and the consideration is paid when tax invoices are raised, which is the earliest or 12 months after the date of the supply of the services.

96. Where there is a continuous supply of services, as in the construction of a property, the point at which VAT is due to be accounted for is determined by Regulation 93 of The Value Added Tax Regulations 1995.

97. Otherwise where services are supplied in the course of the construction under a contract which provides per payment of such supplies to be made periodically or from time to time, those services shall be treated separately and successively supplied at the earliest of the following times (a) each time the payment is received by the supplier and (b) each time that the supplier issues a VAT invoice.

98. Consequently HMRC say that any relevant tax points occurring before the discharge of the Section 75 condition relate to supplies that are not eligible for zero rating and thus are taxable at the standard rate of VAT.

99. HMRC say that the Notes to Group 5 Schedule 8 apply equally to the supply in the course of construction not just to completed buildings. They say that the loans written off were payments, not donations, in the meaning of *Church Schools* as CR expected something in return which was directly connected to the supply of making the site.

100. HMRC say that there is a reciprocal performance and agreement as outlined by QL's former tax adviser which is evidence of reciprocal performance and so distinguishes the *Tolsma* case.

101. Similarly, HMRC say that the *Carlton Lodge Club* case can be distinguished because CR had an interest in the House and land as a shareholder; he paid for the

supply by means of the 04/13 invoice and received a supply directly related to the construction and preparation of the ground which is what the invoice related to.

**Decision**

102.The Tribunal found, on the facts before it, that QR had made a supply for a consideration within the terms of Section 1 VATA and the PVD.

*Supply*

103.There was an agreement between QL and CR to provide construction services which included the cost of "making the site". The evidence for this came from the former tax adviser and from the facts before the Tribunal and was, as HMRC claim, incontrovertible. The email of 19th December was explicit that QL was "acting as a contractor in respect of the construction of a new dwelling" and referred to CR as the "new owner".

104.The email of 19 December 2013 stated that "QL would take on the role of contractor and will incur the costs etc and would effectively provide the construction of the new dwelling". The email of 27 January 2014 said that CR is undertaking the construction of a new house and referred to CR's possible use of the DIY Builders Scheme. Invoices were raised by QL to CR.

105.Notwithstanding that there was no written agreement, there was a clear agreement and this was more than a mere understanding. The Tribunal does not accept that failure to meet the terms of the Requirements of Writings (Scotland) Act 1995 precluded an agreement or intention to transfer land but instead stated how the actual transfer of land is to be formally documented. That Act does not deal with the agreement for supply in this case which concerned the supply of construction services.

106.CR had an expectation of an interest in the House and it was because of that interest he engaged a separate legal entity, QL, to supply construction services. The interest was that the House would become his and his wife's on completion. The former tax adviser offered to provide a written agreement (his email of 19 December 2013) in relation to "an agreement between QL and CR (for) design and build". It is not credible that CR would pay or finance the construction without such an interest.

*Direct Link*

107.The Tribunal considered that there was a direct link, and consequently a *quid pro quo*, and there was a consideration "paid" by means of cancelling debt (for which there was also no written agreement) for the supply of construction services.

108.The legal relationship between QL and CR constituted a direct link and the Tribunal did not accept that the supply was "made by the loan" in the meaning of *Church Schools*. Instead the remuneration received by QL, the provider of the service, constituted the VAT value received by them in return for the construction services

supplied to CR and accordingly did not align with the circumstances referred to in the *Tolsma.*

109.There was insufficient evidence to prove that the existence of a loan was a perceived or actual financial difficulty for QL or to establish with whom it had this difficulty. CR was the sole shareholder and the creditors of QL were paid (by means of the loans from CR). The only threat to the financial security of QR could have come from its sole shareholder and lender, who is CR.

110.The contention that CR received nothing in return for the write-offs of his loan and that they were only so written off as a voluntary release purely motivated by concern that QL should not be put in financial difficulties was not persuasive. In terms of the "understanding", CR, and his wife would subsequently receive ownership of the House. That House would have been worthless and would not have met the appropriate building conditions had it not been for the "making of the site" which was required to construct suitable foundations for the building the House or any other dwelling.

*Zero rated supplies/Note (2)*

111.The Tribunal preferred QL's submissions in relation to the application of Note (2)(c), to Group 5 of Schedule 8, that the only time when it is possible to decide whether or not a building under construction is designed as a dwelling can be determined after completion.

112.The Tribunal agreed that all the four conditions in Note (2) must be satisfied at the same time given the language used in the Note and agreed with QL's three-part analysis of the earliest time at which all four conditions are capable of being satisfied.

113.The Tribunal consider that a dwelling does not exist until building works have been completed; that the conditions (a) to (c) are framed in the present tense; and accept that one is only able to determine whether or not a building "consists" of a self-contained living accommodation if the completed building does in fact have self-contained living accommodation.

114.In relation to Note (2)(d), the condition is that the construction or conversion has been carried out in accordance with consent can be determined only when the building is complete. In practical terms, this means when the building is completed and the planning authority are satisfied that the conditions of the consent have been, or even could possibly have been, satisfied.

115.The Tribunal accepts QL's submission that there is nothing unusual about a change in circumstances resulting in a subsequent change to a VAT liability and that HMRC's interpretation, that the Note (2) conditions can be met before completion, could lead to abuse whereby tax relief is obtained but the dwelling, when actually completed, does not meet the conditions of relief.

116.Both QL and HMRC referred to the *Shields* case, the former as authority that the building must be completed in order to consider whether Note (2) has been caught and

the latter as authority that it together with *Richard Burton* support the view that if there is a prohibition on a "separate disposal" that is sufficient so that the property does not qualify as one designed as a dwelling.

117.In *Shields*, the Upper Tribunal Judges Sinfield and Devlin stated that there had been a number of Tribunal decisions relating to Note (2) (c) which had reached different conclusions on whether or not similarly worded planning conditions prohibited separate use or disposal. They referred to and noted their approval to First-tier Tribunal's disposal of the same case as follows:- "The one thing that it is possible to distil from a review of the cases is that each planning condition must be considered on its own terms".

118.These cases, however, turn more on whether the particular planning condition prohibited separate use or disposal, whereas in this case there was clearly, for a period of time, a section 75 condition which referred to separate disposal and not use.

119.The issue before this Tribunal is when, that is to say at which point in time, an assessment is or can be made as to whether the circumstances of the particular planning conditions, considered on their own merits, are caught or not caught by Note (2) (c). At paragraph 40 the Tribunal said "Whether or not Mr Shields was entitled to recover VAT incurred in constructing the dwelling under section 35, must be considered in the light of the facts when the construction or conversion has been carried out and the claim is made". In *Shields*, the construction of the dwelling and the claim predated the new planning permission which was not retrospective and only removed the condition with effect from 13 February 2012. The original planning permission was given in 17 October 2006 and Mr Shields made his claim in January 2011 after the property had been constructed.

120.In, *Shields*, therefore, the retrospective planning permission occurred after the building had been completed and after the claim had been made. In this case the retrospective planning permission was granted before the building was constructed and the claim made and the Tribunal, therefore, distinguishes the Upper Tribunal decision in *Shields.*

121.The other cases before the Tribunal which discussed the timing of when a decision can be made as to whether or not Note (2)(c) has been engaged, or not, were *Michael James Watson* and consequently, as it is referred to within it, *Keith Laming*.

122.The case of *Keith Laming* was not available at the Tribunal hearing but subsequently provided. This case referred to a dwelling where the planning permission provided for a direct internal access to a dwelling by means of two internal doorways. HMRC stated that consequently the building was not a new house but an annexe to an existing one and fell foul of, among other conditions, Note (2)(b).

123.The First-tier Tribunal Chairman stated:-"even where there to be a retrospective planning permission granted, the relevant time for HMRC to consider whether a building is to be zero rated is at the time of completion". This decision was referred to in the First-tier Tribunal case of *Michael James Watson* cited by HMRC as authority

that zero rating was rejected because the amended planning permission did not cover the period when the works were carried out.

124. *Michael James Watson* concerned circumstances where the retrospective planning application and decision was removed after the completion of the building, as in *Shields* and therefore does not detract from the proposition set out in *Laming* and indeed supports it.

125. The Tribunal do not consider that where there is a continuous supply of services, as in construction of property, a tax point at 30 April in terms of Regulation 93 of the VAT Regulations 1995 precludes QL from making a claim for zero rating. The Tribunal also consider that the existence of a tax point does not change the nature of the supply itself which is the subject of this appeal

126. The appeal is allowed.

127. This document contains a full finding of facts and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**RUTHVEN GEMMELL W.S.**
**TRIBUNAL JUDGE**

**RELEASE DATE: 21 FEBRUARY 2017**

## Appendix 1

## Legislation

### Sections 1, 4, 5, 30, 35 and 49 VATA

Section 35 of the VATA provides for the refund of VAT to persons constructing certain buildings. So far as relevant to this appeal, section 35 is as follows:

"(1) Where —

(a) a person carries out works to which this section applies,

(b) his carrying out of the works is lawful and otherwise than in the course or furtherance of any business, and

(c) VAT is chargeable on the supply, acquisition or importation of any goods used by him for the purposes of the works,

the Commissioners shall, on a claim made in that behalf, refund to that person the amount of VAT so chargeable.

(1A) The works to which this section applies are —

(a) the construction of a building designed as a dwelling or number of dwellings…."

Section 35(4) of the VATA provides that the notes to Group 5 of Schedule 8 apply for construing section 35 as they apply for construing that Group. By virtue of section 96(9) of VATA, Schedule 8 must be interpreted in accordance with its notes.

Note (2) to Group 5 of Schedule 8 is as follows:

"(2) A building is designed as a dwelling or a number of dwellings where in relation to each dwelling the following conditions are satisfied -

(a) the dwelling consists of self-contained living accommodation;

(b) there is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling;

(c) the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision; and

(d) statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent."

Section 80 VATA - Recovery of overpaid VAT

(1) Where a person has (whether before or after the commencement of this Act) paid an amount to the Commissioners by way of VAT which was not VAT due to them, they shall be liable to repay the amount to him.

(2) The Commissioners shall only be liable to repay an amount under this section on a claim being made for the purpose.

(3) It shall be a defence, in relation to a claim under this section, that repayment of an amount would unjustly enrich the claimant.

(3A) Subsection (3B) below applies for the purposes of subsection (3) above where —

(a) there is an amount paid by way of VAT which (apart from subsection (3) above) would fall to be repaid under this section to any person ("the taxpayer"), and

(b) the whole or a part of the cost of the payment of that amount to the Commissioners has, for practical purposes, been borne by a person other than the taxpayer.

(3B) Where, in a case to which this subsection applies, loss or damage has been or may be incurred by the taxpayer as a result of mistaken assumptions made in his case about the operation of any VAT provisions, that loss or damage shall be disregarded, except to the extent of the quantified amount, in the making of any determination —

(a) of whether or to what extent the repayment of an amount to the taxpayer would enrich him; or

(b) of whether or to what extent any enrichment of the taxpayer would be unjust.

(3C) In subsection (3B) above —

- "the quantified amount" means the amount (if any) which is shown by the taxpayer to constitute the amount that would appropriately compensate him for loss or damage shown by him to have resulted, for any business carried on by him, from the making of the mistaken assumptions; and
- "VAT provisions" means the provisions of —

(a) any enactment, subordinate legislation or Community legislation (whether or not still in force) which relates to VAT or to any matter connected with VAT; or

(b) any notice published by the Commissioners under or for the purposes of any such enactment or subordinate legislation.

(4)The Commissioners shall not be liable, on a claim made under this section, to repay any amount paid to them more than three years before the making of the claim.

(4A)Where —

(a) any amount has been paid, at any time on or after 18th July 1996, to any person by way of a repayment under this section, and

(b) the amount paid exceeded the Commissioners' repayment liability to that person at that time, the Commissioners may, to the best of their judgement, assess the excess paid to that person and notify it to him.

(4B) For the purposes of subsection (4A) above the Commissioners' repayment liability to a person at any time is —

(a) in a case where any provision affecting the amount which they were liable to repay to that person at that time is subsequently deemed to have been in force at that time, the amount which the Commissioners are to be treated, in accordance with that provision, as having been liable at that time to repay to that person; and

(b) in any other case, the amount which they were liable at that time to repay to that person.

(4C) Subsections (2) to (8) of section 78A apply in the case of an assessment under subsection (4A) above as they apply in the case of an assessment under section 78A(1).

(6) A claim under this section shall be made in such form and manner and shall be supported by such documentary evidence as the Commissioners prescribe by regulations; and regulations under this subsection may make different provision for different cases.

(7) Except as provided by this section, the Commissioners shall not be liable to repay an amount paid to them by way of VAT by virtue of the fact that it was not VAT due to them.

## Appendix 2

## Case Referred To

*Carlton Lodge Club v Customs and Excise Commissioners* [1974] STC 507

*EC Commission v UK (*Case 416/85) [1988] STC 456

*Apple and Pear Development Council v Customs and Excise Commissioners* (case 102/86) [1988] STC 221

*Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C – 16/93) [1994] STC 509

*Customs and Excise Commissioners v Church Schools Foundation Ltd* [2001] EWCA Civ 1745, [2001] STC 1661

*Keith Laming v Commissioners for HMRC* [2009] UKFTT 44 (TC)

*Revenue and Customs Commissioners v Shields* [2014] UKUT 453 (TCC), [2015] STC 643

*Michael James Watson v Revenue and Customs Commissioners* [2010] UKFTT 526 (TC)

*Revenue and Customs Commissioners v Richard Burton* [2016] UKUT 0020 (TCC)