[2017] UKFTT 0564 (TC)

TC06006

Appeal number: TC/2016/3722

VAT – supplies in the course of construction of student accommodation – application of provisions of Group 5 Schedule 8 VATA 1994 - whether accommodation is designed as a dwelling – yes – how liability is to be determined when supply of building is prima facie eligible both as dwelling and relevant residential – note 2 designed as a dwelling takes precedence – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

SUMMIT ELECTRICAL INSTALLATIONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE AMANDA BROWN

Sitting in public at Centre City Tower, 5 - 7 Hill Street, Birmingham on 28 June 2017.

Mr Glyn Edwards CTA, VAT Director, MHA MacIntyre Hudson LLP, tax advisor, for the Appellant

Ms Babita Hargun, representing officer of HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the liability of supplies made by Summit Electrical Installations Limited ("the Appellant") as an electrical subcontractor to Create Construction Ltd ("Create") in connection with the construction of student accommodation at Primus Place, Jarrom Street Leicester ("Primus Place"). In particular whether the supplies are zero rated as supplies in the course of construction of buildings designed as a series of dwellings as the Appellant contends, or standard rated as supplies in the course of construction of a relevant residential building as HM Revenue and Customs ("HMRC") contend.

Relevant facts

2. There was no dispute between the parties as to the facts which are set out in paragraphs 3 - 17 below.

3. The Appellant is an electrical contracting company. It undertakes electrical installations in commercial buildings, schools, public buildings and larger residential blocks. It employs 36 people.

4. In late 2014 following the submission of a tender, the Appellant was appointed as the electrical subcontractor working to Create Construction Ltd ("Create") on a development known as Primus Place.

5. Primus Place is a block of student studio flats. By reference to the planning permission it is a seven storey building comprising 140 studio flats and associated facilities. By reference to the plans it appears that each of floors 1 – 6 are substantially similar in layout with the majority of the studio flats being the same size approximately 5m by 3m and rectangular in shape. There are some larger studios on some of the floors and these are not all rectangular in shape. On the ground floor there is a communal reception, cycle store, and laundry. In addition management offices, stores, bins and plant rooms are situated on the ground floor.

6. The planning permission is granted subject to one relevant condition which provides:

> "A minimum of 126 flats within the development shall be identified on a plan that has been submitted to and approved in writing by the local planning authority, shall not be occupied other than as student accommodation. Other than staff associated with the management, maintenance and security of the development, no person other than a full time student attending the University of Leicester or DeMontfort University (or such higher/further educational establishment as may be agreed in writing by the local planning authority) shall occupy these flats at any time. At no time shall more than 140 students occupy the development…."

7. Mr Chand, director of the Appellant gave evidence that each of the studio flats was fitted out with a bathroom pod (ie a unit including shower, sink and toilet) installed in the corner of the room. In addition there was a small kitchenette with dish washing sink, countertop, cooker, fridge and microwave. Through a stud wall with no door was an open plan/sleeping area and walk in cupboard.

8. The work summary provided indicates that the works undertaken included the installation of: lighting and power for all studios and communal areas, data and telephone cabling, TV and AV systems, fire alarms, disabled alarms etc. The work under the contract commenced in December 2014 and was completed in September 2015. The final sum paid for all works was £605,500.

9. By reference to the evidence of Mr Chand the Tribunal understands that the flats were made available to purchasers on a buy to let basis. As per the planning consent use of the flats was restricted to use as student accommodation. Occupation was restricted to full time students attending one of the identified universities.

10. By its return for the VAT quarter ended 31 March 2015 the Appellant claimed repayment of £36,316.02 representing the excess input tax incurred in that period over output tax declared. The Appellant considered that its supplies in connection with three developments including Primus Place were zero rated.

11. The Appellant's return was selected for a credibility check. In the course of this check HMRC and the Appellant were able to agree the liability of supplies in connection with two of the three development. However, in connection with Primus Place they were unable to agree.

12. Create provided to the Appellant what is known as a zero rating certificate. This certificate certifies that the developer of the site (and the party that engaged Create to construct the buildings) intended to use the buildings for a relevant residential purpose, namely student living accommodation.

13. On the basis that the zero rating certificate was evidence of Create's intention to zero rate its supplies to the developer and on the basis that the buildings were therefore to be used for a relevant residential purpose (rather than on the basis that the accommodation created was a series of flats designed as a dwelling) HMRC refused to permit the Appellant to zero rate its supplies to Create.

14. On the basis of this decision HMRC adjusted the return for period 03/15 reducing the VAT credit by £1,365.62 by assessing the Appellant to output tax in respect of the value of supplies in that period made to Create which HMRC considered to be subject to VAT at the standard rate.

15. The Appellant approached Create and proposed to issue VAT only invoices. Create refused to accept the invoices on the basis that, in its view, the VAT was not properly chargeable (and thereby recoverable as input tax) and that in any event it had a significant impact on its cash flow.

16. With its customer refusing to accept and pay the VAT only invoices the Appellant was left with little choice but to obtain a judicial determination of the liability of the supplies. Either to confirm its entitlement to zero rate or to compel Create to accept that the supplies were to be properly standard rated.

17. The decision in this appeal is relevant to the determination of the liability of supplies made in connection with Primus Place in subsequent VAT periods and will provide guidance in relation to the work undertaken in relation to Primus Place Phase 2. The matter is also of importance to other suppliers of Create who, the Tribunal was told, have similar appeals.

Legislation

18. Section 30 and item 2 to Group 5 Schedule 8 Value Added Taxes Act 1994 the provide for the zero rating of:

> Item 2
>
> The supply in the course of construction of (a)(i) a building designed as a dwelling or number of dwellings or (ii) intended for use solely for a relevant residential … purpose … of any services related to the construction other than the than the services of an architect, surveyor or person acting in a consultant or in a supervisory capacity.
>
> Item 4
>
> The supply of building materials to a person to whom the supplier is supplying services within item 2 … of this group which include the incorporation of the materials into the building (or its site) in question.

19. The notes to Group 5 Schedule 8 provide the definition of the phrase "designed as a dwelling". Note 2 provides:

> A building is designed as a dwelling … where … 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 thereof
>
> (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 … has been carried out in accordance with that consent.

20. Note 4 defines relevant residential purpose:

> "Use for a relevant residential purpose means use as …. (d) residential accommodation for students …"

21. Note 12 lays down certain criteria to be met if supplies are to be zero rated pursuant to relevant residential purpose:

> "Where all or part of a building is intended for use solely for a relevant residential purpose …
>
> (a) a supply relating to the building (or any part of it) shall not be taken to be for the purposes of items 2 and 4 as relating to a building intended for such use unless it is made to a person who intends to use the building (or part of it) for such a purpose, and
>
> (b) a grant or other supply relating to the building (or any part of it) shall not be taken as relating to a building intended for such use unless before it is made the person to whom it is made has given to the person making it a certificate in such form as may be specified in a notice published by the Commissioners stating that the grant or other supply (or a specified part of it) so relates".

The issues

22. By reference to HMRC's statement of case and skeleton argument it was not at all apparent what the issue between the parties in fact was.

23. HMRC had concluded that the supplies made by the Appellant in connection with Primus Place were standard rated because, as a relevant residential purpose building the only supply qualifying to be zero rated was the supply by Create to the developer. HMRC contended that the supplies by all Create's subcontractors were standard rated with Create being entitled to deduct the input tax so incurred as attributable to the zero rated supply of the construction services.

24. This position is articulated first in an email dated 12 June 2015 in which HMRC state:

> Where a building qualifies for zero rating as both a dwelling and relevant residential purpose building (as in this case) it is up to the customer of the main contractor to decide which provision to rely on (as at 15.1 of 708). If the customer has decided to treat it as Relevant Residential building his certificate can only be issued to the main contractor and the subcontractor must standard rate the supply"

25. Further, by their letter dated 16 July 2015 HMRC state:

> "Where a contractor is constructing a building for a client that is eligible to be built under Note 2 or Note 4, we expect the contractor to determine the liability

of his supplies and those of any subcontractors based upon the actions of the client. If the client gives a VAT certificate, then the building will be built under note 4 and the sub-contractors supplies will be standard rated. If no certificate is given then the subcontractors supplies will be zero rated. Once the client takes possession of the completed building, they are still free to rely on Note 2 or Note 4 for any supplies they make. Since the building was correctly constructed at the time (either under note 2 or note 4) there is no requirement for the contractor or subcontractors to amend the VAT treatment of their supplies if say, the building was built under note 4 and the client subsequently relies on note 2 for supplies they make of the completed building or vice versa.

26. The Appellant, by its appeal and its skeleton argument contended that it was entitled to rely on the provisions of Item 2 and note 2 and treat its supplies as zero rated as being made in the course of construction of a building designed as a number of dwellings. Zero rating under this head, the Appellant contended, applied to its services. The Appellant accepted that if Primus Place was not a building designed as a number of dwellings then its supplies were standard rated as HMRC alleged.

27. This issue was referred to by the parties as the Relevant Residential Issue.

28. By reference to a letter dated 2 February 2017, in which HMRC state "examination of whether the project met the definition of a dwelling was not required", the statement of case, and the skeleton argument there was nothing to indicate that HMRC challenged the Appellant's assertion that Primus Place was a building designed as a number of dwellings and the issue between the parties was limited to the Relevant Residential Issue.

29. However, the Tribunal understands that approximately one week prior to hearing (and after both skeletons were served) HMRC sought to introduce an argument that Primus Place was not in fact a building designed as a number of dwellings thereby depriving the Appellant of its argument under the Relevant Residential Issue. In brief HMRC contended that the definition provided in note 2 was not met on the basis that condition 2(c) (requiring that the separate use or disposal of the dwelling not be prohibited) was not met.

30. The parties agreed that the studio flats: (a) consisted of self-contained living accommodation, (b) had no provision for direct internal access as between them; and (c) had been constricted in accordance with a valid planning consent. Accordingly, save for condition 2(c) the conditions in note 2 were met.

31. This issue was referred to as the Condition 2(c) Issue.

32. The logical way to deal with these issues is the Condition 2(c) Issue first and then the Relevant Residential Issue.

Condition 2(c) Issue

33. The Appellant contends that there is no prohibition on the separate use or disposal of each of the studio flats.

34. By reference to the case law considered below the Appellant contended that the planning condition for Primus Place and set out in paragraph 6 above does not amount to a restriction on either the separate use or disposal of the dwelling on the basis that whilst use is restricted to a class of individuals (namely students of Leicester and DeMontfort Universities) that was not a restriction previously considered by the Tribunal to represent a prohibition on separate use or disposal. In order to be a relevant prohibition the Appellant contends that it would need to prevent use separate from other identified or specified land and not merely use by students attending identified universities.

35. In contrast HMRC reliant on broadly the same cases as the Appellant considered that the planning condition prevented the use of the flats separately from the business of the Universities and was thereby precisely the type of prohibition envisaged in note 2(c). HMRC contended that the reference and limitation as to the institutions at which the students were attending was a prohibition the use of the accommodation separate from the activities and buildings of the Universities.

36. The Tribunal was referred to a number of First-tier Tribunal judgments and to the Upper Tribunal judgments in *Roy Shields [2014] UKUT 453* and *Richard Burton [2016] UKUT 20*. Both these cases are binding on this Tribunal.

37. Mr *Shields* had made a claim to recover tax paid under the DIY builders' scheme. The circumstances in which a claim can be made are subject to the provisions of note 2.

38. The dwelling under consideration in Shields was constructed as an equestrian facility manager's residence. One of the planning restrictions was that "the occupation of the dwelling shall be limited to a person solely employed by the equestrian business".

39. The Upper Tribunal reviewed a number of previous First-tier Tribunal judgments concerning a variety of occupancy conditions. It went on to outline the approach to be taken:

> (1) Analyse the terms of the planning condition carefully to determine whether it prohibits the separate use and/or separate disposal of the dwelling (para 41).
>
> (2) "Separate use or disposal" refers to use or disposal that is separate from the use or disposal of some other land (including any building or other structure on it) (para 42).

(3) A term prohibiting use for a particular activity or disposal generally would not fail to satisfy note 2(c) unless the effect of the term in that particular case was to prohibit use or disposal separately from use or disposal of other land (para 42).

(4) The effect of the term should be determined by construing the words of the planning permission, including any conditions and reasons and by reference to the approved plans and where necessary the planning context, and applying those words to the facts of the particular case (para 43).

40. Following that approach the Upper Tribunal determined that the condition in that case requiring that the dwelling be occupied by a person who worked at a specified location prohibits the use of the dwelling separately from the specified location with the consequence that it did not comply with the condition in note 2(c).

41. The case of *Burton* concerned the provisions of note 2(c) in the context of a claim by Mr Burton again under the DIY builders' scheme. Mr Burton was the owner of a site and lake which he had developed and operated as a fishery. He constructed a dwelling on the site pursuant to a planning permission which restricted occupation of the dwelling such that only "a person solely or mainly employed or last employed by [the fishery] or a widow or widower of such a person, or any resident dependants" could occupy.

42. The Judge considered that in construing the planning permission the whole consent needed to be considered in a way which was "benevolent, applies common sense and, where appropriate, takes account of the underlying planning purpose for the condition as evidenced by the reasons expressed."

43. Adopting the approach advocated in *Shield* the Upper Tribunal considered that the appropriate interpretation of Note 2(c) as being "separate from". In the circumstances of the case before it the Upper Tribunal therefore considered that the relevant planning condition was to ensure, by means of the occupancy restriction, that the accommodation was retained for the purposes of the fishery business. As a consequence of the planning restriction each occupant of the dwelling was required to have a specific link to the fishery. The Upper Tribunal concluded at paragraph 96:

> "It is that required link to specific land or premises which is crucial, and which puts cases such as the present in a different category from those which have no such link or to which the link is too general or too tenuous. … No doubt there will be cases which are borderline and therefore difficult to call, but I do not regard the present case as one of those. Here the link between the occupancy of the building and the [fishery] is sufficiently close, specific clear and unequivocal"

44. It is the Tribunal's view that the terms of the planning condition are clearly not a prohibition of the type envisaged in note 2(c). The language of the planning condition is very broad and limits the class of user and that those students should be studying full time at Leicester or DeMontfort universities. But by reference to the

judgment of the Upper Tribunal attendance at one of the universities cannot be equated with a link to specific land; a link which the Upper Tribunal identifies as crucial. HMRC contended that the Tribunal should interpret the planning condition as representing to link to specific university buildings. When challenged as to which university buildings Ms Hargun answered "all of them".

45. The Upper Tribunal in *Burton*, by reference to a number of First-tier Tribunals to which it was taken, clearly envisage that there will be a spectrum where a link to specified or identified land will become progressively weakened to a point where it is so tenuous that it cannot be considered to be a link of the type envisaged in the legislation.

46. The Tribunal was given by HMRC a copy of a report that indicated that there were, in 2013 just shy of 30,000 students in Leicester attending the two universities. There are many villages and towns smaller than the student population of Leicester. To see a restriction narrowing the class of occupier not to the user of any specific or identified land but to such a vast class of people cannot, in the Tribunal's view, represent a prohibition on separate use.

47. The parties agreed that there was no prohibition on separate disposal. On the documents available that must be correct and by reference to the evidence of Mr Chand it was clear that each of the studio flats was available to purchase on the basis that it would be let to students. Further, though no evidence was led to this effect, the Tribunal considers it is a matter on which it feels able to take judicial notice, students are a transient population. Commonly they will be at university only for three years and may stay in halls, private accommodation such as that at Primus Place or other student houses. Each letting represents a separate disposal of the studio. If separate disposal were prohibited the development simply would not have served its purpose namely to provide student accommodation.

48. For these reasons the Tribunal concludes that Primus Place is a building designed as a number of dwellings by reference to note 2.

Relevant Residential Issue

49. Having determined that Primus Place is a building designed as a number of dwellings by reference to note 2 the question arises as to whether the legislative provisions of Group 5 (and in particular as asserted by HMRC the provisions of note 12) have the consequence that as a result of the issue of a zero rating certificate a subcontractor making supplies in the course of construction of a number of dwellings can be denied zero rating.

50. HMRC contend by its skeleton that the requirement to charge VAT is not discretionary and yet submitted that Create "chose" to zero rate the supply to the developer of Primus Place under note 4 and that as a consequence of paragraph 15.8 VAT Notice 708 where "the client gives a VAT certificate, then the building will be built under note 4 and the subcontractors supplies will be zero rated".

51. HMRC contended, initially without reference to the legislation, that "we cannot have different liability treatments in the same chain of supply. Though it is possible for a building to be both 'designed as a dwelling' and 'intended for use as an RRP'[Relevant Residential Purpose], once the main contractor has elected to make the supply of his services to a person constructing an RRP building, this must dictate the nature of the supply being made by the subcontractor. As the subcontractor to such a supply his case for zero rating is extinguished".

52. By their skeleton argument HMRC contended "the VAT liability of supplies made by subcontractors is dependent upon whether or not the building will be built relying on note 2 … or note 4. As the customer [the developer] have originally issued the Certificate under note 4, the Appellant's supply is standard rated in accordance with the legislation" though no analysis of the relevant legislation was provided.

53. When pressed by the Tribunal, and after an adjournment to take instruction, Ms Hargun stated that it was HMRC's policy and that policy was based on the provisions of note 12. HMRC invited the Tribunal to interpret note 12 as follows or something similar:

> Where all or part of a building ***whether or not it meets the requirements of note 2*** is intended for use solely for a relevant residential purpose …
>
> (a) a supply relating to the building (or any part of it) shall not be taken to be for the purposes of items 2 and 4 as relating to a building intended for such use unless it is made to a person who intends to use the building (or part of it) for such a purpose, and
>
> (b) a grant or other supply relating to the building (or any part of it) shall not be taken as relating to a building intended for such use unless before it is made the person to whom it is made has given to the person making it a certificate in such form as may be specified in a notice published by the Commissioners stating that the grant or other supply (or a specified part of it) so relates
>
> ***Where such a certificate is issued it shall be determinative of the nature of the supply and the extent to which the supplies also meet the requirements of note 2 shall be ignored for VAT purposes***
>
> (emphasis added)

54. The Appellant contended that in respect of buildings which meet the definition of 'dwellings' how the building will be used is irrelevant. Whether a building is a dwelling (or a group of dwellings) is a matter of design and planning conditions – actual intended use is significant when considering whether a building qualifies for relief as a 'relevant residential' property but has no role to play in determining whether the appellant's works qualify under the separate heading of dwellings.

55. The Appellant contended that HMRC's policy to deny zero rating where both note 2 and note 4 applied was simply wrong on the basis that if a building can be zero-rated because it is designed as dwellings, then the subcontractor is entitled to apply that relief, irrespective of whether it also qualifies as 'relevant residential' because of the issue of a certificate further up the supply chain. It was contended that any other conclusion would undermine legal certainty – a subcontractor can satisfy himself on whether a project involves the construction of dwellings based on design and planning features. If by reference to that exercise the supplies he makes are zero rated there is no question election or choice. The issue of a certificate regarding use is a matter between the main contractor and the client and hence it was clear that suppliers down the chain should standard rate but only where the only basis for zero rating is note 4.

56. The Appellant also noted that HMRC's policy as set out in Notice 708 was inconsistent as, in relation to the legislation that applies where, within a period of 10 years, there is a change of use in relation to a relevant residential purpose building a change of use charge arises (in essence removing the benefit of zero rating) unless the building also qualifies as a dwelling or number of dwellings under note 2.

57. The Tribunal considers that there is absolutely no basis for HMRC's policy or submission with regard to this issue. The Tribunal accepts in its entirety the Appellants submissions.

58. The provisions of note 2 define when a building is designed as a dwelling for the purposes, in this case, of the application of item 2 and thereby item 4. Where a building meeting the requirements the supply of services in the course of construction of that building (or materials by someone supplying those services and incorporating them input the building) are zero rated. As HMRC stated the correct liability to tax is, in most instances, not discretionary. Any subcontractor can establish for itself whether the building that it is constructing meets the conditions of note 2. If the building meets those requirements the subcontractors supplies will be zero rated.

59. The position of the contractor is that their supplies may be zero rated either as a consequence of the application of note 2 or where the contractors client issues a certificate, as a consequence of note 4. The contractor probably cares little whether it receives a certificate or not as it knows that the supplies are zero rated. A certificate will, of course, be critical where the building is not designed as a dwelling or number of dwellings but is to be used for relevant residential purposes. In those circumstances only the contractor benefits from zero rating but that is entirely understandable in the functioning of a self assessing tax as in those circumstances the zero rating arises as a consequence of factors known and certified only as between the developer and the contractor and not the subcontractors.

Decision

60. The Tribunal determines that Primus Place is a building designed as a number of dwellings within note 2 to Group 5 Schedule 8 VATA 1994 with the consequence

that any supply made by a person in the course of construction of it, including the Appellant, is required to zero rate their supplies. As a consequence the assessment to output tax by way of adjustment to the return is inappropriate.

61. On this basis the Appellant's appeal is allowed.

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

AMANDA BROWN
TRIBUNAL JUDGE

RELEASE DATE: 14 JULY 2017