TerryDockley&Co
TAKING THE STING OUT OF VAT

VAT insight November 2017

The latest VAT developments that could affect you or your clients' businesses

Building conversions: Upper Tribunal reluctantly upholds the absurd

In September 2013 I outlined the bizarre way that the VAT treatment of building conversions can vary according to how you divide up an existing building. I took the common situation where a builder or developer converts a pub with a first-floor manager's flat into dwellings, with a view to an onward sale. Assuming the pub has not been empty for two years or more, the following table summarises the VAT rates payable on the works and the extent to which the builder can recover that VAT:

End result	Conversion works	Sale of freehold or long lease	VAT recovery
One house	Standard-rated	Exempt	No
2 flats:			
Ground floor	Reduced-rated	Zero-rated	Yes
Ist floor	Standard-rated	Exempt	No
Two semi-detached houses	Reduced-rated	Exempt	No

HMRC considers the sale of the two semi-detached houses to be VAT exempt because each house includes part of an existing dwelling (the manager's flat). In my September 2013 Insight I was pleased to share the good news that the First-tier Tribunal had taken a different view in *Alexandra Countrywide Investments Limited* and decided that such a sale should be zero-rated. Sadly, I must now report that the Upper Tribunal has decided that HMRC is correct in these circumstances. There were two appeals that were heard together.

Languard New Homes

Before the conversion, the building in question comprised the following:

Second floor (upper floor of manager's flat)
First floor (lower floor of manager's flat)
Pub

An additional floor was added, and, after the conversion, the building looked like this (not to scale!)

New top floor	Maisonette 3 (upper floor)	Maisonette 4 (upper floor)
Second floor	Maisonette 3 (lower floor)	Maisonette 4 (lower floor)
First floor	Maisonette 1 (upper floor)	Maisonette 2 (upper floor)
Ground floor	Maisonette 1 (lower floor)	Maisonette 2 (lower floor)

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DD & DM MacPherson

In this case, there was a shop and storage space on the ground floor, with living accommodation on both the remainder of the ground floor and on the first floor. The building was turned into two semi-detached houses.

Judgment

The Upper Tribunal found that neither the sales of the maisonettes in *Languard* nor the sales of the houses in *MacPherson* qualified for zero-rating because the new dwellings in each case incorporated parts of the respective buildings that had always been residential.

The judges recognised that this interpretation of the legislation could lead to some arbitrary results. They recalled the example posed in the previous Tribunal decision in *Calam Vale* in 2000:

" …if you take a four-storey office block with a wide frontage and a caretaker's flat occupying the whole of the attic and convert that block vertically into four town houses (each incorporating a quarter of the attic) you will get no relief; if you convert it horizontally into four flats, leaving the attic untouched, you will get relief".

The Upper Tribunal added its own example, a large gym with a small caretaker's flat. If you split the building into three flats, with two occupying only the space previously occupied by the gym and the third incorporating part of the gym and the flat, only the sale of the first two flats would qualify for zero-rating. Nonetheless, they found for HMRC.

Conclusion

Sadly, these decisions indicate that the table above remains correct and the VAT treatment of conversions continues to be arbitrary in the extreme. Tread warily.

To discuss how this may affect your clients or your business, or to talk about a VAT issue in general – contact:

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