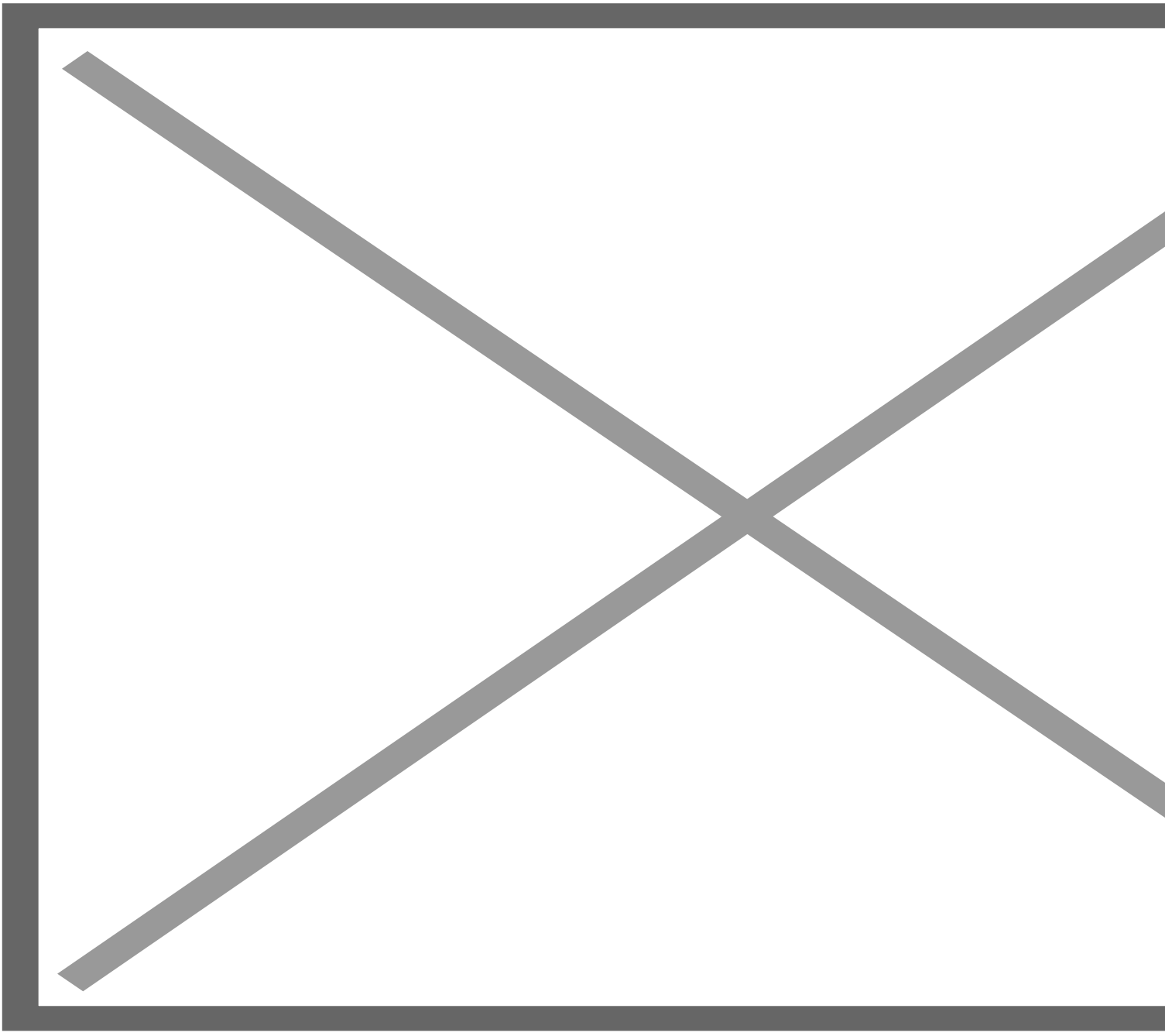
Solving the dwellings puzzle

Indirect Tax



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Alison Horner and *Glyn Edwards* on the implications of the Upper Tribunal's decision on the issue of VAT on new build student accommodation

Key Points

What is the issue?

Last summer, MHA MacIntyre Hudson successfully challenged HMRC's VAT policy on new build student accommodation. The Upper Tribunal turned down HMRC's appeal against the decision of the First-tier Tribunal.

What does it mean to me?

The decision provides assurance to universities who want to use planning restrictions to ensure that there is sufficient local accommodation for students studying at their institution.

What can I take away?

Now that zero-rated dwellings are being constructed even where planning consent restricts occupation to students of named universities, planners can be bolder in defining and limiting the class of residents of a new build development, without creating unexpected tax problems.

Last summer, Summit Electrical Installations Limited (Summit) successfully challenged HMRC's VAT policy on new build student accommodation before the First Tier Tribunal. Summit, which provides electrical services to main contractors working on student accommodation, had zero-rated its services on a new build development in Leicester, known as Primus Place. HMRC have just lost their appeal to the Upper Tribunal.

The case might appear a pointless exercise in tax semantics. This was best summed up at the First-tier tax Tribunal hearing by HMRC's representative, with the question: 'What are we here for?' This was a reasonable query. In theory, the whole matter could have been resolved without an appeal, if Summit simply issued VAT-only invoices to its customer, who would have been able to reclaim the VAT charged as input tax. The problem for Summit was that its customer refused to pay VAT on the works and later in this article we will explain why the decision is important beyond cash flow implications for the parties involved.

What were the issues?

The main contractor at Primus Place had received a certificate from the developer-landlord claiming relief from VAT on the basis that the new building would be used for a relevant residential purpose (RRP) i.e. a communal building for students. Ordinarily sub-contractors working on RRP buildings are not entitled to zero-rate their services – VAT must be charged at 20%. This is based on the wording of VATA 1994 Schedule 8 Group 5 Note (12) which limits the relief to supplies made to 'a person who intends to use the building' for a relevant residential purpose.

HMRC's first line of attack was therefore based on Note (12). Summit were not in the position of making a supply to the user of the student accommodation and therefore could not apply the zero-rate.

However, student accommodation has changed significantly from the time when 'communal living' meant a bedroom on a long corridor at the end of which was a bathroom shared with 20 others, and a dining room in an entirely separate building. Today's students shudder at the thought of 'shared facilities' and Primus Place therefore involved the construction of units which were designed as self-contained living accommodation including kitchenettes and en-suite bathroom facilities. Summit therefore argued that the zero-rate could be applied as Summit were working on 'dwellings'. The relief for dwellings is broader than for RRP buildings and allows both main and subcontractors to zero-rate their services.

The problem with certificates

HMRC's opening position in the First-tier tribunal was to argue that subcontractors must charge VAT if a certificate has been issued to the main contractor claiming zero-rating under the RRP relief, even if the construction would also meet the definition of dwellings. In HMRC's view, the issue of the certificate at the end of the supply chain dictated the VAT treatment for everyone.

This argument followed HMRC's published policy but, the First-tier Judge, Amanda Brown, dismissed that policy as entirely wrong, stating 'The Tribunal considers that there is absolutely no basis for HMRC's policy or submission with regard to this issue.'

HMRC accepted this part of the judgement and I hope that they change their published guidance to reflect this.

Can students live in dwellings?

Throughout the dispute, HMRC had been asked in correspondence whether they accepted that the student accommodation in question met the VAT definition of dwellings in VATA 1994 Schedule 8 Group 5 Note (2). Frustratingly, neither the decision-maker nor the officer who conducted the statutory review would answer this question, arguing that the case was solely about certificates for RRP buildings.

On the day of the First-tier Tribunal hearing however, HMRC announced they would also be arguing that the accommodation did not amount to dwellings and would fail to qualify for the zero-rate, even if their submissions about certification failed.

HMRC's argument on the 'dwellings' issue was based on the wording of the planning consent for the development which limited occupation to '... full time student[s] of Leicester or De Montfort University (or such higher/further educational establishments as may be agreed in writing by the local planning authority.' In HMRC's view this represented a restriction on 'separate use' of each unit and therefore prevented them being treated as dwellings for VAT purposes under Note 2(c) of Group 5. Judge Brown was equally emphatic in her rejection of this argument noting that there are almost 30,000 students in Leicester and that '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.'

HMRC appealed this part of the decision to the Upper Tribunal.

The Upper Tribunal's judgement

In the Upper Tribunal [UKUT 0176) Mr Justice Nugee and Judge Judith Powell reviewed cases dealing with the meaning of 'separate use' in Note 2(c) of Group 5. HMRC did not dispute that the decided cases were consistent: a 'separate use' restriction will not be found unless the effect of the relevant term in the planning consent is to prohibit use of the premises separately from the use of other specific land or buildings. HMRC argued that there was an implied link to specific buildings, as the planning consent for Primus Place restricted occupation of flats at the development to students attending one of two universities in Leicester. In HMRC's submission, the planning restriction was simply referring to all of the universities' buildings and this was sufficient to link the student accommodation to specific buildings.

The Upper Tribunal rejected this submission and accepted the arguments made by Summit that the planning consent was merely a restriction on a category of users i.e. students. The Tribunal considered a situation where either university added buildings to their estate, stating '….it is far from uncommon for universities to take on

new sites. But if Leicester University were, at the date of the planning permission, carried on at sites A, B and C, and later expanded onto site D, we cannot think that letting a flat at Primus Place to a student enrolled at Leicester University but who only ever attended site D would be a breach of Conditions.'

While this links the accommodation to establishments i.e. the universities, the example illustrated perfectly that there was no link to specific buildings and HMRC's appeal against the decision of the First-tier Tribunal inevitably failed.

Why it matters: the contractor's position

Main contractors in the student accommodation sector will be delighted with the outcome of this case. If HMRC had succeeded, main contractors would have been forced to pay VAT to subcontractors whenever planning consent referred to students of particular universities. While this VAT would be reclaimable, the amounts involved are large and the cash flow impact is significant.

HMRC have been taking a strong approach to repayment claims, disallowing VAT charged by sub-contractors where student accommodation was being constructed. Time and money was being wasted by the lack of clarity in this area.

Sub-contractors have been hesitant to take the bold step to zero rate services when there has been so much uncertainty, and main contractors still struggle to persuade them that VAT should not be charged. In many cases written advice is needed from the contractor to the sub-contractor giving assurances that, should VAT have been charged, this will be honoured.

In addition, main contractors found themselves in an invidious position where developers would insist no certificate would be provided as they had seized on the dwellings definition as being a less risky position to take. In the absence of a certificate confirming RRP relief, main contractors were in the same position as sub-contractors, uncertain whether the construction really qualified for zero-rating as dwellings.

Wider implications

There are wider implications however. The alternative relief for RRP buildings is only available where the end-user certifies that a development will be used solely for student accommodation. This condition is breached if a landlord intends to let flats out to others during vacation periods. This could place a landlord in the impossible situation of incurring VAT on the new build and being unable to reclaim this VAT, in whole or in part, due to VAT exempt lettings to students. The additional costs would make many developments unviable and the Upper Tribunal's confirmation that the wider relief for zero-rating of dwellings still applies will be very welcome.

The decision provides assurance to universities who want to use planning restrictions to ensure that there is sufficient local accommodation for students studying at their institution. A planning consent which only refers to 'students' is often insufficient, particularly in large cities where high numbers of students are competing for limited accommodation. Now that zero-rated dwellings are being constructed even where planning consent restricts occupation to students of named universities, planners can be bolder in defining and limiting the class of residents of a new build development, without creating unexpected tax problems.

The Tribunal judgment can be found on GOV.UK. Glyn represented Summit Electrical at the First-tier Tribunal and instructed Michael Thomas of Pump Court Tax Chambers at the Upper Tier. With construction clients in the student accommodation sector, Alison was involved in helping her clients deal with the risk areas.