**UPPER TRIBUNAL (LANDS CHAMBER)**

**UT Neutral citation number: [2015] UKUT 0495(LC)**
**UTLC Case Number: LRX/48/2015**

**TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007**

***LANDLORD AND TENANT – service charges – whether VAT on services provided by managing agent to landlord recoverable as service charges – scope of VAT Notice 48: extra statutory concession para 3.18 – concession only applies to mandatory service charges and does not extent to services supplied to a landlord by third parties***

**IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE FIRST-TIER TRIBUNAL PROPERTY CHAMBER (RESIDENTIAL PROPERTY)**

**BETWEEN:**

**MRS JANINE INGRAM** **Appellant**

**and**

**CHURCH COMMISSIONERS FOR ENGLAND** **Respondent**

**Re: 20 The Water Gardens,**
**Burwood Place,**
**London**
**W2 2DA**

**Before Her Honour Judge Alice Robinson**

**Sitting at: Royal Courts of Justice, Strand, London WC2A 2LL**
**on**
**8 September 2015**

Mr Martin Reiss for the Appellant
*Edwin Johnson QC* instructed by Charles Russell Speechlys for the Respondent

The following cases are referred to in this decision:

*R v Her Majesty's Commissioners of Inland Revenue, ex parte Wilkinson* [2005] UKHL 30
*Conway and others v Jam Factory Freehold Limited* [2013] UKUT 0592 (LC)

## DECISION

### Introduction

1. This is an appeal against a decision of the First-tier Tribunal Property Chamber (Residential Property) ("F-tT") dated 11 March 2015 in which it determined that certain VAT charges were recoverable as service charges.

2. The appellant and applicant before the F-tT is the lessee of a flat known as 20, The Water Gardens, Burnwood Place, London W2 2DA ("the Flat") pursuant to a long lease dated 21 February 1996 ("the Lease") whereby the Flat was demised for a term of 75 years from 25 March 1965. The respondents are the freehold owners of the buildings known as The Water Gardens which include the Flat.

3. By an application dated 11 November 2014 pursuant to s.27A of the Landlord and Tenant Act 1985 ("the 1985 Act") the appellant challenged the inclusion within service charge demands of certain items of VAT in the three service charge years 2011/12, 2012/13 and 2013/14. In its decision dated 11 March 2015 the F-tT rejected that challenge and held that the relevant items were recoverable.

4. Permission to appeal was granted on 23 June 2015 by the Tribunal (Martin Rodger QC, Deputy President). The decision states:

> "The VAT treatment of service charges is not straightforward and is not well understood. Uncertainty in this area is highly undesirable and it is appropriate for permission to appeal to be granted to enable the applicant's contentions on the effect of the Extra Statutory Concession to be considered."

5. The issue which arises in this appeal is whether the relevant items of VAT included in the service charges fall within an extra statutory concession set out in VAT Notice 48 paragraph 3.18 and therefore should not have been included in the service charges.

### Factual background

6. The services which the respondents must provide and the charges which the appellant must pay for them are set out in the Third Schedule of the Lease. This contains the lessor's covenants including obligations to maintain, repair, clean and also to

> "employ such number of porters and staff as the Lessors shall from time to time think reasonable in and about the performance of the relevant covenants by the Lessors… and the Lessors may pay to Porters and staff in addition to wages such allowances in respect of

uniform rent food and maintenance as the Lessors shall from time to time determine And generally the Lessors may employ and pay such contractors agents or servants (including the Agent) and may incur such costs as they shall think necessary or desirable in and about the performance of the covenants and provisions of this Schedule" (paragraph 7).

7. Provision for payment of service charges is made in paragraphs 11 to 13 of the Third Schedule. Paragraph 11 begins with the words:

> "To the intent (a) that the Lessors shall be fully and effectually indemnified in respect of the cost to the Lessors of the performance of the covenants and provisions of this Schedule the Lessees shall pay by way of additional rent to the Lessors…"

Paragraph 12(2) provides that the appellant must pay a .684% share of the costs.

8. The respondents seek to discharge their obligations in the Third Schedule by the employment of Knight Frank LLP ("KF") as managing agent under block management agreements for The Water Gardens. The latest such agreement is dated 6 January 2014 and covers the period 30 December 2013 to 28 December 2014 but I was informed that similar previous agreements covered earlier periods. The agreement provides for payment by the respondents of a fee which is set out in Schedule 1 Part 2. First, this provides for a flat fee of £130,369.63. Second it provides for "Fees for the Services described in 2.3 of Schedule 2" namely "15% of the total salaries for all site staff employed" (or a relevant proportion of the salary as relates to The Water Gardens). The services described in paragraph 2.3 of Schedule 2 are, in effect, human resources (HR) services as would normally be provided by an HR department "for all site staff employed for the Block (including where appropriate management personnel, cleaning and security services)". The end of Schedule 1 Part 2 and clause 7.2 of the agreement make clear that the fees are exclusive of VAT which is payable on top. In addition, the fees do not include disbursements.

9. There is no dispute that the service charges for the 3 years in question include sums described as "HR fee" and "salaries" paid to KF which include VAT. The 2013/2014 year service charge also includes "salaries" paid to 'Promise', a subsidiary company of KF. All the sums claimed as "HR fee" and "salaries" are supported by invoices from KF or 'Promise' to the respondents. The invoices relating to "HR fees" are squarely in the nature of a fee; the invoices refer to "HR Management fee for [date] based on [x] % of salary costs as detailed on the attached sheet." The invoices relating to "salaries" appear to involve simply passing on the salary costs. All the invoices charge VAT on the "HR fees" and "salaries".

10. The appellant does not dispute that the "HR fee" and "salaries" charges are properly recoverable as service charges pursuant to the Lease. Her complaint is that, as a matter of law, VAT need not have been paid by the respondents to KF or 'Promise' on such fees and salaries so the VAT element of them was unreasonably incurred for the purposes of s.19 of the 1985 Act and should not be passed on to the lessees.

**Value Added Tax ("VAT")**

11. VAT is a charge on the supply of goods and services. As a general rule VAT must be charged where the following four conditions are satisfied, see the Value Added Tax Act 1994 ("the 1994 Act") and in particular s.4:

(1) A supply of goods or services is made within the UK for a consideration.

(2) The supply is made by a person who is, or should be, registered for VAT.

(3) The supply is made in the course of or in furtherance of a business of the supplier.

(4) The supply of the relevant goods or services does not fall into any exempt category for VAT purposes.

12. The letting of property constitutes the supply of land for VAT purposes. However, subject to exceptions, the letting of property is exempt from VAT so that no VAT is chargeable on rent, see s.31 and Group 1 of the exemptions in Part II of Schedule 9 to the 1994 Act. A landlord may elect to waive the exemption from VAT in respect of commercial property, see Schedule 10 to the 1994 Act. Where such an election is made, VAT is chargeable on the rent. Such an election is not however available in respect of residential land, see paragraph 5 of Schedule 10. In that case, VAT is not chargeable on the rent.

13. The question of whether VAT is chargeable on service charges depends upon whether the service charge is in the nature of rent and thus indivisible from the supply of accommodation. This does not depend upon whether the service charge is reserved as rent under the relevant lease but on whether the service charge is a charge directly related to the tenant's right of occupation, see *Service Charges and Management: Law and Practice* by Tanfield Chambers, 3rd ed paragraphs 10-012 to 10-014. Thus if a service charge payable in respect of residential property is in the nature of rent then, just as the rent is exempt from VAT, so is the service charge.

14. The VAT treatment of service charges is therefore dependent upon the charge being made by the lessor as part of the consideration for the supply of the accommodation. However, there may be cases where a service charge is payable in respect of residential accommodation but not to the person who has supplied the accommodation. For example, a freeholder may be liable to pay a service charge in respect of maintenance of common areas on an estate. In such a case it cannot be said that the service charge is part of the consideration for the supply of accommodation and thus the exemption from VAT provided by the 1994 Act does not apply.

15. However, in such a case, VAT is not payable on the service charge by virtue of an extra statutory concession. Details of this (and other extra statutory concessions) are given in VAT Notice 48. The introduction states:

"**1.2 What is an extra statutory concession?**

In certain circumstances where remission or payment of revenue is not provided for by law, the department may allow relief on an extra-statutory basis. ESCs are remissions of revenue that allow relief in specific sets of circumstances to all businesses falling within the relevant conditions. They are authorised when strict application of the law would create a disadvantage or the effect would not be the one intended.

**1.3 How are ESCs applied?**

HMRC ESCs are of general application. That is, a concession may be exercised by anyone to whom the circumstances set out in the concessions apply without reference to HMRC…"

16. Paragraph 3.18 of Notice 48 states as follows:

"**3.18: exemption for all domestic service charges**

The concession 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. The concession does not exempt service charges paid in respect of holiday accommodation as defined in paragraph 1(e) of and Notes 11 13 to Group 1, Schedule 9, VAT Act 1994 (formerly paragraph 1(d) of and Notes (10) (10A) and (10B) to Group 1, Schedule 6, VAT Act 1983)." ("the Concession")

17. The Concession was referred to in an HMRC press briefing Business Brief 3/94 shortly before its introduction in the following terms:

"Previously service charges paid by freehold owners of domestic property, and by anyone for services which are not supplied by or under the direction of the lessor or ground landlord, have been taxable. This was because they could not be consideration for any supply of land.

This has led to an anomaly for the occupants of residential property, since the liability of the service charges they pay towards the upkeep of the common areas does not depend on the services provided, but instead on the tenure of their residence and on the status of the supplier.

The new concession means that the liability of the service charge will no longer depend upon the tenure of the residence or on the status of the supplier. What will be important is whether each resident is obliged to accept the service because it is supplied to the estate of buildings or blocks of flats as a whole.

Optional services supplied personally to a resident, such as carpet cleaning and shopping continue to be taxed in their own right."

18. Guidance on the Concession is given in VAT Notice 742: land and property, section 12, published on 29 May 2012. Paragraph 12.1 refers to the basic position already described, that service

charges payable by a tenant to a landlord are exempt from VAT being treated as ancillary to the main supply of exempt domestic accommodation. Section 12 continues:

"**12.2 What if I provide services to freehold owners of dwellings?**

If you provide services to freehold owners of dwellings your supply is taxable because there is no supply of domestic accommodation to link those services to. However, this is unfair to freehold owners, especially those living on the same estate as leaseholders. To address this inequity an extra-statutory concession allows all mandatory service charges paid by occupants of dwellings towards the:

(a) upkeep of the common areas of a housing estate, such as paths, driveways and communal gardens; or

(b) upkeep of the common areas of a block of flats, such as lift maintenance, corridors, stairwells and general lounges; and

(c) general maintenance of the exterior of the block of flats or individual dwellings, such as painting, and

(d) the provision of an estate warden, house manager or caretaker

to be treated as exempt from VAT.

**12.3 What if the landlord supplies additional services to occupants?**

If the landlord makes a separate charge for un-metered supplies of gas and electricity used by occupants, it should be treated as further payment for the main supply of exempt domestic accommodation. However, if the landlord operates a secondary credit meter, the charges to the occupants for the gas and electricity they use are separate supplies of fuel and power subject to VAT at the reduced rate.

Optional services supplied personally to occupants, such as shopping, carpet cleaning or painting a private flat, are standard-rated.

The charge made by the landlord to the occupants for managing the estate and collecting the service charges is further payment for the main supply of exempt domestic accommodation.

**12.4 What if a managing agent provides services to occupants on behalf of a landlord?**

A managing agent acting on behalf of a landlord can treat the mandatory service charges to occupants as exempt, providing the agent invoices and collects the service charges directly from the occupants.

However, any management fee collected from the occupants is standard-rated because it relates to the managing agent's supply to the landlord."

**The First-tier Tribunal decision**

19. The appellant's case before the F-tT was that the Concession applies and KF as managing agent should have taken advantage of it. Not to have done so was negligent. The Concession exempts all mandatory service charges paid by the occupiers of residential property towards the upkeep of the flats and buildings and towards the provision of a warden, caretakers and people performing a similar function for the occupants. The reference in the Concession to the provision of a warden etc applies to the service charges made in this case which relate to salaries paid to porters and the like.

20. The respondents' case before the F-tT was that the Concession exempts residential occupiers from paying a service charge outside a landlord and tenant relationship. It does not exempt from VAT costs incurred by the respondents to third party contractors. Where such costs are incurred, the respondents are liable to pay VAT on them to the third party contractors. The respondents and managing agents are entitled to pass this on to the lessees as part of the cost of the services provided for which the service charges are levied.

21. After summarising the VAT position generally, the F-tT said this:

> "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 that 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 rather 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."

**Submissions on the appeal**

22. Mr Reiss, who appeared on behalf of the appellant, submitted that the salaries on which VAT had been charged related to porterage and that these and charges for HR fall within the category of "the provision of a warden, caretakers and people performing a similar function" set out in the Concession. Whatever the purpose of the Concession, such charges fall within the clear wording of it. The F-tT had wrongly focussed on assumptions about the purpose of the Concession rather than looking at the actual wording.

23. However, insofar as the Concession's purpose was to avoid a disadvantage as referred to in paragraph 1.2 of VAT Notice 48, the appellant was disadvantaged. Whereas before porters had been employed directly by the respondents, now they were employed by KF which had resulted in the service charge being increased by the 20% rate of VAT on those salaries. Those services were no longer in the nature of rent because the supplier of them (KF) was not the lessor and the whole point of the Concession was to enable the exemption for residential service charges to apply notwithstanding the managing agent's lack of tenure. Accordingly the exemption from VAT for residential service charges should have been claimed as allowed for by the Concession.

24. He supported his submission by reference to email correspondence from HMRC received in response to requests for advice. Although these were not before the F-tT Mr Johnson, counsel for the respondents, did not object to them being referred to as he said that in fact they supported the respondents case. In his request Mr Reiss stated:

> "My lease requires that my landlord provides caretakers. These caretakers have previously been employed by my landlord but are now being provided by managing agents. The managing agents are currently charging VAT when billing the landlord for the caretakers which is then passed on to the tenants in the service charge accounts. My query is that, on the basis that the provision of caretakers is a mandatory service charge, whether the provision of caretakers is exempt from VAT provided the managing agents collects the charge directly from the tenants including myself and no longer from the landlord?"

The response refers to paragraph 12.4 of VAT Notice 742 and then states:

> "This guidance relates to dwellings, therefore if the managing agent were to collect the service charge relating to the caretaker directly from the tenants this could be treated as an exempt supply."

25. Mr Reiss sought further clarification from HMRC:

> "I should be grateful if you would confirm that… [the Concession] does not depend upon the tenure of the occupant and does not depend on the status of the supplier thereby including the circumstances set out in VAT Notice 742 section 12.4…"

The response quotes the Concession and then states:

> "If these charges are collected by a third party then according to the concession, stated above, they can be treated as exempt. However, any charge to the landlord by a third party for their collection/management services would be standard-rated."

26. Mr Reiss also relied upon an email from another firm of managing agents to the effect that the cost of wages paid by them are charged at cost to the service charge with no VAT. However, this was not before the F-tT either and he had no further information about the relationship between the managing agent, landlord or tenants in that case.

27. Mr Reiss submitted that the HMRC responses clearly meant that if KF invoiced the lessees directly for the cost of caretakers and the like, the charges would be exempt from VAT. It was unreasonable of the respondents not to require this which means that the VAT charges were not reasonably incurred for the purposes of s.19 of the 1985 Act. Indeed there were provisions in the block management agreement between the respondents and KF which obliged KF to use best practice which would include claiming the benefit of the Concession, see paragraph 5.2.

28. The same would be true for other services which the lessees are required to pay service charges for such as cleaning and building repairs. If contractors undertaking such work invoiced the lessees directly VAT would not be payable on those services by virtue of the Concession. In those cases it would be unreasonable to require such contractors to bill lessees individually owing to the number of them and differing percentages payable for service charges. However, that did not apply to the managing agent who was billing the lessees for service charges in any event.

29. This approach is consistent with paragraph 12.4 of VAT Notice 742 which says that provided the managing agent invoices the occupants directly the charges are exempt. Although paragraph 12.4 also states that a management fee is standard rated Mr Reiss drew a distinction between the flat rate management fee and the fee which charges a percentage of salaries. The former is a fee for managing the property which the respondents would otherwise be responsible for and was therefore providing a service and benefit to them. The latter involved providing and managing staff which was "people performing a similar function" for the purposes of the Concession. It is a service for the benefit of the lessees for which the lessees could and should be directly charged and to which the Concession applies.

30. For the respondents Mr Johnson submitted that the Concession applies to mandatory service charges paid by occupants of residential property to persons who were not also supplying accommodation. It is not relevant to service charges payable by the appellant because they are in the nature of rent, being directly related to occupation of property and owed to the respondents who also supply the accommodation. The service charges therefore automatically fall within the exemption from VAT that applies to the supply of land. Thus VAT is not payable on the service charges themselves.

31. The purpose of the Concession is to secure that benefit for those who are also liable to pay service charges in respect of the occupation of residential property but where the liability is owed to someone who is not also supplying the accommodation such as an estate owner or residents management company. The Concession therefore remedies an unfairness that would otherwise exist under normal VAT rules. In support of this submission he relied upon the passage in the Tanfield Chambers book on Service Charges and Management, paragraph 10-015.

32. He also submitted that this construction is consistent with the other HMRC material produced on behalf of the appellant which indicates that the purpose of the Concession is to remove the link between the tenure of the occupier's residence and the status of the supplier of the services. The Concession does not enable a third party supplier of services to a lessor to claim the benefit of the exemption.

33. Mr Johnson further submitted that the HMRC material also makes clear that any optional services will be subject to VAT. Any services provided by KF would be optional because there is no contractual relationship between the appellant and KF. As such KF is under no legal obligation owed to the appellant (as opposed to the respondents) to provide any services nor is the appellant under any legal obligation owed to KF (as opposed to the respondents) to reimburse KF for the provision of any services.

**Decision**

34. In my judgment the starting point must be the wording of the Concession itself. What are exempt are "all mandatory service charges or similar charges" paid by residential occupiers "towards… [the upkeep of buildings] and towards the provision of a warden, caretakers and people performing a similar function for those occupants".

35. For present purposes only I am prepared to assume that all of the disputed charges, i.e. VAT on the "HR fee" and "salaries", relate to the provision of a warden, caretakers and people performing a similar function and thus satisfy the last part of the Concession. However, none of the charges are mandatory service charges paid by the appellant as required by the first part of the Concession. The mandatory service charges paid by the appellant are those invoiced to her by KF on behalf of the respondents. As Mr Johnson stated, the Concession is irrelevant to these because they are charges in the nature of rent owed to the supplier of the accommodation and are exempt from VAT in any event. The disputed charges are sums paid by the respondents to KF or Promise for the provision of services supplied by KF or Promise to the respondents i.e. sums paid by the lessor to a third party for the provision of services by the third party to the lessor.

36. The position is exactly the same as with any other services supplied to the respondents to enable them to fulfil their obligations in the Third Schedule of the Lease such as the provision of cleaning or maintenance of buildings. The fact that charges for those services are passed on to the lessee as service charges does not convert sums paid by the lessor to third parties into mandatory service charges paid by the lessees. If the appellant's approach to the Concession is correct, any supplier of services to a lessor the cost of which is passed on to residential lessees as service charges would be entitled to the benefit of the Concession. This could exempt large numbers of suppliers of services from paying VAT.

37. The exemption of such suppliers of services who would ordinarily pay VAT from an obligation to do so when the charges will be passed on as service charges is unlikely to have been intended. The function of extra statutory concessions is described by Lord Hoffman in *R v Her Majesty's Commissioners of Inland Revenue, ex parte Wilkinson* [2005] UKHL 30, paragraphs 20 and 21,

passages with which the other Law Lords agreed. The power to make them arises under s.1 of the Taxes Management Act 1970 which gives "a wide managerial discretion" as to the best means of collecting taxes levied by the exchequer. Specifically, the power enables the commissioners "to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of Parliamentary time." Any extra statutory concessions which go beyond that would be unlawful.

38. In my judgment the formulation of a policy that exempted large numbers of suppliers of services who normally pay VAT from an obligation to do so when the charges are passed on to residential occupiers as service charges could not reasonably be described as dealing with a minor gap or anomaly or a hardship at the margins. It would also arguably create more injustice than it would remedy. Why should a residential occupier who pays for building maintenance through service charges be in a better position than a residential occupier who has to pay for such work directly? Further, such a policy would also be impractical. Third parties would not necessarily know whether the cost of services supplied would be passed on to residential occupiers as service charges.

39. On the other hand, the approach of the House of Lords in *Wilkinson* supports the view that the Concession is designed to deal with the anomaly that residential occupiers who have to pay a service charge to someone who does not supply their accommodation must pay VAT on the service charge itself as held by the F-tT. This is also consistent with the press briefing 3/94 announcing the Concession and paragraph 12.12 of VAT Notice 742. However, all residential occupiers who pay a service charge must reimburse, through the service charge, any VAT paid by the person levying the service charge to the supplier of the services which go to make up the service charge. This is also made clear by the second sentence of paragraph 12.4 of VAT Notice 742 which refers to the management fee payable by a landlord to a managing agent being standard-rated. In my view there are no grounds for drawing a distinction in principle between services supplied to a landlord by, say, a builder or cleaning contractor, and services supplied by a managing agent, whether they comprise the provision of porters or of management services for a fee.

40. In his oral submissions Mr Reiss appeared to accept that VAT had to be paid by the respondents to the third party supplier of services because he said that in order to gain the benefit of the Concession the supplier of the services had to invoice the residential occupier directly. His case is that managing agents could easily invoice the lessees directly for cost of porters and other staff and that if they did, the Concession would apply as advised by HMRC's emails and paragraph 12.4 of VAT Notice 742.

41. In my judgment the submissions of Mr Johnson are a complete answer to this argument. The Concession only applies to service charges which are mandatory. Any charges made by a third party to a lessee in these circumstances would not be mandatory because there is no contractual relationship between the lessee and the third party supplier. The lessee would be under no legal obligation to pay the third party supplier, only the lessor. The supply of such services, as between residential occupier and supplier, would be entirely optional as would payment for them by the occupier.

42. In my view the appellant and Mr Reiss have been misled by the first sentence of paragraph 12.4 of VAT Notice 742 and the emails from HMRC which are unclear. Paragraph 12.4 states:

> "A managing agent acting on behalf of a landlord can treat the mandatory service charges to occupants as exempt, providing the agent invoices and collects the service charges directly from the occupants."

As Mr Johnson pointed out, a managing agent who invoices an occupant on behalf of the landlord does not need to rely upon the Concession. He is acting as the landlord's agent when making the service charge demand which, being in the nature of rent, is exempt from VAT. He submitted that this sentence in paragraph 12.4 must refer to a situation where the managing agent has a right to invoice and collect the rent direct from the occupant. In my view, this could be the case if, e.g., the managing agent is in fact a management company with the right to collect service charges in its own right. However, that is not consistent with the words "acting on behalf of a landlord" which appear to indicate that the managing agent is acting as agent not in its own right.

43. A similar error appears in the HMRC emails both of which refer to charges being collected directly by a managing agent or third party being exempt. This would only be the case if the managing agent or third party was either acting as the landlord's agent (in which case the Concession is unnecessary) or is entitled as a matter or law to demand the service charge in its own right. Such misleading advice is disappointing given Mr Reiss's careful explanation of the position in his queries to HMRC.

44. To summarise:

(1) Mandatory service charges paid by a residential occupier to the landlord which are in the nature of rent, being directly related to the tenant's right of occupation, are exempt from VAT by virtue of s.31 and Schedule 9, Part II Group 1 of the 1994 Act and it is not necessary to rely on the Concession.

(2) Mandatory service charges paid by a residential occupier which are not in the nature of rent because they are owed to a person who does not supply any accommodation fall within the Concession and are therefore exempt from VAT provided they are paid "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" but not otherwise.

(3) The Concession does not apply to optional services supplied by a landlord, managing agent or anyone else to a residential occupier.

(4) The Concession does not apply to any charges paid by the landlord (or other person levying the service charge) to third parties for the supply of services even though the cost of those services is passed on to a residential occupier through a service charge.

45. The effect of this is that where a lessor employs staff directly and passes the cost on to the lessees through the service charge, no VAT is payable on those salaries. On the other hand, where the same staff are employed by a managing agent who invoices the lessor for those services, VAT is payable on the salaries which is passed on to the lessees through the service charge. Given that the standard rate of VAT is 20%, this could give rise to significantly increased service charges. That may potentially give rise to an argument as to the reasonableness of properties being managed in this way and that the VAT thus passed on via the service charge is not reasonably incurred for the purposes of s.19 of the 1985 Act. However, the appellant has not sought to raise such an argument in this case, to do so would require evidence and depend very much on the facts of the particular case. Thus it would be wrong of me to express any view about it.

46. For all these reasons the respondents are entitled to claim the disputed items of VAT as service charges and the appeal is dismissed.

47. This decision is final on all issues other than the costs of the reference including whether an order should be made under s.20C of the 1985 Act. A letter inviting submissions on costs accompanies the decision. Before making any submissions on costs the parties should carefully consider rule 10 of The Tribunal Procedure (Upper Tribunal)(Lands Chamber) Rules 2010 as amended by The Tribunal Procedure (Amendment No. 3) Rules 2013.

Dated: 15 September 2015

Her Honour Judge Robinson

**ADDENDUM ON COSTS**

48. In submissions dated 22nd September 2015 the successful respondents make no application for costs in respect of this appeal. They also submit that it would not be appropriate for the Tribunal to make any order under s.20C of the 1985 Act in respect of the costs of the appeal.

49. In Submissions dated 29th September the appellant makes an application for an order under s.20C that "the costs incurred by the Respondent in connection with the proceedings are not to be regarded as relevant costs" for the purpose of determining the amount of service charges. The grounds of that application are twofold. First, the respondent had succeeded on an argument not raised until the hearing on 8 September and, if it had been raised earlier, the

appellant might not have pursued the appeal. Second, that there has been a lack of transparency concerning the transfer of employment of porters form the respondent to KF.

50. In a response dated 6 October the respondent submits (1) that the appellant does not have leave to appeal against the F-tT's decision not to make an order under s.20C, (2) that the argument on which the respondent succeeded was made in response to a point raised by the appellant for the first time at the Tribunal hearing and (3) the complaints about lack of transparency are irrelevant to the issue of whether or not to make an order under s.20C.

51. It is not immediately clear from the appellant's submissions whether "the proceedings" in respect of which the s.20C application is made includes all of the proceedings including those before the F-tT or only the appeal to the Tribunal. Insofar as it is intended to include the proceedings before the F-tT then in my judgment the appellant is not entitled to make the application because it involves an appeal against the decision of the F-tT for which no leave has been granted.

52. The order dated 23 June 2015 granting permission to appeal states that

> "2. The application under section 20C, Landlord and Tenant Act 1985 was rightly dismissed by the First-tier Tribunal (FTT) in view of its decision. Permission to appeal that issue is conditional on the Tribunal reaching a different conclusion from the FTT on the effect of the Extra Statutory Concession."

The Tribunal has reached the same decision as the F-tT on the effect of the extra statutory concession and accordingly the appellant has no leave to challenge the F-tT's decision on whether an order under s.20C should be made in respect of the costs of the F-tT proceedings.

53. Turning to whether an order should be made in respect of the costs of the appeal, the authorities relating to the exercise of the discretion under s.20C were comprehensively reviewed by the Tribunal (Martin Rodger QC, Deputy President) in *Conway and others v Jam Factory Freehold Limited* [2013] UKUT 0592 (LC). The power should be exercised so as to achieve justice and equity, giving proper weight to the outcome of the substantive dispute.

54. The starting point is that the respondents have wholly succeeded in the appeal. As to the submission that success was based on a new argument, I agree with the respondents that they were responding to an argument put forward on behalf of the appellant for the first time at the appeal hearing. The appellant's Skeleton Argument argued that the respondents should have claimed the benefit of the extra statutory concession, not that KF should have invoiced the lessees directly so the lessees could claim it, see e.g. paragraph 2.7 of the Skeleton Argument. The argument for the appellant made orally at the hearing is recorded in paragraph 40 of my decision and the response, which I accepted, in paragraph 41. This submission provides no support for making an order under s.20C.

55. As to the submission based on lack of transparency, whatever the position prior to the appeal, by the time of the appeal the appellant was fully aware that the employment of porters had been transferred from the respondents to KF and of the effect that had had on the service charges. The F-tT had clearly rejected the appellant's argument that the service charges should not include VAT on porterage services supplied to the respondent by KF. Insofar as there was any previous lack of transparency, that can have played no part in the appellant's decision to appeal to the Tribunal. Nor in my judgment would it form any fair basis on which to deprive the respondent of the right to recover the costs of the successful appeal through the service charges.

56. For all these reasons the application for an order under s.20C is rejected.

Dated: 22 December 2015

Her Honour Judge Robinson