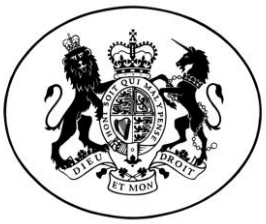
[2019] UKFTT 427 (TC)



TC07242

Appeal number: TC/2016/04869

VAT – Zero-rating – Group 5 Sch 8 VATA 1994 – Construction –whether an "extension" or an "annexe" to existing building – whether capable of functioning independently – whether intended for use otherwise than in the course or furtherance of a business

FIRST-TIER TRIBUNAL
TAX CHAMBER

YESHIVAS LUBAVITCH MANCHESTER **Appellant**

- and -

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

TRIBUNAL: JUDGE CHRISTOPHER STAKER
MRS MARY AINSWORTH

Sitting in public at Manchester on 29 November 2018

Michael Firth, counsel, for the Appellant

Samantha Carr, HM Revenue and Customs Solicitor's Office and Legal Services, for the Respondents

DECISION

Introduction

1. The Appellant appeals against a decision of HMRC that certain building work was standard-rated rather than zero-rated for VAT purposes.

Background facts

2. Yeshivas Lubavitch Manchester (the "**Appellant**") is a charity providing education for children between the ages of 3 and 16 in the Jewish community in Manchester and the North West of England. It is not registered for VAT.

3. The Appellant owns and maintains Oholei Yosef Yitzchok Lubavitch Schools ("**OYY Schools**"), which runs a day nursery for boys and girls between the ages of 3 and 5 (the "**nursery**"), and a day school for girls between the ages of 5 and 16 (the "**school**").

4. In about 2013, it was decided to move OYY Schools to a newly acquired site. The new site, which had previously been a residential property, contained a detached house, some 120 years old, that had a basement and three further floors (the "**existing building**"). The existing building was to remain and to have only minor internal works. An existing single story extension to the rear of the building was to be demolished. A new single storey area was then to be constructed to the rear of the existing building (the "**new structure**").

5. The Appellant accepts that the work on the existing building is appropriately standard rated. It is the VAT treatment of the new structure that is in issue in this appeal. The Appellant contends that it should be zero rated. HMRC contend that it is standard rated.

6. Planning permission for the works was applied for in December 2013. The school began the move to the new site in late 2016 when the works were nearing completion.

7. The new structure is physically connected to the existing building. The majority of the area of the new structure consists of a large open rectangular space which can be partitioned into two by a sliding/folding acoustic screen. This area is similar to a typical school hall or gymnasium, and indeed, one half of it is labelled on one of the plans as "multi purpose hall / dining, indoor sport etc". This area is referred to below as the "**hall**". The longer walls of the hall, which is the part of the new structure that is furthest from the existing building, run parallel to the back wall of the existing building. The space between the longer wall of the hall closest to the existing

building, and the existing building itself, is taken up by two long and narrow areas that run parallel to the longer walls of the hall. For convenience, these two areas are referred to below as "**corridors**". Thus, the back wall of the existing building forms the longer wall of one of the corridors, and the longer wall of the hall nearest the existing building forms one of the longer walls of the other corridor.

8. Under the original plan, the two corridors were to be divided by a solid party wall, with no internal access between the two. The corridor abutting the existing building was to have internal access to the existing building, and the entrance to this corridor was to become the new main entrance to the existing building. The former main entrance at the front of the existing building was to be turned into a fire escape door. The main entrance to the hall was to be on one of the shorter sides of the hall itself, quite near to the new main entrance of the existing building. From the hall, there was then to be internal access to the corridor abutting the hall. This corridor was to contain toilets, a kitchen, storage area and some other rooms.

9. However, there was a subsequent change of plan in about March 2016, as a result of discussions with HMRC indicating that HMRC would not view the original plan as qualifying for zero rating. When the works were finally completed, there was no internal access from the existing building to any of the new structure at all. The back wall of the existing building in effect became a party wall to the whole of the new structure. The former main door to the existing building remained its main door. The entrance to the corridor abutting the existing building became the main entrance to the new structure. From that corridor there was now internal access to the second corridor, and through it to the hall. The corridor abutting the existing building, rather than being an entrance area to the existing building as originally envisaged, ultimately became the main entrance area to the new structure.

10. The Appellant contracted with Core M (Contractors) Ltd ("Core M") to undertake the building works. Core M handed over the property to the Appellant on 30 March 2016. According to the Appellant, when Core M's involvement ended the building works had not yet been completed, and the outstanding works were undertaken by the Appellant itself.

11. In a letter dated 25 March 2015, Core M had sought HMRC's confirmation that the proposed building work would be zero-rated. There followed various exchanges between HMRC on the one hand, and Core M, the Appellant's agent and the Appellant on the other. As has been noted, the course of these exchanges led the Appellant to change plans in March 2016. The exchanges culminated in HMRC issuing a decision dated 23 August 2016, concluding that the work was standard rated. That decision was subsequently upheld in a 1 February 2017 HMRC review decision. The Appellant now appeals against that decision.

Applicable legislation

12. Article 2(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**Directive**") relevantly provides as follows:

> The following transactions shall be subject to VAT:
>
> (a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such ...
>
> (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such …

13. Article 9(1) of the Directive relevantly provides:

> "Taxable person" shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.

14. Section 30(2) of the Value Added Tax Act 1994 ("**VATA**") provides that a supply of goods or services is zero-rated if the goods or services are of a description for the time being specified in Schedule 8 VATA.

15. Item 2 in Group 5 of Schedule 8 VATA specifies:

> The supply in the course of the construction of—
>
> (a) a building … intended for use solely for … a relevant charitable purpose …
>
> of any services related to the construction other than the services of an architect, surveyor or any person acting as a consultant or in a supervisory capacity.

16. Item 4 in Group 5 of Schedule 8 VATA specifies:

> The supply of building materials to a person to whom the supplier is supplying services within item 2 or 3 of this Group which include the incorporation of the materials into the building (or its site) in question.

17. Note 6 of the notes to Group 5 of Schedule 8 VATA ("**Note 6**") relevantly states:

> Use for a relevant charitable purpose means use by a charity in either or both the following ways, namely—
>
> (a) otherwise than in the course or furtherance of a business …

18. Note 16 of the notes to Group 5 of Schedule 8 VATA ("**Note 16**") relevantly states:

> For the purpose 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; or
>
> (c) subject to Note (17) below, the construction of an annexe to an existing building.

19. Note 17 of the notes to Group 5 of Schedule 8 VATA ("**Note 17**") relevantly states:

> Note 16(c) above shall not apply where the whole or a part of an annexe is intended for use solely for a relevant charitable purpose and—
>
> (a) the annexe is capable of functioning independently from the existing building; and
>
> (b) the only access or where there is more than one means of access, the main access to:
>
> (i) the annexe is not via the existing building; and
>
> (ii) the existing building is not via the annexe.

The issues

20. The Appellant accepts that work on the existing building is appropriately standard rated, and only contends that the works for the new structure qualify for zero rating. HMRC contends that the work on both the existing building and the new structure was undertaken pursuant to a single contract for a single scheme of works to convert and alter the existing building for use as a school premises, and that the VAT treatment of the new structure cannot be determined in isolation from the scheme of works as a whole.

21. The Appellant's case is that the new structure qualifies for zero rating under Items 2 and 4 in Group 5 of Schedule 8 VATA. The Appellant contends that these works are not excluded by Note 16 because the new structure is not an "enlargement of, or extension to" the existing building (Note 16(b)), but rather, an "annexe" that is capable of functioning independently from the existing building, with the new structure and the existing building each having their own means of access (Note 16(c) and Note 17). On the other hand, HMRC contends that the new structure not an annexe, and that in any event it is not capable of functioning independently and does not have its own main access.

22. Even if the requirements of Note 17(a) and (b) are satisfied, the new structure will only qualify for zero rating if it was intended for use solely for a relevant charitable purpose (Item 2(a) and chapeau to Note 17), and this requirement will not be satisfied if the new structure was intended for use "in the course or furtherance of a business" (Note 6(a)). HMRC contend, and the Appellant disputes, that the new structure was intended for use "in the course or furtherance of a business".

The hearing

23. At the hearing, Mrs Risa Klyne, a trustee of the main donor to the Appellant, gave oral evidence and was cross-examined. The Tribunal also had before it a witness statement of HMRC Officer Paul Davies, who did not give oral evidence. Oral closing submissions were made on behalf of the Appellant. Due to lack of time, the HMRC closing submissions were made in writing after the hearing, to which the

Appellant replied in writing. The Tribunal has also taken into account the skeleton arguments of the parties and the documents in the hearing bundle.

The evidence of Mrs Klyne

24. The witness statement of Ms Klyne states amongst other matters as follows.

25. The premises are to be donated by the Appellant to Beis Chaya Mushka Limited, a charitable company, which will make them available for a peppercorn rent to OYY Schools, another charitable company.

26. The charities have not, and will not, be run on a for profit basis at any time. The school has never made a profit, and actively seeks donations from the community to cover shortfalls each year. The school and nursery only charge contributions set at a level designed to ensure that they cover the running costs. Donations are sought to contribute towards the running costs. Any disadvantaged children have their contribution subsidised with donations from the OYY Schools charity. No parent is turned away for lack of payment as the focus is on religious matters.

27. Core M carried out the refurbishment work in the existing building as well as constructing the new structure, but raised separate invoices for each. Due to a relationship breakdown with the contractor, the site was left unfinished and the Appellant had to manage completion of the works.

28. The Appellant maintains an office in the new structure for its own charitable purposes, and the new structure is also used by the other charities operating out of the building.

29. The school does not need a separate hall or nursery to operate, and even if it did, it could utilise the facilities at the local grammar school. The new structure is not used as a sports hall. The school children do eat their packed lunch in the new structure, which takes 25 to 30 minutes four times a week. This is done as a convenience rather than a necessity as they have the choice to eat their packed lunch in the library in the main school and many do this. The kitchen in the nursery is used for cooking activities for the nursery children, and not for school lunches.

30. The nursery and the school are two distinctly different activities and both the nursery and the school are capable of operating independently from one another. The nursery accepts both boys and girls whereas the school only accepts girls. Both the nursery and the school have their own separate entrances, toilet facilities, classrooms, eating areas and playgrounds. The nursery is fitted out and equipped for nursery aged children and the school for school aged children. There is no through connection and physical integration between the nursery and the school, and it has been designed this way so smaller children in nursery are separated from older/larger children.

31. The school started operating from the refurbished building in November 2016. The nursery started operating from the new structure later once all works were complete.

32. The second witness statement of Mrs Klyne states amongst other matters as follows. There are no fees payable for nursery children, only voluntary contributions. If parents cannot afford to pay, they do not pay. Each year approximately 60% of the children will pay full voluntary contributions and the remainder pay a reduced rate depending on affordability and their individual circumstances. The level of contributions payable will be proposed by the parents and agreed by the Head. The witness statement attaches a 14 November 2018 letter from the school, stating that 64% pay full contributions, 18% paid 50-60% contributions, and 18% paid 15-25% contributions. (It is not entirely clear whether these percentages relate to the school and nursery, or just the nursery.)

33. In examination in chief, Mrs Klyne stated amongst other matters as follows. The ethos of the school is not just education but development of great human beings. It is always a priority of the school not to refuse a child based on lack of parental funds. The school has benefactors who will pick up the shortfall. However, where possible parents will always pay something, enabling them to maintain dignity and to enable them to say they paid for their child's education. In some cases, parents pay nothing.

34. In cross-examination, Mrs Klyne said amongst other matters as follows.

35. Ofsted reports were incorrect when stating that the school charged "fees"; this was because Ofsted applied a "tick box" methodology and their report did not reflect the individual circumstances of this school.

36. The school teachers are paid. She did not know if some of the donations to the school were made by parents with children at the school. She was not sure but some teachers may have children at the school.

37. The school decided to move to the new site because this was cheaper than renovating the old site. There was a nursery at the previous site, but the school and nursery were always run separately as two separate entities. For cooking lessons, the school uses the facilities at another school up the road, not the kitchen in the new structure. The new structure is not used for school assemblies. The school may use the hall in the new structure for religious meetings or fundraising events.

38. The new structure has its own independent boiler which is in the basement of the existing building for safety reasons. The thermostat for the new structure is located within the new structure. There are also electric storage heaters in the new structure. These are used to provide additional heat when it is very cold, or to provide heating if the boiler breaks down.

The evidence of HMRC Officer Paul Davies

39. The witness statement of Officer Davies describes the procedural history leading up to the taking of the HMRC decision that is the subject of the present appeal. The witness statement also sets out Officer Davies' reasons for considering that the new structure is not entitled to be zero rated.

The documentary evidence

40. The documentary evidence in the hearing bundle includes the following.

41. A letter dated 25 March 2015 from Core M to HMRC states that "The girls school will not be run on a for profit basis, and the nursery will only charge fees set at a level designed to ensure they cover their costs, as per the Yarborough [sic] Children's Trust".

42. A letter dated 25 September 2015 from Core M to HMRC states: "The charities will not be run on a for profit basis at any time and the school and nursery will only charge contributions set commensurate at a level designed to ensure that they cover the running costs, as per the Yarborough [sic] Children's Trust. Any disadvantaged children will have their contribution subsidised with donations from the Oholei Yosef Yitzchok Lubavitch Schools Limited charity."

43. An e-mail dated 2 February 2016 from the Appellant's agent to HMRC states: "We can confirm that the school does have an aspirational target of 'fees' which are aimed at covering costs, but no child is turned away if their parents are unable to reach that level, and fees are not directly linked to attendance. Previously it has been run informally as an exempt charity so there was no need to file accounts with the charity commissioners but it is now the intention to formalise matters with the registration referred to above. The school is run for religious purposes only and that is its ethos—there is no profit motive at all."

44. An e-mail dated 19 June 2016 from the Appellant's agent to HMRC forwards a message from what appears to be a commercial nursery, stating that its charges are £200 per week. The e-mail from the agent goes on to state that the nursery run by the Appellant requests a voluntary contribution of £100 per month while market rates are £400 to £800 per month, so that the Appellant operates at 25% of market rates.

45. An application dated 2 February 2016 made by OYY Schools to the Charity Commission for registration as a charity states amongst other matters as follows:

> The trustees also wish to have a system of paying out grants to families on low income as the families that send to the school are breadline or below and they feel that this would be very suitable to run alongside the school activities. It is separate to the schools activities even though the overlap is evident in that fees might be reduced or waived if people can't afford to pay nevertheless the trustees will ensure that this is a separate function to the school. ...
>
> The grants paid out or fees waived will enable children from families on low income to receive a normal education without being compromised. …
>
> For the grants it will be up to the trustees to decide and it will be primarily based on the level of funds available to pay out after which it will be based on criteria that the trustees will set such as those on government benefits or those that can prove that they are on low income. …

> The trustees will ask for voluntary contributions for the college from parents—they are aware that they will not be able to cover the annual costs of the school unless they fundraise too as the parent body will in the main be on low income.
>
> It is possible that there will be parents not paying anything at all and the trustees recognise that they will have to find the shortfall.

46. An application dated 2 February 2016 made by Beis Chaya Mushka Ltd to the Charity Commission for registration as a charity states amongst other matters as follows:

> The trustees wish to purchase or receive a building that this charity will hold for the sole purposes of education. ...
>
> The school that the trustees wish to help by providing this building which they wish to keep in the charity sector yet separate from the running of the school for commercial reasons. …
>
> Whether the charity will charge for the usage of how much will be open to negotiation with the school trustees and governors. …
>
> The trustees may charge a rent as mentioned earlier.
>
> The trustees recognise that they may not recover the running costs from the school and are prepared to either fundraise for the shortfall or provide the funds required to ensure smooth financial running.

47. An Ofsted report of an inspection of OYY Lubavitch Girls' School on 3-4 July 2012 states amongst other matters as follows. The school opened in 1980 and in 1997 received registration as an independent day school for girls aged from 3 to 16 years of age and for boys aged from 3 to 5 years (on the original main site). In 2010 the registration was changed to include a group of boys aged 6-12 years at a separate site. At the time of this report, there were 93 pupils on the main site (83 girls and 7 boys), of which 21 were in the Early Years Foundation Stage. There were at the time 130 full time pupils on roll (83 girls and 47 boys) and no part-time pupils. Annual fees for day pupils were £2,900 to £4,500.

48. An Ofsted report of an inspection of OYY Lubavitch Girls' School on 17-19 March 2017 states amongst other matters as follows. There were at the time of this report 122 pupils on roll including 21 full time children in the early years; 16 of these children were in receipt of public funding. The gender of pupils was "Boys/Girls (Separate arrangements)". Annual fees for day pupils were £6,240.

49. A printout from a page of the Independent Schools Council website dealing with the Oholei Yosef Yitzchok School states that the school has 125 pupils, of whom 56 are boys aged 5-16 and 69 are girls aged 3 to 16, with boys and girls taught separately. It states that day fees per term are £1,460 to £6,630, and that there are no scholarships or bursaries. The date of this website printout is not clear.

50. An income and expenditure account for OYY Lubavitch Girls School indicates that in the year ending 30 September 2016, it had income of £186,278, of which £103,879 was "parental contributions", £26,074 was "childcare vouchers", £34,717

was "donations", £36 was "bank interest" and £21,080 was "security grants", and £473 was "milk scheme".

51. An income and expenditure account for OYY Lubavitch Girls School indicates that in the period 1 October 2016 to 31 July 2017, it had income of £164,454, of which £92,419 was "parental contributions", £33,265 was "childcare vouchers", £22,849 was "donations", £10 was "bank interest" and £15,911 was "security grants".

52. Unaudited financial statements for Oholei Yosef Yitzchok Lubavitch Schools for the period 1 December 2016 to 31 August 2017 state amongst other matters as follows. The organisation was registered as a charity on 22 July 2016. In the period in question, the main aim of the charity continued to be the provision of a pre-school nursery, and educational facilities to girls, for children aged 2 to 16. The charity would give out grants in line with its objects. There were no individual or institutional grants made during the year. Donation and grant income amounted to £64,721, and "income in respect of contributions and fees" or "voluntary contributions" amounted to £90,823.

The Appellant's submissions

53. The new structure is an "annexe" given the lack of integration with the existing building. It is immaterial that a previous structure at the rear of the existing building was first demolished: what was previously on the site but is no longer on the site cannot affect the characterisation of the construction works.

54. The mere fact that construction of an annexe takes place in the context of other works being done to the existing building does not mean that the construction of the annexe cannot be zero-rated.

55. The annexe is "capable of functioning independently from the existing building". It is immaterial that the heating plant is housed in the existing building's basement, and that the principal's office and staff facilities are in the existing building and that the main hall in the new structure is used for dining by the older pupils 4 days per week. The legislation does not require that the main building is used or capable of use without the annexe.

56. The existing building and the annexe clearly have their own separate main accesses.

57. The new structure is not being used in the course or furtherance of a business. Reliance is placed on *Customs and Excise v Yarburgh Children's Trust* [2001] EWHC 2201 (Ch), [2002] STC 207 ("***Yarburgh***") and *Customs & Excise v St Paul's Community Project Ltd* [2004] EWHC 2490 (Ch), [2005] STC 95 ("***St Paul's***"). HMRC accept that up to 5% business use of the building can be ignored as *de minimis* (reliance is placed on *Wakefield College v HMRC* [2018] EWCA Civ 95 ("***Wakefield College***") at [5]).

58. The nursery activities are undertaken for social/religious reasons. The voluntary contributions requested from parents are significantly lower than the fees charged by commercial nurseries. The contributions do not cover costs, and the Appellant relies upon donations. The Appellant has a legitimate expectation that its activities will be treated as non-business activities insofar as they are within the scope of *Yarburgh* and *St Paul's*, given that HMRC apply that case law to others in the Appellant's position.

59. For purposes of the legal test in *Wakefield College*, the voluntary contributions of the parents do not satisfy the test for being consideration because they are voluntary and the service could be obtained with or without payment of the contribution. There is thus no direct link between the contribution and the service. In any event, the voluntary contributions do not amount to remuneration. They are voluntary, which means that the service could be obtained with or without payment of the contribution. The actual contribution made is therefore ultimately up to the parents in question and there is no fixing of a fee by reference to the cost of the service.

The HMRC submissions

60. The work undertaken was a single development by a single main contractor whereby the property was purchased with the intention to convert it to use as a single educational establishment.

61. The new structure provided no extra space for activities distinct from but associated with the activities that were carried out in the existing building, because there were no activities being carried out in the existing building at the time of construction.

62. The time of supply was March 2016. Any subsequent alterations do not retrospectively alter what the position was at the time of supply.

63. The new structure cannot function independently from the existing building as it is dependent upon the heating plant which is housed in the existing building's basement, because the principal's office and staff facilities are within the new structure, and because the main hall in the new structure is used for dining by the school pupils at least 4 days per week.

64. The intended charitable use of the completed building was in the course or furtherance of business. The school is an independent day school providing education for 2-16 year olds and was doing so prior to its move to the new premises. Following the decisions in *Yarburgh* and *St Paul's*, HMRC issued Business Brief 02/05 which stated that HMRC would accept that charities which ran nurseries/crèches only, along the same lines as in those cases, would not be treated as a business activity for VAT. The school in this case does not run a nursery/crèche only, and the nursery in this case is not run on the same lines as in *Yarburgh* and *St Paul's*. In this case, the fees and contributions amount to 58% of the total income of the school. The school is run by trained paid staff, under the control of trustees, and fees are charged to all pupils to some degree.

65. In the present case, the link between the services and payments is sufficiently direct to satisfy Articles 2 and 9 of the Directive as established in *Wakefield College*.

66. The definition of "economic activity" for purposes of the Directive provides no exception for activities carried out for the benefit of the public, or for activities where the provider does not seek to make a profit (reliance is placed on *Longridge On the Thames v Revenue And Customs* [2016] EWCA Civ 930 at [84] ("***Longridge***"); *Apple and Pear Development Council v Commissioners of Customs and Excise* [1988] EUECJ R-102/869 ("***APDC***") at [12]). The school in this case is making a supply of education for consideration in much the same way as a fee-paying school. Its principal activity is the making of such supplies to other persons, and it does so for payment, over a period of time with some degree of frequency and scale. The evidence refers to "fees" being charged. The charge made is more than a nominal amount and accounts for a significant proportion of the school's income. Concessionary charges do not suggest a lack of economic activity because economic activity springs from the receipt of income, not profit.

The Tribunal's findings

Whether the new structure can be considered in isolation

67. The legislation provides that supplies of services and building materials for the construction of an annexe are to be zero rated if the relevant requirements are satisfied. The statutory requirements do not expressly include any necessity for the construction of the annexe to take place independently of any construction work on the existing building.

68. In *Roman Catholic Diocese of Westminster v Revenue & Customs* [2018] UKFTT 522 (TC) ("***Roman Catholic Diocese of Westminster***"), a hall had been constructed at the side of a church, as part of a project that involved various other works to the existing church itself. In that case, the Tribunal noted at [15] that:

> In response to a question from the Tribunal, HMRC did not consider that the fact of a single construction contract for all the works coloured the identification of the part relating to the Hall, and accepted that the contract costs could be split between the works which the Diocese accepted were standard-rated and those contended (but disputed) to be zero-rated.

69. The Tribunal considers that the position taken by HMRC in that case was correct. That appears to be the effect of a plain reading of the legislation. In the present case, HMRC point to nothing in the legislation that would arguably require a different result. The construction of an annexe does not cease to be the construction of an annexe, merely because other works are also undertaken by the Appellant at the same time, or even as part of the same contract.

"Extension" or "annexe"

70. For purposes of Note 16 and Note 17:

(1) The expressions "extension" and "annexe" are mutually exclusive.

(2) Determining whether works constitute an "extension" or "annexe" to an existing building requires a comparison of the building:

(a) as it was before the works were carried out; and

(b) as it was to be after the works were completed.

(3) The question is to be answered after an objective examination of the physical characters of the building at the two points in time, having regard *inter alia* to similarities and differences in appearance, the layout, the uses for which the existing building and the new structure are physically capable of being put and the functions which they are physically capable of performing.

(4) The question is to be answered as at the date of supply, not as at the date of completion of the works or subsequently.

(5) The terms of planning permissions, the motives behind undertaking the works and the intended or subsequent actual use are irrelevant, save possibly to illuminate the potentials for use inherent in the building or buildings.

(See, for instance, *Gateshead Jewish Nursery v Revenue & Customs* [2014] UKFTT 685 (TC) ("***Gateshead Jewish Nursery***") at [15], [29]-[32], [35(1)-(3)]; *Roman Catholic Diocese of Westminster* at [19], [21].)

71. The extent to which the new structure is integrated with the existing building is a significant factor. The looser the integration, the more likely it is that the structure will be viewed as an annexe rather than an extension.

(1) The term "extension" refers to building work which provides an additional section or wing to that existing building. It is difficult to conceive of an extension which is not physically attached to the existing building. However simply because the new structure is physically attached does not necessarily mean that it is an extension rather than an annexe.

(2) The term "annexe" connotes something that is adjoined but either not integrated with the existing building or of tenuous integration.

(3) The existence of an internal access to the new structure is a material factor in determining whether the works constitute an extension rather than an annexe. However, simply because the new structure is physically attached with an internal doorway does not necessarily mean that it is an extension rather than an annexe.

(See, for instance, *Gateshead Jewish Nursery* at [17]-[18], [24]-[26], [28], [63].)

72. Because the question is to be answered as at the date of supply, not as at the date of completion of the works or subsequently, it is in this case first necessary to determine the date of supply.

73. HMRC contend that the date of supply was some time in March 2016, that at that time the layout of the new structure was as described in paragraph 8 above, and that it is this layout that must be compared with the existing building as it was before the works were carried out.

74. HMRC do not state definitively exactly which event in March 2016 that they consider to be the date of supply. The written closing submissions of HMRC suggest that the supply of the new structure was made to the Appellant by Core M on either the date of Core M's final invoice (7 March 2016), or the date on which Core M formally handed the property over to the Appellant (30 March 2016), or the date on which HMRC say that Core M formally concluded the contract with the Appellant for purposes of regulation 93 of the Value Added Tax Regulations 1995 (30 March 2016). HMRC have not asked the Tribunal to treat any date earlier than March 2016 as the date of supply. Nor has HMRC asked the Tribunal to find that there were multiple dates of supply over the course of the construction project. The Tribunal has accordingly proceeded on the basis that the date of supply was a single date in March 2016.

75. HMRC refer to an invoice dated 8 November 2016 from Warrington Electrical Services. HMRC argue that this shows that a ceramic tube smash was supplied and installed to exit bolts on the front door fire escape, confirming that this was not the main entrance when the school opened that month. However, the Tribunal considers that it is not clear from this invoice exactly which door is being referred to.

76. The evidence is that the Appellant's agent notified HMRC of the change in plans (from the layout described in paragraph 8 above to the layout described in paragraph 9 above) in an e-mail dated 8 March 2016. That e-mail attached a copy of the new plan, which had been prepared by an architect.

77. The Appellant has not given precise evidence as to the exact date on which the decision was taken to move to the new layout described in paragraph 9 above, or the exact date that instructions were given to the architect to prepare plans for the new layout. However, the Tribunal is satisfied on a balance of probability that it would have taken more than a day or two for the architect to prepare the new plans after the decision on the new layout had been taken. On that basis, the Tribunal finds on a balance of probability that the decision to proceed with the new layout had been taken prior to 7 March 2016, the earliest date identified by HMRC as the date of supply.

78. The Tribunal therefore finds that when undertaking the comparison referred to in paragraph 70(2) above, at the date of supply the building when completed was to have the layout referred to in paragraph 9 above.

79. The Tribunal therefore proceeds to undertake that comparison. In doing so, it does not take into account the terms of planning permissions, the motives behind undertaking the works or the intended use of the existing building and the new structure, or their subsequent actual use. While the intended and actual use illuminate the potentials for use inherent in the building, they are otherwise irrelevant.

80. Physically, there is very limited integration between the existing building and the new structure. Each has its own separate access (a point considered further below), and the entrance doors to each are not particularly close together. The main entrance to the existing building is at the front of that building, while the main entrance to the new structure is located near the rear of the existing building. Thus, it is not possible to pass from one to the other without traversing some distance outdoors.

81. The entrance to the basement of the existing building is located in the new structure, and it appears that it is not possible to access this basement through the existing building. Thus, it may be said that the basement of the existing building has been integrated to an extent into the new structure. However, there has thereby been a corresponding breaking of the integration between the basement of the existing building and the rest of the existing building. There has thereby been no net enhancement of the integration of the existing building and the new structure.

82. The new structure shares a common wall with the existing building. That is to say, the back wall of the existing building serves also as one of the walls of the first corridor in the new structure.

83. The new structure is located on the same parcel of land as the existing building. Thus, it is possible to pass from one to the other without having to leave that parcel of land.

84. The style of the new structure is very different from that of the existing building. The existing building is a 120 year old former residence. The new structure is of a contemporary style.

85. The layout of the new structure is very different from that of the existing building.

(1) The new structure, which has only a single storey, consists of the large hall, which can be divided into two when so required by a folding acoustic screen, as well as a smaller foyer/exhibition space, and some smaller rooms.

(2) The existing building is laid out over multiple storeys. Its rooms are much smaller than the hall in the new structure (and also much smaller than either half of the hall when divided in two by the acoustic partition). However, the rooms in the existing building are also typically larger than the small rooms contained in the new structure.

86. Because of these differences, the uses for which the existing building and the new structure are physically capable of being put, and the functions which they are physically capable of performing, are different. The large open space in the new structure would be capable of being used, for instance, as a school hall or gymnasium. The rooms in the existing building would not be capable of such use. On the other hand, rooms in the existing building are being used as classrooms, while the large open space in the new structure would be far too large for this purpose (even when

partitioned into two), while the other rooms in the new structure would be too small for this. The foyer/exhibition space in the new structure is perhaps the one space that would be large enough to be used as a classroom, but would be unsuitable for this given that it is an access route from the entrance to other parts of the new structure.

87. It may be that the existing building and the new structure could suitably be used together by a single entity for a single purpose. For instance, they might both be used by a single school, utilising the rooms in the existing building as classrooms, and the hall and rooms in the new structure as a school hall and offices. However, that is not determinative. In *Catholic Diocese of Westminster*, a church hall was found to be an annexe, even though the existing church and the new hall were both being used together by the same entity for its overall functions.

88. The Tribunal finds that the new structure is not sufficiently integrated to be considered an extension to the existing building. On the other hand, it has a sufficient degree of integration to prevent it from being considered an entirely separate building. The Tribunal finds that it is an annexe for purposes of Note 16 and Note 17.

"Capable of functioning independently"

89. For purposes of Note 17(a):

(1) The question whether an annexe is capable of functioning independently from the existing building is to be determined having regard to the objective character of the building and of the annexe.

(2) The annexe must be capable of functioning independently in the form in which it has been constructed and without any alteration (subject perhaps to *de minimis* exceptions). That is to say, it is insufficient that it *would* be capable of functioning independently if significant alterations were undertaken.

(3) The way in which a building does in fact function is not determinative.

(See, for instance, *Chelmsford College v Revenue & Customs* [2013] UKFTT 400 (TC) ("***Chelmsford College***") at [21]-[24]; *Gateshead Jewish Nursery* at [33], [35(7) and (9)], [69], [72]-[73], [77]; *St Brendan's Sixth Form College v Revenue and Customs* [2018] UKFTT 128 (TC) ("***St Brendan's***") at [13]; *Roman Catholic Diocese of Westminster* at [27].)

90. The absence of a separate electricity supply does not necessarily mean that an annexe cannot function independently (see, for instance, *Gateshead Jewish Nursery* at [79] *St Brendan's* at [39]; but compare *Chelmsford College* at [30]-[31]).

91. In *Catholic Diocese of Westminster* at [27], it was held that central heating arrangements for the new structure is relevant but not a dominant issue. In that case, at the date of completion of the works, the new structure had its own boiler separate from that serving the existing building, although this separate boiler was at the time located in the existing building. However, the thermostat for the new structure was located in the new structure itself. The Tribunal considered that the fact that the

temperature in the new structure could be controlled from the new structure was sufficient to constitute a heating system that functions separately from the existing building.

92. In *Gateshead Jewish Nursery* at [77] the Tribunal considered that the addition of electric room heaters or a wall mounted electric water heater would not involve any alteration to the way in which the annexe was constructed. On that basis, an annexe would be capable of functioning independently if it could do so with the addition of electric room heaters and/or a wall mounted electric water heater.

93. In *Gateshead Jewish Nursery* at [79] the Tribunal considered that the absence of a separate electricity supply would be *de minimis*. See also *St Brendan's* at [39].

94. The Tribunal sees no reason why the annexe in this case would not be capable of functioning independently. It has its own toilets, kitchen, storage and office spaces. It is connected to water and electricity. It has its own separate boiler, which (on the oral evidence given) can be controlled from within the annexe itself. In any event, the Tribunal is satisfied that the annexe could, without any alteration to the way in which it was constructed, be fitted with its own electrical heating, if it does not already have this (the evidence of Mrs Klyne is that it does). If the annexe does not have its own separate electricity and water supplies and metres (a matter on which the evidence is not clear), the Tribunal would regard that as *de minimis*. The Tribunal finds that this requirement is satisfied.

Independent access

95. It is necessary to determine, having regard to the character of the building and of the annexe, what objectively should be considered to be the main access to each. This test is answered, not by what happens in practice, but by reference to what might reasonably be expected to be the main access having regard to the characteristics of the annexe and the existing building, and the layout and physical position of the annexe and the existing building. Actual or intended use is only illustrative and not determinative. (See *Gateshead Jewish Nursery* at [34], [35(8) and (9)], [83], [86].)

96. In this case, there is no access to the annexe internally via the annexe. Nor is there any access to the existing building internally via the annexe. This necessarily means that each has its own separate main access.

97. The fact that the existing building and the annexe are on the same parcel of land, access to which from the street is via a common gate, does not alter this conclusion. The requirement of Note 17 is merely that the main access to the existing building not be via the annexe, and that the main access to the annexe not be via the existing building. This requirement is clearly satisfied in this case.

"Otherwise than in the furtherance of a business"

(a) Findings of fact

98. Having considered the evidence, the Tribunal makes the following findings of fact on a balance of probability.

99. At the site to which this appeal relates, OYY Schools runs both a school for girls between the ages of 5 and 16 (the "school") and a nursery for boys and girls between the ages of 3 and 5 (the "nursery"). The nursery is located in the annexe, while the school is in the existing building. The school and nursery are therefore largely separate activities in separate spaces (the existing building and the annexe respectively), with some limited overlap (in particular, pupils in the school eat their lunch in the annexe about 4 times per week). The Tribunal accepts Mrs Klyne's evidence that the hall and kitchen in the annexe are not used for lessons for the pupils from the school. However, while the school and nursery are physically separate, they are not necessarily administratively separate. Both are run by the same organisation on the same site. There appears to be some overlap in the staff (apart from anything else, it seems that the head teacher of OYY Schools is responsible for both the school and nursery). OYY Schools does not keep separate accounts for the school and the nursery.

100. OYY Schools applied to the Charity Commission for registration as a charity in February 2016, as did Beis Chaya Mushka Ltd. Thus, at the time of the supply to which this appeal relates, March 2016, it was intended that the site when completed would be used by a registered charity.

101. The school and the nursery are run on a non-profit basis. A substantial number of the children at the school and nursery come from financially disadvantaged backgrounds, and OYY Schools has a philosophy of seeking where possible to accommodate children irrespective of their financial means.

102. However, OYY Schools nonetheless needs to finance its activities. It does so through amounts paid by the parents of children attending the school and nursery, and through donations and grants.

103. The Tribunal finds that it is more likely than not that OYY Schools sets a fixed amount that is to be paid in respect of each child attending the school or nursery (which may be different for different year groups). Where a child's family consider that they cannot afford that fixed amount, they can ask the school to reduce the amount or to waive it altogether. The school may or may not agree to do so. One reason why the school may not agree is that it may simply have insufficient funds to provide places at reduced or no fees to the number of children seeking places on that basis. (The school's 2 February 2016 application to the Charity Commission states, in response to a question about the "grant application and allocation process", that the trustees of the school were "sure it will be oversubscribed"). There may be other reasons why the school may decline to accept a particular child, either at all, or on the basis of reduced or completely waived fees. The school's application to the Charity Commission states:

> The trustees and governors meet to discuss applications and they will decide who is most suitable to enter the college.
>
> The criteria will be based on the person's ability and knowledge and the family background to see if the family fits into the ethos of the school.
>
> For the grants it will be up to the trustees to decide and it will be primarily based on the level of the funds available to pay out after which it will be based on criteria that the trustees will set such as those on government benefits or those that can prove that they are on low income.

104. The Tribunal does not unnecessarily repeat the evidence on which these findings are based, which is set out in paragraphs 26, 32, 35 and 41-52 above. The evidence that there is a fixed amount that each child is required to pay includes in particular the evidence of Mrs Klyne that "the school and nursery only charge contributions set commensurate at a level designed to ensure that they cover the running costs" (paragraph 4 of her witness statement), and the statement of the Appellant's agent (paragraph 43 above) that "the school does have an aspirational target of 'fees' which are aimed at covering costs". There are other references to "fees" in documents prepared by or on behalf of the school itself (see paragraphs 41, 45 and 52 above). Furthermore, the school's application to the Charity Commission indicates that the reduction or waiving of fees is a separate function to the normal activities of the school (see paragraph 45 above). Ofsted reports also refer to the charging of fees (paragraphs 47 and 48 above).

105. The Tribunal finds that these fees are set at a level designed to ensure that OYY Schools covers its costs. Donations are then used to subsidise the fees of a proportion of these children. The percentage of the children whose fees are subsidised is large. The evidence is that in November 2018, 64% of children were paying the full fee, and 36% were paying reduced fees, although none were attending without payment of any fees at all (paragraph 32 above). The evidence of Mrs Klyne is that it is only in rare cases that nothing is paid at all, and that the philosophy of OYY Schools is that families should always pay at least something for each child who attends, if at all possible.

106. The Appellant seeks to argue that because benefactors make donations to OYY Schools without sending a child to attend, while those sending children to attend pay varying amounts and sometimes nothing at all, OYY Schools is analogous to the busker described in *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* [1994] ECR I-743, [1994] STC 509 at [16]-[17]. In that case the CJEU noted that some passers by place money in a busker's collecting tin without lingering to listen to music, while others linger for a considerable period without paying anything, so that there is no direct link between the service provided and the payments received. The Tribunal does not accept that this is a valid analogy.

107. The Tribunal is satisfied on the evidence that a child cannot attend the school or nursery without paying the normal fixed amount, unless the school agrees to reduce or waive that amount. In the event that the school agrees to reduce the amount, payment

of the reduced amount will then be a condition of attendance. Whether they are called "voluntary contributions" or any other name, the amounts paid by the families of children attending the school or nursery are in substance fees, and the Tribunal will refer to them as such.

108. While the school also receives donations and grants, these are separate from the fees charged in respect of children attending the school or nursery. There is no evidence of anyone paying the set fees without sending a child to the school or nursery. It is not possible to conflate the fees and the donations by referring to both as "voluntary contributions".

(b) Applicable legal principles

109. Item 2 in Group 5 of Schedule 8 VATA requires that at the time of supply, the building was "intended for use solely for … a relevant charitable purpose". Note 6 defines "use for a relevant charitable purpose" to include use "otherwise than in the course or furtherance of a business".

110. The word "business" in Note 6 has the same meaning as the expression "economic activity" in Article 9(1) of the Directive.

111. "Economic activity", within the meaning of Article 9(1) of the Directive, requires a supply "for consideration" within the meaning of Article 2 of the Directive.

112. A supply for consideration requires a legal relationship between the supplier and the recipient, pursuant to which there is reciprocal performance whereby the goods or services are supplied in return for the consideration provided by the recipient. There is no need for the consideration to be equal in value to the goods or services: it is simply the price at which the goods or services are supplied (*Wakefield College* at [52]).

113. For there to be an economic activity, the supply must also be made for the purposes of obtaining income therefrom on a continuing basis. A supply meeting this test is referred to for convenience as one made "for remuneration" (a different concept to the concept of "for consideration") (see *Wakefield College* at [52]-[55], [59]; *Longridge* at [70], [72]-[73], [84]).

114. Determining whether there has been a supply for remuneration requires a fact–sensitive enquiry. There is not a checklist of factors to work through. Factors considered to be significant in other cases may provide helpful pointers, but the same factors may assume different relative importance in different cases. (*Wakefield College* at [59]).

115. This enquiry does not involve subjective factors such as whether the supplier is aiming to make a profit, and concessionary charges are therefore not an indicator against economic activity (*Wakefield College* at [55]; *Longridge* at [93]).

116. The fact that a provider has charitable status does not automatically mean that its operations cannot constitute a "business" within the meaning of Note 6. A charity,

as part of its operations, may for instance conduct a business designed to make money for its support, such as a charity shop. However, the payment of fees is not a deciding factor but only one of the factors to be put in the balance in determining whether a charity's activities constitute a "business" (*St Paul's* at [17], [27]).

(c) Application of legal principles to the facts

117. HMRC's case is that OYY Schools is a single educational entity, and that it is necessary to consider the school and nursery as a single inseparable activity. The Appellant on the other hand argues that the annexe is (and was at the time of supply) intended for use by the nursery only, such that only the nursery should be considered when determining whether the annexe is used for "business" activities. This is important to the Appellant, given its reliance on *Yarburgh* and *St Paul's*, which related specifically to playgroups and nurseries.

118. The Tribunal finds that the mere fact that both the school and nursery are run by the same organisation, which includes both activities in a single set of accounts, does not mean that all parts of the site need to be regarded as in use by both the school and nursery. If a single organisation uses an annexe solely for non-business charitable activities, and the pre-existing building for business activities (such as a charity shop), there is no reason in logic why it should be said that the annexe is being used for business purposes. HMRC point to nothing in the wording of the legislation or any case law that would require any other conclusion.

119. Having looked at the plans of the site, and considered the evidence, the Tribunal is satisfied on a balance of probability that in this case any use of the annexe for the purposes of the school (such as the fact that most school pupils eat their lunch there some 4 days a week) is *de minimis*, and that any other use of the school hall is likewise *de minimis*. There is an office in the annexe used by the Appellant and other charities, but part of the Appellant's own activities would relate to the nursery as opposed to the school, and the office that it occupies is in any event a very small portion of the floor space of the annexe. It appears that HMRC accept that up to 5% business use of a building can be ignored as *de minimis* (see *Wakefield College* at [5]). The Tribunal is satisfied that any non-nursery use of the annexe would be within this order of magnitude. The Tribunal therefore confines itself to consideration of the nursery when determining whether the annexe is used for "business" purposes.

120. The Tribunal is satisfied that where a child is accepted for attendance at the nursery, a legal relationship is established whereby educational services are provided by the school or nursery in return for the payment of fees (full or reduced) by the child's family. There is a supply for consideration. The rare cases where fees are waived entirely are *de minimis*.

121. The critical question is whether the supply is "for remuneration". Answering this question requires a fact–sensitive enquiry of all relevant circumstances as a whole.

122. The Tribunal takes into account the following matters, which could be said to weigh in favour of the conclusion that the supply is made "for remuneration":

(1) the sole activity of the nursery is the provision of educational services to the children who attend;

(2) those services are supplied for a form of payment or consideration, over a period of time with some degree of frequency and scale;

(3) the nursery is a significant, if minority, part of the total undertaking of OYY Schools;

(4) the fees paid are a significant amount of the nursery's income, and make a significant contribution to the cost of running the nursery;

(5) the level of the normal fee is fixed by reference to the cost of running the nursery, and thereby fixed by reference to the cost of providing the supply to the child in respect of whom the fee is paid;

(6) the benefit of the fee paid accrues to the child on behalf of whom the fee is paid, and the amount of the benefit is proportionate to the amount of the fee paid, at least in the case of a child who pays the full fee;

(7) in the case of a child who benefits from fee remission, the remitted part of the fee is paid out of donations and grants to OYY Schools, so that for practical purposes a full fee is still paid in respect of that child, partly by the child's family and partly through donations; and

(8) there is no reason to suppose that there are not other nurseries that operate on a similar basis, with fees set at a level to cover costs, with the fees of some pupils subsidised through additional donations and grants.

Compare *Wakefield College* at [79]-[85]; *Longridge* at [92]; *APDC* at [14]-[15].

123. On the other hand, the Tribunal also takes into account the following considerations.

(1) It was held in *Yarburgh* and *St Paul's* that, in the circumstances of those particular cases, the running of a nursery or crèche by a charity was not a business activity for purposes of Note 6.

(2) More recent case law, including in particular *Wakefield College*, does not cast doubt on the correctness of *Yarburgh* and *St Paul's*. HMRC did not in these proceedings seek to argue that *Yarburgh* and *St Paul's* were incorrectly decided, but sought to distinguish those cases on their facts.

(3) HMRC contend that the percentage of the nursery's finances that are obtained through fees is significantly higher than in the case of *St Paul's*. However, in *St Paul's*, the High Court upheld the decision of the VAT and Duties Tribunal, from which it quoted the following passage at [53]:

> … we think there is an essential similarity between the two cases [*Yarburgh* and *St Paul's*] in that fees were set at a level designed to ensure that the operation broke even. If there are differences

> between the two cases they seem to us to be differences of scale or degree rather than of principle. … Though it cannot be said that the management of an activity is irrelevant to its character, the essential focus must be on the activity itself. In this case it is the not-for-profit provision of a day nursery. If that (or something very close to it) is a charitable activity when carried on (as in Yarburgh**)** by a cooperative, does it cease to be charitable, and become a business activity, when it is managed by those who perform it even though in every other respect it is materially identical? In our view the answer to that question is no. The nature of the activity is unchanged. The financial constraints under which it is undertaken are identical. The level of the fees will not go up or down depending upon who is on the committee; their level is dictated by the available income and the cost of supplying the service, factors which would not change in any way if parents dominated the committee, or were its only members.

(4) The nursery in this case is run on a not for profit basis.

(5) The evidence is that a significant number of the children attending the nursery are from disadvantaged backgrounds. This is borne out by the fact that in November 2018, some 36% of the children were paying substantially remitted fees.

(6) Accordingly, a substantial number of the children catered for by this nursery would not be catered for by commercial nurseries, namely those from families who cannot afford commercial nurseries.

(7) The Tribunal finds that in the present case, the amount of fees charged for children attending the nursery was not of itself sufficient even for the nursery to break even. Had there been no other sources of income, the nursery would in fact have run at a loss. The Tribunal is satisfied that such a loss would have been unsustainable. Thus, if the fees had been the only source of income, the nursery would not have continued to exist at all.

(8) The reality is therefore that while the nursery was funded in part from fees paid by families of children attending the nursery, the ability of the nursery to exist and to carry out its charitable purposes depended on receipt of donations and grants from other sources. The Tribunal finds that it cannot be said in this case that the supply of nursery services was made for the purposes of obtaining income therefrom on a continuing basis. If anything, the converse was the case, namely that the fees were charged for purposes of enabling the nursery services to be supplied. However, the fees themselves were not sufficient for that purpose.

(9) The Tribunal does not assume that every activity that runs at a loss, or that every nursery run by a charity, is for that reason alone necessarily excluded from the definition of a business under the *Wakefield College* analysis. However, in all the circumstances of this case as a whole, the Tribunal finds that the fees charged cannot be considered "remuneration" within the meaning of the *Wakefield College* analysis. Nor does the

Tribunal consider the donations and grants to be "remuneration" in this sense.

124. The Tribunal therefore does not find this case relevantly different from *Yarburgh* and *St Paul's*.

125. The Tribunal therefore finds that the provision of educational services to children attending the nursery is not a supply "for remuneration" within the meaning of the *Wakefield College* test. The making of such supplies is accordingly not an "economic activity" within the meaning of Article 9(1) of the Directive, and is not a "business" for purposes Note 6. The Tribunal finds that the annexe when constructed was "intended for use solely for … a relevant charitable purpose" within the meaning of Item 2.

Conclusion

126. For the reasons above, the appeal is allowed. The construction of the annexe is zero rated in accordance with Items 2 and 4 in Group 5 of Schedule 8 VATA.

127. 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.

DR CHRISTOPHER STAKER
TRIBUNAL JUDGE

RELEASE DATE: 01 JULY 2019