

**Lennartz - alteration and renovation works  
Whitechapel Art Gallery (20720)**

**Summary**

The VAT Tribunal has held that the Lennartz principle, which enables organisations to recover input VAT on capital assets and then account for VAT on deemed supplies for non-business use, is available not only for the purchase and construction of new assets but also for 'capital' works to assets such as extension, alteration, refurbishment and renovation. This decision may be highly significant for organisations which have a mixture of business and non-business activities and have incurred, or are planning to incur, significant costs in the extension, alteration, refurbishment or renovation of buildings. Tax payers which have been denied Lennartz accounting in such circumstances should also seek professional advice, as there may be opportunities to obtain retrospective recovery with interest.

**Background**

The Appellant is a registered charity. Its primary activity is non-business (i.e., the display of works of art to the public for no consideration) but it also has taxable activities (shop income and hire of the gallery premises under an option to tax). It obtained the adjoining premises, a former library, with a view to extending the gallery to include further gallery, reading and storage space and a restaurant. It obtained planning permission for the 'conversion and alteration' of the existing gallery and for the library.

It was common ground that the majority of the works were zero-rated as approved alterations to a listed building used for a relevant charitable purpose, under Item 2, Group 6, Schedule 8 VAT Act 1994, and a proportion was zero-rated as the provision of facilities for disabled persons under Item 12, Group 12, Schedule 8. Some of the works related to the restaurant and, to the extent that those were taxable works, it was agreed that the VAT would be wholly recoverable.

The dispute concerned whether the Appellant was entitled to apply the Lennartz VAT accounting mechanism to the VAT incurred on the remainder of the works.

The Appellant argued that its use of the building would be predominantly non-business and it should be entitled to recover the input VAT in full and account for output VAT on the non-business supply of the assets deemed to take place by para 5(4), Schedule 4 VAT Act 1994 (derived from art 26(1)(a) Principal VAT Directive 2006/112/EC) in the manner prescribed by reg 116A VAT (General) Regulations 1995, SI 1995/2518.

Although the precedents for Lennartz accounting had been limited to situations where an asset was created (i.e., to new buildings), the Appellant contended that there was no reason why the works in question here (which would add considerable and enduring value to the existing asset and constituted capital, rather than revenue, expenditure) should not be treated in the same way. There were parallels with the Capital Items Scheme, where VAT incurred on extension and refurbishment works was subject to adjustment over a ten-year period.

For HMRC, it was argued that Lennartz accounting could only apply to the creation of a new asset, and in this case the new asset was the additional building, not the development works. Only goods fell within the scope of art 26(1)(a), in the economic sense of valuable goods and in the structural sense of a new physical asset, and therefore there would be no deemed non-business use under that article or para 5(4), Schedule 4 to which to attribute the input VAT. Recovery must therefore be denied.

**Held**

The Tribunal noted that all previous Lennartz cases had involved the creation of new assets. However, it could find nothing in the case law which suggested that art 26(1)(a) could only be applied to newly created assets. It was clear that, once the works had been completed, the gallery would constitute capital goods, and its use for the Appellant's non-business purposes would constitute "the use of goods forming part of the

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assets of a business ... for purposes other than those of his business, where the VAT on such goods was wholly or partly deductible" for the purposes of art 26(1)(a). The Tribunal went on to comment that 'capital goods' could be created or acquired in a number of ways including, but not limited to, construction and purchase".

The Tribunal therefore decided that, as the Appellant would be required to account for output VAT in respect of its non-business use of the library, the VAT incurred on the renovation and alteration works must be recoverable.

### **Implications**

As the Tribunal itself commented, "This is the first case involving the applicability of the Lennartz principle to construction work when a taxable person has acquired an existing building which he then reconstructs." This decision may therefore be significant for those organisations which have a mixture of business and non-business activities and have incurred, or are planning to incur, significant costs in the extension, alteration, refurbishment or renovation of buildings. Further, those which have been denied Lennartz accounting in these circumstances should seek the advice of a VAT advisor, as there may be opportunities to submit claims to obtain retrospective recovery with interest.