VAT update – 21 October 2015

In this month's edition of the VAT update we look at:

1. Bedale Golf Club PE recovery for clubhouse refurbishment
2. Vouchers and sales promotion schemes appeal on 5 to 7 October
3. Temporary rental of rooms by a charity was a taxable business purpose
4. VAT on services provided by managing agent to landlord recoverable as service charges

1. Bedale Golf Club only get PE recovery for clubhouse refurbishment

I find it easy to see two sides to the argument which led to an appeal before the First-tier tribunal (FTT). The issue argued for the Bedale Golf Club, a small golf club in North Yorkshire with over 400 members, was that the input tax on a refurbishment and repair of the clubhouse should be fully recoverable because the items involved including chairs, curtains and maintenance work on a lift was in the area of the lounge bar which made taxable supplies.

HMRC's contention was that the clubhouse was linked to the club membership which meant that the input tax was residual and only the partial exempt (PE) fraction could be recovered. In other words the exempt supply of golf club membership was inextricably linked to food and drink consumption and therefore input tax could only be recovered according to the club's residual input tax recovery method.

The VAT at issue was the difference between full input tax recovery and the PE recovery fraction, and amounted to £567 for the period 09/13. This amount may seem small but the underlying principle could be significant for many golf clubs.

The FTT agreed with HMRC's analysis, stating at paragraph 50(7) that 'from an economic perspective, the exempt and taxable supplies are closely interconnected and are intended to feed off each other' and that 'use of the clubhouse by the members is an intrinsic part of their membership and is inseparable from the exempt supplies of sporting services.' It therefore found that the costs involved were not incurred exclusively for making taxable supplies

If you have any clients who are golf clubs and partially exempt, you should read the **decision.**

2. Vouchers and sales promotion schemes

In last month's VAT update I reported on the FTT decision of Associated Newspapers (AN) in which the appeal had been settled in favour of the appellant. This meant that AN could reclaim input VAT on vouchers given away in its sales promotion schemes. The case followed the earlier (2014) First-tier Tribunal decision that no output tax was due on vouchers given away by AN in its sales promotion schemes.

HMRC have appealed both decisions and both appeals are now scheduled to be heard together on 5-7 October 2015 at the Upper tribunal (UT). The decision of the UT could have important implications for the VAT treatment of vouchers used in sales promotion schemes so I recommend that advisers should be alert for the decision when it emerges.

3. Temporary rental of rooms by a charity is a taxable business purpose

Advisors of charities should take note of the decision in **The Trustees of the Institute for Orthodox Christian Studies, Cambridge v Revenue & Customs [2015] UKFTT 449.** The buyer had declared that its intended usage of the building would be for a relevant charitable purpose with the result that the vendor which had opted to tax the building did not charge VAT on the sale of the property.

HMRC contended that the requirements of Schedule 10 paragraph (7) (1), which if satisfied would allow the disapplication of the option to tax for supplies where a property is to be used solely for non-business purposes, had not been met. The appellant is a charity whose aim is to further religious education and knowledge of the doctrines, history and culture of the Orthodox Church. It provides higher education principally for Christian clergy and laity from Orthodox Churches in Eastern Europe, the Middle East, Russia and Greece. Its functions also include meeting the needs of developing Orthodox parishes in the United Kingdom.

The Property, 25/27 High Street, is a three-storey building consisting of sixteen rooms of various sizes. It was available to purchase and considered adequate for the Institute's needs, having potential for teaching rooms, library accommodation, student study areas, storage for a large collection of books, possibilities for library expansion, for further lecture and seminar rooms, and (with planning permission) an opportunity to develop limited accommodation for students and visiting scholars on the top floor.

The seller took professional advice, which confirmed that provided the Property was to be used for 'relevant charitable purposes' and the trustees gave a declaration to that effect, VAT need not be charged. The Appellant contacted HMRC's Bootle office, which advises charities, and was referred to Public Notices 742 and 701/1 and received similar confirmatory advice. Reverend Deacon Dragos Herescu, Secretary of the Institute says in his witness statement that he was told that if the building was to be used for charitable purposes and if the office space amounted to not more than 5% of the property, VAT was not chargeable on the transaction.

Using a mixture of loans and funds from legacy donations, it paid £800,000 for the building after declaring the building would be used for a relevant charitable purpose. That figure therefore did not include VAT. Cash flow was a problem therefore the charity buyer proposed that for a temporary period those tenants who occupied the building and who wished to remain would be offered new short-term tenancies subject to a landlord option to break after three months. The purpose was to raise monies to offset ongoing overheads until such time as the conversion works started, rather than allow rooms to remain idle and unoccupied.

This temporary letting was, argued HMRC, a business purpose and made the declaration given by the buyer to the vendor invalid. HMRC raised an assessment for £133,333.33 output tax due on the sale based on the 'deemed VAT inclusive' consideration received by the seller of £800,000.00.

The tribunal decided that the renting out of rooms in the Property which generated income of £28,128 amounted to business use. The fees from teaching which were around £70,000 annually cannot be regarded as anything other than consideration for the teaching and other supplies it makes. The FTT accept that the fees are at a lower level than they may have been had the Institute been seeking to profit, but in terms of its annual income they represent a significant amount. Further, the predominant purpose of its activity, which was charitable, is not a determining factor. The requirements of VATA 1994 Schedule 10 paragraph 7 (1) would not be satisfied and VAT should have been charged and accounted for by the seller, but the buyer had indemnified the seller for any VAT which became payable.

4. VAT on services provided by managing agent to landlord recoverable as service charges

In **Ingram v Church Commissioners for England [2015] UKUT 495**, the tenant objected to paying VAT on service charges supplied by a managing agent. She lost at the FTT and this appeal was to the Upper Tribunal (UT).

The services which the landlord respondents must provide and the charges which the appellant must pay for are set out in the Third Schedule of the 75 year 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. 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).
The landlord had subcontracted the management services to a property agent, Knight Frank LLP ("KF") as managing agent. The agents charged VAT but the tenant argued that an extra statutory concession applied and that 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.

I was surprised that the FTT and now the UT even considered this appeal. Experienced practitioners know that there is no effective right of appeal when HMRC refuse to grant a concession. The only

route is by way of judicial review and for that the legal hurdle of the decision being wholly unreasonable is too high for there to be an effective right. From the outset, I should have thought it was clear that the appeal was doomed to fail.

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.

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.

The judge added: "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."

Derek Allen
16 October 2015

The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.

This podcast concentrated on VAT. There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 31 October 2015.