10685

FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	:	**LON/OOBK/LSC/2014/0577**
Property	:	**20 The Water Gardens, Burnwood Place, London W2 2DA**
Applicant	:	**Mrs J. Ingram (leaseholder)**
Representative	:	**Mr M. Reiss (Holland Reiss & Co)**
Respondent	:	**The Church Commissioners for England (landlords)**
Representative	:	**Mr E. Johnson QC instructed by Louise Clark of Charles Russell Speechlys LLP, solicitors**
Type of Application	:	**Application under section 27A of the Landlord and Tenant Act 1985 to determine the liability to pay a service charge**
Tribunal Members	:	**Professor James Driscoll (Judge) and Mr Trevor Sennett (Tribunal Member)**
Date of Hearing	:	**23 January 2015**
Date of Decision	:	**11 March, 2015**

DECISION

The Decision summarised

1. The landlords are entitled to charge the leaseholder the VAT they incurred in paying contractors for services.

2. This liability for VAT is not covered by the 'VAT Notice 48: extra statutory concessions' published by HM Revenue on 21 March 2012.

3. The tribunal determines that the following VAT charges were properly included in the service charge demands and they are recoverable in full from the leaseholder: £56.77 for the year ending 24 March 2012; £111.29 for the year ending 24 March 2013 and £155.84 for the year ending 24 March 2014.

4. No order is made under section 20C of the Landlord and Tenant Act in relation to the landlord's costs in resisting the leaseholder's application for a determination.

Background

5. This application is made by Mrs Ingram who is a leaseholder of a flat in the subject premises, known as the Water Gardens, which is part of the Hyde Park Estate. Her landlords, the Church Commissioners for England, are the respondents to the application. The landlords have appointed the firm of Knight Frank as managing agents for the estate.

6. Directions were given for the conduct of the application on 14 November 2014. A bundle of documents was prepared for the hearing. It included pages of accounts and similar documents though little reference was made to those documents during the hearing.

The hearing

7. The hearing was held on 23 January 2015 when the leaseholder was represented by Mr Reiss who is an accountant. Mr Johnson QC represented the landlords and he was accompanied by his instructing solicitor Ms Clark. Also present was Mr McKeown who works for the landlord and Mr Devere-Catt a partner at Knight Frank.

8. We are required to determine a single issue, namely, whether the managing agents acted correctly in charging VAT on bills they have to for services delivered. For the leaseholder it is contended that the VAT should not be charged as there is an extra statutory concession

which exempts service charge payers from being charged VAT for such items. She seeks this determination for the service charge years ending 24 March 2012, 24 March 2013 and 24 March 2014.

9. The landlord's position is that they are required to pay the VAT element on all bills they receive from contractors who carry out works or deliver other services to the property.

The leaseholder's submissions

10. Mr Reiss made an opening set of submissions. He spoke to his statement of case dated 19 December 2014. According to Mr Reiss, the landlords and their managing agents, failed to take advantage of an extra statutory concession which exempts certain service charges from VAT. He added that he has consulted with the Mainstay Group who manage a block of flats similar in size to the subject property who told him that they use this concession and thereby avoid having to charge their leaseholders for VAT in paying contractors.

11. He referred the tribunal to a copy of a document issued by HM Revenue entitled 'VAT Notice 48: extra statutory concessions' on 21 March 2012. Paragraph 3.18 is the concession he says applies to service charges. It exempts from 1 April 1994 all mandatory service charges or similar charges paid by the occupants of residential property towards the upkeep of the dwellings or block of flats in which they reside and towards the provision of a warden, caretakers, and people performing a similar function for those occupants.

12. The landlords gave him access to their offices to carry out an inspection of documents relating to the service charges. This showed that the managing agents when they settle bills or accounts from their contractors pay the VAT element of the charges. In turn they include this when charging the leaseholder for service charges. He calculates that the leaseholder has been incorrectly charged for VAT for these years in the following sums: £56.77 for the year ending 24 March 2012; £111.29 for the year ending 24 March 2013 and £155.84 for the year ending 24 March 2014.

13. VAT should not have been paid for these items, he submits, as the managing agents failed to take advantage of the concession. This failure on the part of the managing agents, was in his view negligent. He considers that the reference in the Concession to the provision of a warden, caretakers and people performing similar functions for occupiers applies to the service charges made in this case.

14. He also told us that he has consulted a VAT expert who supports his opinion. However, he did not produce either a statement or a

report from this person. In addition he referred us to press release issued by Revenue and Customs dated 27 October commenting on a decision of the European Court of Justice in a case called *RLRE Tellmer* which he says supports his view. Also included in the bundle which he prepared is a document entitled *Business Brief 3/94* published in February 1994 which describes the scope of the Concession.

The landlord's submissions

15. Mr Johnson QC responded by submitting that the Concession does not apply to service charges generally and does not apply to the circumstances of this application. He elaborated on the written submissions made on behalf of the landlord and the managing agents dated 5 December 2014 and in his written submissions dated 20 January 2015. He interprets the leaseholder's application as a challenge to the reasonableness of the service charges made for these three years. The alleged unreasonableness was the failure to claim the benefit of of the concession which amounted to having unreasonably incurred VAT which should not have been included as part of the service charges.

16. He told us that the landlords resist this challenge principally because they do not accept that as a matter of law the Concession applies to residential service charges in general and that it is, in fact, a concession that has a much more limited remit.

17. As an alternative, he submits that the VAT was incurred in good faith with the result that if his primary argument is incorrect the VAT was reasonably incurred and is therefore recoverable as part of the service charge.

18. VAT, he reminded us, is a charge on the supply of goods and services made in the UK (or the Isle of Man) made by a person who is registered for VAT in the course of the business of the supplier and which is not specifically exempted by the legislation.

19. In general the letting of property is exempt from VAT with the result that no VAT is chargeable on the rent. (To complete this picture Mr Johnson QC told us that landlords may elect to waive the exemption for lettings of commercial property). Where a service charge is in the nature of a rent, VAT is not payable. If it is not in the nature of rent, it is chargeable.

20. In his view the Concession provides an exemption for all residential occupiers paying a service charge outside a landlord and tenant relationship such as a freeholder who pays charges for the

upkeep of communal areas on an estate. This interpretation is confirmed by a statement by the authors of *Service Charges and Management* in chapter 10 (entitled 'VAT and TAX').

21. Mr Johnson also submits that this position is supported by the briefing paper Mr Reiss cited in his submissions (and not the other way around as Mr Reiss suggested).

22. This led Mr Johnson QC to argue that the landlords cannot charge VAT on the service charge itself. As the grant of the lease of the applicant's flat is a supply of accommodation, the rent and the service charge itself are exempt from VAT. Mr Johnson added that the result would be different if the service charge was payable to a third party for providing services in which case VAT could be charged. If this situation arose the Concession would apply.

23. The service charge payable to the landlord is exempt from VAT but the costs incurred with third party contractors are not exempt from VAT. The landlord and the managing agents are entitled to pass on this on to the leaseholder as part of the costs of the services provided for which service charges are levied.

24. As the Concession does not, he submitted, apply to the VAT challenged by the applicant leaseholder, the VAT that is included in the service charges for each of the years in dispute was properly payable.

25. Each of the representatives addressed us on limitations of costs under section 20C of the Act. We deal with this below.

Reasons for our decision

26. As we told the parties and their representatives at the beginning of the hearing, we were unaware of the existence of the Concession until we read the papers for this case. If the leaseholder's challenge is well-founded it could potentially affect hundreds of thousands of blocks of residential flats. It would certainly affect other leaseholders of flats in the Water Gardens and other properties in the Hyde Park Estate owned by the landlords.

27. However, we have concluded that the leaseholder and her representative were mistaken in concluding that the landlord was negligent in not claiming the benefit of the Concession and that she should not have been charged the VAT incurred by Knight Frank in securing the provision of works and services.

28. Even though Mr Reiss told us that the Concession is used by the managers of the Mainstay Group, and that he has consulted with an expert who supports his position, he did not produce a statement or other evidence to confirm this.

29. On a first reading the Concession appears to apply to certain services such as warden services and the like. However, when viewed in the wider context it is clear to the tribunal that the concession relied on by Mr Reiss has a far more limited remit. It follows that the landlords and their managing agents could not use the concession to free certain charges from VAT.

30. We agree with the submissions made by counsel for the landlords.

31. Value added tax, commonly known as 'VAT', is chargeable under the Value Added Tax Act 1994. It applies to various transactions, including certain supplies of goods and services and it must be charged by a supplier who is registered for the tax.

32. Part II of the 1994 Act contains a number of cases which are exempt from VAT. These are defined in section 31 and schedule 10 of the 1994 Act. Supplies of accommodation is one such exemption. This is why the supply of accommodation is exempt from VAT. VAT is not chargeable on the actual service charge made by or on behalf of the landlord.

33. This brings us to the *VAT Notice 48: extra statutory concessions* which was published by HM Revenue on 21 March 2012. The table of contents shows that it includes a very wide range of concessions and many of them (including concession 3.18 'VAT: exemption for domestic service charges') state that their purpose is designed to remove inequities or anomalies in administration. Chapter 1 of the Concession explains the meaning of an extra-statutory concession by commenting that they are designed to make a concession 'when strict application of the law would create a disadvantage or the effect would not be the one intended' (1.2 at page 2 of the document).

34. In our judgement this means that concession 3.18 has a far more limited remit than the leaseholder claims. What disadvantage or unintended effect would be remedied by allowing a builder, for example, to carry out work on behalf of a landlord and not to charge VAT?

35. We agree with Mr Johnson QC that the scope of the concession is described well in Chapter 10 of *Service Charges and Management: Law and Practice* (3rd Edition published by Sweet & Maxwell, 2013)

where the authors of that chapter deal with services provided by someone other than a landlord. They give the example of mandatory service charges payable by the owner of a freehold for the upkeep of paths or gardens on a development. As there is no supply of accommodation in such a case, VAT would be chargeable on service charges made of a freehold owner but not on a leaseholder. By any standards this is an anomaly and it is one to which the Concession in 3.18 applies. Thus the freehold owner, in that example, cannot be charged VAT on the service charge. This position is also supported by the *Business Brief 3/94.*

36. As concession 3.18 has no application to charges made to leaseholders of residential property the managing agents on behalf of the landlords were entitled to pass on VAT incurred in paying for services or the costs of works to the premises.

37. In view of these conclusions we do not need to deal with the landlord's alternative argument, that is if their understanding of the scope of the Concession is wrong, that the challenged VAT was reasonably incurred as it was paid in good faith in the belief that it was due.

38. We determine that the leaseholder must pay the sums of £56.77 for the year ending 24 March 2012; £111.29 for the year ending 24 March 2013 and £155.84 for the year ending 24 March 2014. These are the sums included in the relevant service charge demands for VAT.

39. Finally, we address certain issues on the landlord's costs. Under section 20C of the Landlord and Tenant Act 1985 the tribunal may order that any costs incurred by the landlord in proceedings should not be included in a service charge. For the leaseholder it was submitted that such an order should be made. The landlord took the opposite view.

40. Under section 20C the tribunal must make an order that is 'just and equitable in the circumstances'. We do not consider that it would be just and equitable to make a section 20C order in the circumstances of this case. Although the leaseholder was perfectly entitled to make the challenge the landlord had no alternative but to resist it. The landlord was also successful in defending its position. It is also relevant that the issue affects all the leaseholders in the Water Gardens estate.

41. We have decided, therefore, that the landlord is entitled, in principle, to include their professional costs incurred in resisting the application as part of a service charge. As with any service charge this element must be reasonable.

41. Accordingly, no order is made under section 20C of the Landlord and Tenant Act 1985.

James Driscoll and Trevor Sennett
11 March 2015

Appendix of the relevant legislation

Landlord and Tenant Act 1985

Section 18

(1) In the following provisions of this Act "service charge" means an amount payable by a Tenant of a dwelling as part of or in addition to the rent -
(a) which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the Landlord's costs of management, and
(b) the whole or part of which varies or may vary according to the relevant costs.
(2) The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the Landlord, or a superior Landlord, in connection with the matters for which the service charge is payable.
(3) For this purpose -
(a) "costs" includes overheads, and
costs are relevant costs in relation to a service charge whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period.

Section 19

(1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period -
(a) only to the extent that they are reasonably incurred, and
(b) where they are incurred on the provisions of services or the carrying out of works, only if the services or works are of a reasonable standard;
and the amount payable shall be limited accordingly.
Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise.

Section 27A

(1) An application may be made to a Leasehold valuation tribunal for a determination whether a service charge is payable and, if it is, as to -
(a) the person by whom it is payable,

(b) the person to whom it is payable,
(c) the amount which is payable,
(d) the date at or by which it is payable, and
(e) the manner in which it is payable.
(2) Subsection (1) applies whether or not any payment has been made.
(3) An application may also be made to a Leasehold valuation tribunal for a determination whether, if costs were incurred for services, repairs, maintenance, improvements, insurance or management of any specified description, a service charge would be payable for the costs and, if it would, as to -
(a) the person by whom it would be payable,
(b) the person to whom it would be payable,
(c) the amount which would be payable,
(d) the date at or by which it would be payable, and
(e) the manner in which it would be payable.
(4) No application under subsection (1) or (3) may be made in respect of a matter which -
(a) has been agreed or admitted by the Tenant,
(b) has been, or is to be, referred to arbitration pursuant to a post-dispute arbitration agreement to which the Tenant is a party,
(c) has been the subject of determination by a court, or
(d) has been the subject of determination by an arbitral tribunal pursuant to a post-dispute arbitration agreement.
But the Tenant is not to be taken to have agreed or admitted any matter by reason only of having made any payment.

Section 20B

(1) If any of the relevant costs taken into account in determining the amount of any service charge were incurred more than 18 months before a demand for payment of the service charge is served on the tenant, then (subject to subsection (2)), the tenant shall not be liable to pay so much of the service charge as reflects the costs so incurred.
(2) Subsection (1) shall not apply if, within the period of 18 months beginning with the date when the relevant costs in question were incurred, the tenant was notified in writing that those costs had been incurred and that he would subsequently be required under the terms of his lease to contribute to them by the payment of a service charge.

Section 20C

(1) A tenant may make an application for an order that all or any of the costs incurred, or to be incurred, by the landlord in connection with proceedings before a court, residential property tribunal or leasehold valuation tribunal, or the Upper Tribunal, or in connection with arbitration proceedings, are not to be regarded as relevant costs to be taken into account in determining the amount of any service charge payable by the tenant or any other person or persons specified in the application.
(2) The application shall be made—

(a) in the case of court proceedings, to the court before which the proceedings are taking place or, if the application is made after the proceedings are concluded, to a county court;
(aa) in the case of proceedings before a residential property tribunal, to a leasehold valuation tribunal;
(b) in the case of proceedings before a leasehold valuation tribunal, to the tribunal before which the proceedings are taking place or, if the application is made after the proceedings are concluded, to any leasehold valuation tribunal;
(c) in the case of proceedings before the Upper Tribunal, to the tribunal;
(d) in the case of arbitration proceedings, to the arbitral tribunal or, if the application is made after the proceedings are concluded, to a county court.
The court or tribunal to which the application is made may make such order on the application as it considers just and equitable in the circumstances.