



Date 19 June 2019
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Memo

Subject Summary of Snagging/Cladding following Grenfell Tower

To JVCC

From VAT Policy Reliefs Team

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We have reviewed the legislation, case law and guidance for snagging and have concluded that in the majority of cases snagging will not apply to the replacement of cladding. It may be possible to obtain the zero-rating for the replacement cladding as snagging in a few specific situations, but this will be limited.

A more detailed explanation and conclusion is provided below.

Background information about snagging

We have received enquiries regarding whether the replacement of cladding following Grenfell Tower (GT) could be zero-rated as the cost of the cladding would be passed to the tenants under their service charge agreement.

This is keeping with the FTT decision in Citiscape (March 2018), which was heard in the Property Chamber. The Times newspaper on 13 March 2018 covered the Citiscape decision in an article that was entitled: - 'Leaseholders face £2m bill to replace unsafe cladding'.

When considering zero-rating we consider our guidance on snagging (VCONST02600 - provided in Annex A), which refers to the case of Mr and Mrs James. Snagging was only zero-rated when the supply was made 'in the course of construction', however the courts ruled that snagging could be allowed after a Certificate of Completion had been issued (not in the course of construction) because "the building can't be said to be complete or fit for purpose". In this particular case the reason for refusing a DIY refund claim was because "*snagging or correction of faults ... carried out after the building had been completed ... can only be zero-rated if it is carried out by the original contractors and correction of faults forms part of the building contract. When the snagging is carried out by a different contractor, the work is to an existing building and does not qualify to be zero-rated*". In the case of Mr and Mrs James the plastering was started in early March 2005 and the Appellants had moved into their house in the same month shortly after they became aware that the work was defective.

In finding for Mr and Mrs James the VAT Tribunal found that their occupation of the building while works were continuing, did not determine whether the construction of their house had

been completed, prior to the issue of the Certificate of Completion, hence snagging was allowed.

Building contracts frequently include retention clauses. These will allow the customer to hold back a proportion of the contract price once the work has been completed, pending confirmation that the supplier has done the work properly and has rectified any immediate faults that might be found. This is sometimes referred to as snagging.

Although there is no specific provision in the VAT Act for snagging, the meaning of “in course of construction” will include these retention periods. It will also include remedial works, if the property was damaged, unsafe or inhabitable, even if a completion certificate has been granted as per the case of Mr and Mrs James.

Prerequisite for VAT relief on building work done as snagging

1. Remedial work must have been part of the initial qualifying zero-rated construction or qualifying reduced rated conversion of a building.
2. The remedial work must be connected to the original build, via a retention clause in the contract to carry out damages or an ongoing dispute advising that the works had not been completed.
3. The person commissioning the remedial work must have a ‘person constructing status’ for the initial construction.
4. The remedial work is done as soon as possible.

When a property is finished, together with any retention periods and all parties have agreed that the property is complete and meets the planning consent, then snagging would not apply, because the property has been legally agreed, that no more work is necessary for completion. Therefore any replacement cladding would be classed as repair and maintenance and not snagging which has always been standard rated for VAT, unless there is a clause in the contract for the developer to correct any errors.

Buildings that had cladding installed during a refurbishment and repair are not eligible for any VAT relief on the grounds of snagging, because their installation wasn't in the course of constructing a building – this potentially rules out many of the re-cladding enquires following GT on the grounds of snagging.

Where cladding was installed as part of an initial construction work, there is scope for VAT relief (zero rate). The main barrier for buildings in this category is whether the person commissioning the re-cladding has a person constructing status. It is very likely that this requirement would rule out most of the re-cladding work following GT as snagging.

The issue about the time lapse between the initial cladding and re-cladding is an area we can be relaxed about following GT.

Who has person constructing status?

A person who has ‘person constructing status’ is covered in VCONST03520 (shown in Annex B) and is someone who is directly involved in the constructing process. At the time of construction more than one person could have person constructing status as they are directly involved, they could be:

- The developer
- The owner of the land
- The contractor and
- The sub-contractors.

Once the developer or owner of the property grants an interest in the building, the person constructing status does not pass with the grant, this remains with the original developer or land owner. (In the case of Mr and Mrs James they had construction status as they were building their own home.)

Conclusion

This is why in the majority of cases snagging will not apply to the replacement of cladding. The only time it may be possible to allow the replacement cladding as snagging and obtain the zero-rating is if:

- 1. The cladding was on the plans and formed part of the construction of the building.**
- 2. The property is still owned by the developer or freeholder.**
- 3. The cladding being replaced is correcting a fault and is unsafe.**
- 4. The property developer or freeholder organises and replaces the cladding.**

The property developer or freeholder can then recover the costs of the cladding under the service charge arrangements with their tenants.

Annex A

VCONST02600 - Zero-rating the construction of buildings: are my services supplied 'in the course of the construction' of the building: snagging

Snagging is the carrying out of remedial works to correct faulty workmanship or replace faulty materials. Normally these works are carried out by the original contractor under the terms of the original contract and so are not seen as a separate supply of construction services.

However, circumstances may arise where the original contractor is not able to carry out the remedial works and another is contracted to carry out the works. This is seen as a separate supply of construction services:

- if this is made before completion of the building, it is a supply 'in the course of construction' and is eligible for the zero rate
- if this is made after completion, it is not a supply 'in the course of construction' and is ineligible for the zero rate.

However, following the Tribunal decision in **Mr and Mrs James (VTD 20426)**, there may be circumstances where the defect is so bad that even though the building may now be occupied and a Certificate of Completion issued, the building can't be said to be complete or fit for purpose. In such circumstances, we accept that the supply of remedial works is a supply 'in the course of construction' and eligible for the zero rate so long as it is made at the earliest practicable opportunity.

Annex B

VCONST03520 - Zero-rating major interest grants in buildings: 'person constructing a building': who is a 'person constructing' a building

A 'person constructing' a building is a person, who is directly involved in the construction process. At any time more than one person can hold 'person constructing' status. However, it is rare that more than one of them will have the right to grant the major interest in the building.

To be directly involved in the construction process, the person must either physically carry out the works or commission them. This has been confirmed in **Trustees for Hulme Educational Foundation (VTD 625)**, where the Tribunal stated:

...in our view, the words... 'a person constructing a building' should be given their normal everyday meaning. ...In our opinion, the normal meaning of those words mean that a person must either himself construct the building in the sense of putting brick upon brick or stone upon stone, or himself or by an agent enter into a contract or arrangement with another under which that other for him puts brick upon brick or stone upon stone. In other words, the construction must be physically done by the person concerned or by his servants or agents, or the person concerned must himself directly enter into a contract or arrangement for another to do the physical construction works

Examples include:

- a person who owns (or has an interest in) land and develops a property on it
- contractors who build that property.

Owning the land being developed does not automatically entitle a person to 'person constructing' status. For example, someone who allows their land to be developed by another but does not construct or commission the building does not have 'person constructing' status.