

## ZERO RATING OF CONSTRUCTION WORKS ON EXISTING BUILDINGS

Tarlochan Lall, Barrister, Monckton Chambers

The Upper Tribunal's decision in *Revenue and Customs Commissioners v J3 Building Solutions Ltd* [2017] UKUT 253 (TCC) ("**J3 BS**") perhaps belatedly seeks to clarify the law in relation to the zero rating of construction works to existing buildings although relevant statutory provisions changed in 1995. Rather than clarifying the law, it exposes a conflict in authorities which needs resolving.

*J3 BS* concerned works on land which had a coach house used as a dwelling. The old building had some modern flat roofed extensions. The works involved the demolition of the existing structure apart from two walls and part of a third wall. Works were undertaken to improve the retained walls. New walls were built to complete an enclosed structure. The height of the structure was increased. The footprint of the old building with extensions was increased. *J3 BS* claimed zero rating on the works under Value Added Tax Act 1995 Schedule 8 Group 5 on the grounds that the works involved the construction of a building designed as a dwelling. HMRC denied zero rating on the grounds that the works involved the 'conversion, reconstruction or alteration of an existing building' within note (16)(a) to Group 5 so they were disqualified from being zero rated. HMRC in particular relied on the works amounting to an alteration. There was no dispute that the works were in the course of construction. The dispute related to whether they were disqualified from zero rating by notes (16), and in particular the impact of note (18).

Note (16) in material respects provides that

"For the purposes of this Group, the construction of a building does not include –

- (a) The conversion, reconstruction or alteration of an existing building; or
- (b) Any enlargement of, or extension to, an existing building except to the extent the enlargement or extension creates an additional dwelling or dwellings."

Note (18) provides that

"A building only ceases to be an existing building when:

- (a) Demolished completely to ground level; or
- (b) The part remaining above ground level consists of no more than a single façade or where a corner site, a double façade, the retention of which is a condition or

requirement of statutory planning consent or similar permission.” This paragraph provides for what will be referred to as “**deemed complete demolition**”.

The FTT, not having been referred to relevant case law, identified that case law itself and relied on the Upper Tribunal’s decision in *Revenue and Customs Commissioners v Astral Construction Ltd* [2015] UKUT 21 (TCC) [2015] STC 1033 (“**Astral**”) for the following two tests:

- firstly, the FTT regarded itself bound by the UT’s finding in *Astral* that the construction works did not have to involve the construction of a completely new structure in order to qualify for zero rating. There was no dispute over this; and
- whether the works amounted to a conversion, reconstruction or alteration was a matter of fact and degree. This involved a two stage test of comparing the state of affairs before and after the works and asking whether as a matter of fact, degree and impression, what had been done was a conversion, reconstruction or alteration. This test had been derived from a number of cases referred to in *Astral*, including *Commissioners of Customs and Excise v Marchday Holdings Limited* [1997] STC 272 (“**Marchday**”). The Upper Tribunal noted that

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

It is that failure to consider note (18) as an integral part of the decision making process that the UT found was the flaw in the FTT’s reasoning. Note (18) was introduced in 1995, after the *Marchday*, and the cases referred to in *Astral*, had been decided. It defines what an existing building is, an expression used in note (16). As such when applying note (16), the starting point is to ask whether there is an existing building as defined in note (18). Then it is necessary to test whether there has been any conversion, reconstruction or alteration, or as appropriate enlargement or extension of the existing building.

### **Conversion, reconstruction or alteration**

On the facts of *J3 BS*, there was no planning condition requiring the retention of the walls that were retained, so there was no deemed complete demolition as a result of which the building would have been treated as effectively ceasing to be an existing building. Absent that deeming, as there had not been complete demolition of the old structure, as a matter of law, there remained an existing building by virtue of note (18).

The next question was whether there was a conversion, reconstruction or alteration. A related question is whether the *Marchday* test needs to be applied to decide whether there has been a conversion, reconstruction or alteration. The Upper Tribunal essentially held that the question has to be answered by giving the words in note (16)(a) their ordinary meaning. In particular, it is the wide scope of the meaning of the word “alteration” that is significant. The UT said that

“We think that once one considers the words “conversion, reconstruction or alteration” in the context of relatively small (but not de minimis) remaining parts of the former building it is not possible to imagine any works done which would not fall within one or other of them, particularly “alteration”.

It then followed that it was not necessary to apply the *Marchday* fact and degree test, which led the UT to conclude that

“A *Marchday* type enquiry is no longer relevant as such.”

Absent a complete demolition, actual or that deemed by note (18)(b), an existing building will remain. Whether there has been a complete demolition, where the deeming does not apply, is a question of fact. That question is whether anything remains above ground level. If it does, under note (18) an existing building remains. Then, given the wide scope of the word “alteration”, the UT’s decision suggests that it would be difficult to imagine any works that do not amount to alteration simply because note (18) treats the building as an existing building no matter how different, as a matter of common sense, the newly constructed structure might look. HMRC are bound to argue that the works amount to a conversion, reconstruction or alteration where there has not been complete demolition.

Although that is what results from the Upper Tribunal’s decision in *J3 RS*, there remains the question whether that is really what Parliament intended by enacting note (18). That is especially so because as a matter of common sense and economic reality the works may well create a new dwelling. The advantage of the *Marchday* approach is that it allows common sense and economic reality to prevail. It also allows the words conversion, reconstruction or alteration to be given due and proper consideration, which the decision in *J3 BS* effectively precludes.

### **Enlargement or Extension**

In *Astral*, HMRC unsuccessfully argued that the *Marchday* test had also ceased to be relevant in notice (16)(b) cases concerning enlargements and extensions. The Upper Tribunal held that

[57] We do not accept [HMRC’s] submission that Note ((18)) to Group 5 of Sch 8 to the

VATA has made the fact and degree test, as propounded in *London Diocesan Fund* and *Marchday Holdings* and applied in *Cantrell No 1* and *Cantrell No 2*, irrelevant in this case. Note (18) defines when a structure ceases to be an existing building. It does not say what is or is not an extension or enlargement. Note (18) does not mean that all work, no matter how extensive, done on the site of a building that is not completely demolished to ground level must be regarded as an enlargement or extension. We do not accept that the word 'any' in Note (16)(b) affects our conclusion on this point. We consider that 'any' cannot be construed as applying to treat all works in relation to a building that has not been completely demolished to ground level as enlargements or extensions. That would be to place too much weight on the word 'any' and not enough on 'enlargement' and 'extension'.

The fact that note (16)(a) refers to conversion, reconstruction and alteration and note (16)(b) refers to enlargements and extensions indicates that they are intended to cover different types of works. There must be a degree of overlap. Further, even where there is an enlargement, zero rating is preserved where the work results in there being an additional dwelling or dwellings.

The Upper Tribunal in *J3 BS*, referring to *Astral*, firstly noted that it can be distinguished on the grounds that it concerns enlargements and extensions whereas *J3 BS* was concerned with a conversion, reconstruction and alteration. As for any of HMRC's persistent view that note (18) renders the *Marchday* test redundant in relation to enlargements or extensions and whether *Astral* was wrongly decided, the Upper Tribunal said this:

"...an attack on the decision itself (which HMRC decided not to mount in the *Astral* case itself via a further appeal to the Court of Appeal, as they conceded on the permission to appeal application) to come in another case if HMRC persists in its view."

### Summary

- Note (18) defines existing building. It must be considered and applied as both parts of note (16) refer to an existing building. A *Marchday* type of enquiry is no longer relevant, although it is necessary to decide as a matter of fact whether there has been a complete demolition.
- Where walls are required to be retained by a condition of statutory planning consent or similar consent, the building is deemed to have ceased to exist.
- Almost any works are likely to fit one or more of the descriptions conversion, reconstruction or alteration works, so they are likely to be disqualified from zero rating because it is difficult to imagine works which would not fall within one of those descriptions. Those three nouns are capable of encompassing any work. This is subject to the comments below.
- In the case of enlargement or extension, the Upper Tribunal in *Astral* decided that it was still necessary to consider whether there has been an

enlargement or extension. That must also be the case for conversions, reconstructions or alterations. Although the word alteration is wide in scope, as Stuart-Smith LJ in *Marchday* said

"Somewhere along that line it is possible to say, the original building has ceased to exist, what is being done cannot be sensibly or realistically described as an alteration of it. That was the approach of the tribunal in this case; my judgment is more correct in law." (p279a-b).

- Where there is an enlargement, zero rating is preserved to the extent the works in the creation of one or more additional dwellings. In the case of other enlargements not resulting in additional dwelling(s), note (16)(b) still disqualifies them from zero rating.
- In *J3 BS* the problem was that the coach house was an existing dwelling so no additional dwelling was created, although the point was not considered in that way. A purposive approach to zero rating leads to the question whether zero rating is or should be permitted where there is a new dwelling, even if there is no additional dwelling created as a result of the work. The position in law appears to be that there must be an additional dwelling.
- Note (18) has been in place since 1995. It is surprising it has taken this long for the point to emerge.
- Arguably, there is a degree of conflict between the Upper Tribunal's decisions in *Astral* and *J3 BS* which merit the issues being tested before the Upper Tribunal and probably before the Court of Appeal.

*The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.*