FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	**:**	**LON/00AY/LSC/2019/0338** **LON/00BJ/LSC/2019/0330**
Property	**:**	**Various Properties at St George Wharf and Battersea Reach London SW18**
Applicants	**:**	**Alan Fairleigh (1)** **Mr D and Mrs E Kerin (2)** **Various Lessees of Battersea Reach and St George Wharf (3)**
Representative	**:**	**Phillip Sissons (counsel)** **Daniel Black (counsel)** **Etienne Wong (counsel)**
Respondents	**:**	**St George South London Ltd (1)** **St George Battersea Reach Ltd (2)** **Berkeley Sixty Ltd (3)** **Berkeley Sixty-One Ltd (4)** **Berkeley Seventy-Six Ltd (5)** **Berkeley Seventy- Seven Ltd (6)** **Battersea Reach Estate Company Ltd (7)** **Fairhold Athena Ltd (8)** **Fairhold Holdings (2005) Ltd (9)** **Pennine Trustees Ltd (10)** **Notting Hill Home Ownership Ltd (11)** **Notting Hill Genesis (12)** **Wandle Housing Association (13)** **The Peabody Trust (14)**
Representative	**:**	**Philip Rainey KC (1-7)** **Carl Fain (1-7) (counsel)** **Michael Lee (1-7) (counsel)** **Nicola Shaw KC (1-7)** **Sam Brodsky (1-7) (counsel)** **Simon Allison (counsel) (8)** **Justin Bates (counsel) (9)** **Michael Thomas KC (8-9)** **Forsters LLP (1 – 7)** **Womble Bond Dickinson (8)** **Winckworth Sherwood LLP (9)**
Type of Application	**:**	**Landlord and Tenant Act 1985 s.27A**

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Tribunal Members	**:**	**Judge Siobhan McGrath** **Judge Chris McNall** **Ian Holdsworth FRICS MCIArb**
Date of Decision	**:**	**9th June 2023**

DECISION

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Decision

For the reasons set out below the applications are dismissed

Introduction

1. The issue in this case is whether VAT on service charge costs has been unreasonably incurred by the applicants' landlords in the discharge of their duties under the leases of a large number of flats situated in two prestigious developments on the south bank of the River Thames. The VAT in question was incurred by the landlords' managing agent in the supply of staff costs. That short statement of the issue belies the complexity of a number of questions of law and fact which were considered by the Tribunal in the course of a nine-day hearing, during which extensive evidence of fact was heard, as well as expert evidence both on property management and VAT issues.

2. Two very similar applications had been made to the Tribunal and were heard together. The applications were made by two groups of individual leaseholders and their respective Residents' Associations. As mentioned, the applications concern two large leasehold developments adjacent to the south bank of the River Thames. The first is St George Wharf ('SGW'), which is immediately upstream of Vauxhall Bridge. The second is Battersea Reach ('BR'), which is adjacent to Wandsworth Bridge. BR has in excess of 1,300 leasehold flats and SGW has some 1,185 leasehold flats.

3. The Tribunal in the case comprised a Judge of the Property Chamber, a Valuer Chairman of the Property Chamber and a Judge of the First-tier Tribunal (Tax Chamber).

4. At the hearing the applicants in both the BR and SGW cases were represented by Philip Sissons, Daniel Black and Etienne Wong all of counsel. There are a total of 14 respondents to the applications but only the first to ninth respondents took an active part in the proceedings. For SGW, the first respondent, St George South London Ltd, is the freehold owner. For BR, the second respondent, St George Battersea Reach Ltd, is the freehold owner. The third, fourth, fifth and sixth respondents are all proprietors of concurrent underleases or sub underleases of various blocks in the estate. The seventh respondent was established as "the Management Company" for BR under the tripartite leases pursuant to a section 106 agreement with Wandsworth London Borough Council. At the hearing, the first to the seventh respondents were represented by Philip Rainey KC, Carl Fain and Michael Lee of counsel, Nicola Shaw KC and Sam Brodsky of counsel.

5. The eighth respondent, Fairhold Athena Ltd, holds concurrent underleases of a number of blocks in the respective developments. At the hearing the eighth respondent was represented by Simon Allison of counsel and Michael Thomas KC. The ninth respondent, Fairhold Holdings 2005 Ltd, holds concurrent underleases of a number of blocks at SGW. At the hearing the ninth respondent was represented by Justin Bates of counsel and also by Michael Thomas KC.

6. The total increase in service charge costs for the Estates which results from the incidence of VAT is approximately £500,000 per annum. It was said that, if the current management arrangements are maintained, then this sum would continue to accrue on a yearly basis, in theory, for the whole term of the occupational leases so that potentially millions of pounds are at stake in this application. Be that as it may, the sum of £500,000 must be seen in context and given the number of lessees affected, that sum could also be expressed as being in the region of £149.32 per lessee per year at BR and £162.42 per lessee per year at SGW.

The Developments and the Inspection

7. St George Wharf is a large multistorey mixed-use development comprising 16 residential buildings and one office building (known as Phoenix House). There are 1,185 residential apartments and 29 commercial/retail units on the site, with a total floor area exceeding 1,000,000 sq ft. Some 389 residential dwellings are social housing, either let or in part ownership. The site also includes an underground carpark. The SGW pier, located adjacent to the development, does not form part of the SGW estate. There is a public thoroughfare along the riverside and various landscaped gardens, which form part of the SGW estate.

8. Construction of SGW commenced in 1998 and was completed in or around 2008. The St George Tower, situated adjacent to the south-western boundary, was built in 2014. It does not form part of the SGW estate but does benefit from the communal outside space and access across the landscaped gardens. The residential blocks include ground floor lobby areas, communal staircases, lifts and landings.

9. Battersea Reach ('BR') is a similar residential mixed-use development situated on a 13.34 acre site. The construction of this development was commenced in 2002 and

completed in 2019. It comprises 1352 residential apartments arranged in 17 high rise blocks, with associated below ground carparking and service areas. Some 258 apartments are in social housing, with 72 let on affordable rent tenancies.

10. The ground level is allocated to approximately 40 commercial uses, which include food outlets, gymnasium, offices, doctor's surgery, a dentist and a range of shops and restaurants. There are also on-site staff facilities located at ground level.

11. There are lobby areas to all the blocks. The buildings are serviced by lifts which connect to extensive communal internal landings and passageways. The 17 blocks are served by road access through landscaped gardens, with pedestrian walkways through the site. There is a dedicated public walkway alongside the River Thames which is included within the Battersea Reach estate.

12. When the occupational leases of the apartments on each Estate were granted, they were granted directly by the freeholder owners (R1 for SGW and R2 for BR) to each occupational lessee. In each case the term granted was 999 years. After all of the occupational leases had been granted, the concurrent headleases were entered into. This enabled St George to sell the ground rent income to a third-party investor.

13. Throughout the time since the occupational leases were granted the landlords have discharged their management functions by engaging managing agents who have employed the on-site staff. On behalf of R1-7 it was said that the management and employment arrangements for the Developments were set up that way because it is the best way to deliver a quality service on these large and complex Estates. The practice also continued after the concurrent leases were granted.

14. Over the course of the years there have been three different managing agents. Two of those, Gross Fine and Consort Property Management, proved to be unsatisfactory and in 2012, following a dispute before the Leasehold Valuation Tribunal (which concerned SGW only) they were ultimately replaced by the current managing agent Rendall & Rittner (R&R). In these applications no complaint is made at all about the standard or costs of management. The net cost of the services is not challenged as being unreasonable nor is the standard of works or services in question.

15. Prior to the hearing the Tribunal had an opportunity to visit and inspect both developments. The inspection was also attended by counsel for the applicants and respondents. The Rendall & Rittner Area Director attended throughout and at each estate the Development Manager accompanied the inspection group.

16. The inspection at both sites included viewing a number of blocks that the R&R Manager considered representative of the different types of dwellings at each location. The inspection at SGW began by a roof top viewing of the site. We then went on to inspect at both Estates the lobbies, communal staircases, lifts and concierge areas of the selected blocks. the common areas of both the privately owned properties and the social housing blocks. The property management offices and meeting rooms at both locations were also inspected. The gardens, landscaped areas, pedestrian walkways and carparks were visited and reviewed at each estate including the public and riverside walkways.

17. During our inspection we discussed the operation of the Estates with both Estate Development Managers and were impressed with the knowledge and commitment of the Development Managers to the delivery of property management services at both Estates.

18. The Tribunal is an expert Tribunal and regularly inspects properties of a similar type and size to SGW and BR. We found these properties to be well managed, with comprehensive property services including a 24/7 concierge. The Tribunal was also impressed with the overall standard of maintenance to the common internal areas, exterior landscaped and walkway areas. We agree with the observation of Wendy Pritchard, Group solicitor for the Berkeley Groups Holdings PLC that:

> "An experienced managing agent is needed who understands the changing pattern of the development's use during the day and night, can control deliveries and traffic flows and how to reconcile public and private use and enjoyment to ensure harmony between the different users."

19. The inspection disclosed a good standard of property management in both developments which have multiple commercial and residential uses, which are subject to unfettered public access. We considered that the Estates would be demanding to manage

and need experienced property managers to ensure that appropriate management standards are achieved.

The VAT Issue

20. The applicants' case as put by Dr Soo, who is one of the lessees at SGW and a leading member of the SGW Residents' Association, is that it is unreasonable for the various respondents to arrange matters so that site staff are employed by the managing agent R&R rather than directly by one or more of the landlords because the result of this arrangement is that VAT on staff costs is paid and the service charges demanded from the applicants increase accordingly. As he explained in his amended statement to the Tribunal:

> "The dispute centres on the application of HMRC Extra Statutory Concession 3.18 which came into effect on 1 April 1994, *Ingram v Church Commissioners* [2015] UKUT 495 (LC), Revenue & Customs Brief 6 (2018) and VAT Information Sheet 07/18 of 7 September 2018 with effect from November 2018. My understanding (which appears to be common ground) is that when the site staff are employed by the landlord there is no Staff Cost VAT. However, where site staff are employed by a third party that does not make a supply of land (so, essentially any party other than a landlord), Staff Cost VAT is payable."

21. It is the applicants' case that staff can be directly employed in a way which would not attract VAT and that the change in employment would not cause any significant cost or disruption to the service provided and that it is therefore unreasonable for the landlord respondents to refuse to do so.

22. The relevant legislation is the Value Added Tax Act 1994 schedule 9 group 1 item 1 which exempts from VAT "*the grant of any interest in or right over land or of any licence to occupy land*". As explained by Mr McGuinness in his report on behalf of the eighth and ninth respondents:

> "9.4 ....This provision exempts from VAT the grant of any interest in or right over land unless an exception applies, or an option to tax has been made under VATA 1994 schedule 10. The ground rent due under the residential leases does not meet the

terms of any of the exceptions from the exemption. Any option to tax would be disapplied as a result of VATA schedule 10 para 5 (1), which states:

An option to tax has no effect in relation to any grant in relation to a building or part of a building if the building or part of the building is designed or adapted, and is intended, for use—

(a) as a dwelling or number of dwellings,.....

9. 5 The grant of an interest in residential property is therefore exempt from VAT in the case in question."

23. Additionally, he explained, HMRC's long held position is that contractual service charges under the terms of a residential lease are ancillary to the principal supply of the grant of a right over land and are therefore also exempt from VAT. He said that this can be gleaned from paragraph 12.1 Notice 742 which provides:

"Service charges payable by a holder of a residential lease or tenancy are further payment for an exempt supply of an interest in land by the landlord to the leaseholder or tenant. These periodic charges represent the cost to the landlord of fulfilling his contractual obligations, including the provision of various services, as required under the lease or tenancy agreement"

24. By contrast, it is now clear that the supply of a property management and maintenance service to a landlord by a third-party agent is not connected with or ancillary to the supply of an exempt interest in a property and is therefore standard rated for VAT. Clarity had ultimately been provided in 2018 in Revenue & Customs Brief 6 (2018) and VAT Information Sheet 7/18 of 7th September 2018. However, prior to September 2018, the position was questionable. This was partly as a result of the wording in Extra Statutory Concession (ESC) 3.18 which was described in the parties' tax experts joint statement dated 24th November 2022 as being unclear and that confusion was increased by the apparent existence of HMRC rulings suggesting the scope of application of the ESC was broader than it actually was.

25. We make further observations about ESC 3.18 later in this decision. For now it will suffice to say that it exempts from VAT:

> "[...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."

Additionally, the guidance on the meaning of the paragraph given by HMRC includes the following statement of the effect of ESC 3.18:

> "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 occupiers."

26. During the course of the hearing, there was some discussion about the policy drivers for ESC 3.18 but it became tolerably clear that the concession was intended to ensure a consistency of treatment between freeholders and leaseholders on mixed tenure Estates. Without the concession, a freeholder would have to incur VAT on service charges because the freeholder owns their property outright and therefore services are not provided as part of a supply of property.

27. By 2018, it is common ground, there was uncertainty amongst property professionals as to the correct approach to VAT on service charges. As Mr Voyez, the Tax expert instructed on behalf of the applicants, put it:

> "Property managing agents are not necessarily expected to be VAT experts, and in my opinion there have always been managing agents who have applied the VAT rules incorrectly. HMRC certainly became aware of this, and it explains why Information Sheet 07/2018 published on 7 September 2018 gave a warning, stating that "*If you are a property management company, or similar, who supplies goods and services to landlords and have incorrectly applied or relied on ESC 3.18, you must take action* ... [to] *correctly account for VAT from 1 November 2018*"

Notably, and probably as a reflection of the uncertainty, Information Sheet 07/2018 was intended to operate only prospectively and no retrospective penalties were imposed on that basis.

The Treatment of VAT on Service Charges in BR and SGW until November 2018

28. It is helpful to understand the approach to the treatment of VAT on service charges of both the landlords and of the managers. So far as R&R are concerned, the Tribunal heard from Mr Richard Daver who is the R&R CEO. He described the company as follows:

> "R&R provide a specialist property management service, with specific focus on complex and high-end developments for residential and mixed-use blocks of all sizes and ages on a national basis. R&R currently manage almost 80,000 apartments nationwide across approximately 700 sites and are one of the largest managing agents in the UK"

Given the extent of that portfolio the incidence of VAT is an extremely important matter.

29. Mr Daver said that R&R had long held the view that VAT was not chargeable on any staff costs on the basis that it was a straight through cost and there was no mark up. By contrast, their own management fee was (and continues to be) charged separately, with VAT applied. In 2009, R&R were to take over the management of a leasehold complex known as The Warren with a proposal that R&R take over the employment of the estate staff. Discussion took place between R&R, Berkeley Homes and their solicitors about the position with VAT on site staff costs and the concession in HMRC VAT Notice 742. It was agreed that R&R would write to HMRC seeking clarification as to the availability of the concession where staff were employed by the managing agent on behalf of the landlord. On 1st May 2009 HMRC replied and their letter included the following:

> "I have consulted with our Unit of Expertise and can now advise you that as long as staffing costs relate to the upkeep of common areas and are required to be paid by the leaseholder or tenant under the terms of the lease or tenancy agreement there is no reason why they cannot be included in the exemption for domestic accommodation"

In reliance on this letter, R&R did not as a matter of practice add VAT to the cost of staff employed by them on behalf of landlords.

30. Following the *Ingram* decision in 2015, R&R took advice from UHY Hacker Young LLP and specialist tax counsel (who did not appear in these applications) but did not as a result change their practice. When HMRC issued its policy paper in September 2018, R&R again took advice which confirmed that the salaried on-site staff employed by R&R would be subject to VAT.

31. The position of the Berkeley Group as landlords was dealt with at the hearing by Tina Webster who is the Head of Tax at the Berkeley Group Holdings plc. She explained that in early 2016 she met with R&R and the issue of VAT on staff salaries was raised. Ms Webster had an informal discussion with the Group Finance Director and the Group solicitor. She said that she was informed that there was a mixed approach in the industry but the majority (if not all) agents engaged by Berkeley were not charging VAT. She observed that this seemed to be a well-established and accepted practice. On the other hand, she also discussed *Ingram* with their lead VAT advisor whose opinion was that the current practice remained a grey area but that technically he considered it was correct to say that VAT should be charged.

November 2018 – September 2019

32. When the lessees were informed that as a result of the 2018 guidance from HMRC, VAT would be levied on staff costs, they entered into discussions with R&R, but from the applicants' point of view this did not result in a satisfactory outcome. In April 2019 letters were sent to R&R setting out the applicants' position that the landlords should directly employ the site staff. The letter from Dr Soo is dated 3rd April 2019 and states that it is "a formal notice to the Landlords". After reciting the change in the guidance in respect of the 1994 ESC, the letter concluded: "Please ascertain….the Landlords' reasons, or any justification they may claim to exist for not directly employing the Site Staff."

33. On 3rd May, R&R responded stating that:

> "St George Wharf is a complex mixed-use development including a number of parties with various contractual and property interests. The landlords are not specialist

managing agents, unlike Rendall and Rittner Limited, which have expertise in managing such developments.

Accordingly, the landlords have advised me that they will not be taking over the employment of our on-site staff. It is felt unreasonable for the landlords to be expected to make a substantial change to their respective business models and enter a non-core area of business operations…"

34. On 28th June 2019, Dr Soo wrote again to R&R. He said that the Residents' Association had obtained counsel's advice that the additional costs resulting from the incidence of VAT had not been reasonably incurred. The letter called on the landlords to carry the additional VAT costs themselves or to re-structure the arrangements for the employment of staff. When no response had been received to that letter by 12th August 2019, Dr Soo wrote again to say that the failure left the Residents with no alternative other than to initiate an application to the Tribunal pursuant to section 27A of the Landlord and Tenant Act 1985.

35. In a letter dated 23rd August 2019, Azmon Rankohi, Group Head of Legal for R&R, responded on behalf of the landlords. The landlord's position was stated to be as follows:

"At present 37 staff are employed by us at St George Wharf. Under the ownership structure, there are 7 companies that we understand are in a "landlord" relationship for VAT purposes with the lessees in relation to various areas of the development:

….

To ensure that staff are deployed efficiently across the development, each member of staff provides services to each of the companies that has a landlord relationship with the lessees. There is no one company to whom these services either are provided or could be provided to avoid the VAT charge on staffing costs. Accordingly, we and St George have investigated the possibility of jointly employing the staff. Setting aside whether HMRC could challenge that such an arrangement is not VAT exempt because of the cross-deployment, this approach is simply too unwieldy to be effective.

We believe there are serious employment issues around staff being employed by unconnected joint employers. Whilst it may be possible for the various Berkeley and

St George entities to employ staff jointly, this is not feasible where staff also work for other "landlords" too..............Given the wealth of employment obligations that employers have, the costs of the cross monitoring of the employing companies would be such that any VAT savings would be lost. Similarly, if each company were to employ its own staff, the VAT savings would be lost in the additional costs of employing the additional staff to provide the same level of service to each company and its lessees.

I appreciate that you will find my response disappointing, but we and St George have investigated this matter in depth, liaised with the other landlords and sought external advice before reaching this conclusion.................."

36. In response, Dr Soo intimated that the Residents' Association would lodge a Tribunal application. Unsuccessful attempts were made to arrange a without prejudice discussion and eventually on 3rd September 2019, these proceedings were commenced.

The occupational lease terms

37. There is no dispute that the cost of employing staff is payable under the terms of the occupational leases. Looking at Dr Soo's lease which is one of the sample leases provided in the bundles, the sixth schedule is in two parts. Part 1 contains the maintenance covenants and Part 2 sets out the maintenance expenses. Paragraph 3.1 includes a requirement to contribute to the costs of:

"3.1 Providing and paying for the employment of such persons as may be necessary in connection with the upkeep and management of the Maintained Property and performance of the covenants on the part of the Lessor in this Lease including fees charges expenses salaried wages and commissions paid to any auditor accountant surveyor or valuer architect solicitor managing agent or other agent contractor or employee porters caretakers cleaners and building managers."

And under paragraph 5:

"5. Paying Value Added Tax chargeable in respect of any of the matters referred to in all Parts of this Schedule"

38. For the sake of clarity, we confirm that it is our view that neither paragraph 3.1 nor 3.2 nor paragraph 2 to which the Tribunal was taken, create any presumption of employment over the use of contractors and do not import an obligation on the landlord to employ anyone. We do not accept Mr Sissons's submission that the language used in the leases make it apparent that it was intended that where staff were required to perform services, they would be employed by the landlord.

Sections 18 to 30 of the Landlord and Tenant Act 1985

39. Sections 18 to 30 of the Landlord and Tenant Act 1985 provide the principal statutory framework for the regulation of service charge costs in residential leasehold property.

40. Section 19 provides:

> "**19.— Limitation of service charges: reasonableness**.
>
> (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 provision 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."

41. "Reasonableness" is of a protean quality. In order for the Tribunal to measure its application to the assessment of the payability of service charges it must be understood in context. In *Waaler v Hounslow LBC* [2017] EWCA Civ 45, Lewison LJ observed that, if a landlord incurs costs that are not justified by applying the test of rationality, then they would fall outside the scope of the contractually recoverable service charge. This is a distinct issue from the question of reasonableness, in respect of which he said:

> "25. .....The Landlord and Tenant Act 1985 must have been intended to provide protection against costs which, but for its operation, would have been contractually recoverable. It follows in my judgment that merely applying a rationality test would not give effect to the purpose of the legislation. The statutory test is whether the cost of the work is reasonably incurred.

26. Part of the context for deciding whether costs have been reasonably incurred is the fact that, in principle, the cost of the work is to be borne by the lessees. As Nicholls LJ put it in *Holding and Management Ltd v Property Holding and Investment Trust Plc [1990] 1 E.G.L.R. 65* ….when considering whether the most comprehensive (and expensive) of three possible schemes amounted to repair:

> 'A prudent building owner bearing the costs himself might well have decided to adopt such a scheme, despite its expense. But what is in question is whether owners of 75-year leases in the building could fairly be expected to pay for such a scheme under an obligation to "repair".'

27. This is reinforced by the definition of 'relevant costs' in s.18(3)(c) which ties the meaning of that expression to a service charge as defined by s.18(1). In other words, no cost is a relevant cost unless it is part of an amount payable by a tenant. When any tribunal considers whether a cost has been reasonably incurred it will always have as its context that, if it has been reasonably incurred, the tenant will have to contribute to it."

42. At the hearing, Mr Sissons contended that it is not sufficient for a landlord to say that it has chosen one of two (or more) reasonable courses of action. He said that the choice must be an objectively reasonable one for the landlord to have made and that the most important factor in this consideration is the fact that the lessees are paying. In support of this submission, he referred to the basis upon which Lewison LJ had explained the difference between rationality and reasonableness by reference to the judgment of Rix LJ in *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] Bus LR 1304 [2008] EWCA Civ 116, para 66:

> "Reasonableness and unreasonableness are also concepts deployed in this context, but only in a sense analogous to Wednesbury unreasonableness, not in the sense in which that expression is used when speaking of the duty to take reasonable care, or when otherwise deploying entirely objective criteria: as for instance when there might be an implication of a term requiring the fixing of a reasonable price, or a reasonable time. In the latter class of case, the concept of reasonableness is intended to be entirely mutual and thus guided by objective criteria … Laws LJ in the course of argument put the matter accurately, if I may respectfully agree, when he said that pursuant to the Wednesbury rationality test, the decision remains that of the

decision maker, whereas on entirely objective criteria of reasonableness the decision maker becomes the court itself."

43. We do not agree. The *Socimer* case was not dealing with section 19 reasonableness. At paragraph 37 in *Waaler*, Lewison LJ says:

> "37. In my judgment, therefore, whether costs have been reasonably incurred is not simply a question of process: it is also a question of outcome. That said it must always be borne in mind that where the landlord is faced with a choice between different methods of dealing with a problem in the physical fabric of a building (whether the problem arises out of a design defect or not) there may be many outcomes each of which is reasonable. I agree with Mr Beglan that the tribunal should not simply impose its own decision. If the landlord has chosen a course of action which leads to a reasonable outcome the costs of pursuing that course of action will have been reasonably incurred, even if there was another cheaper outcome which was also reasonable."

And having referred to the statutory duty to consult lessees imposed by section 20 of the 1985 Act he observed that:

> "39. Once the landlord has consulted the tenants and taken their observations into account, it is then for the landlord to make the final decision. In considering whether the final decision is a reasonable one, the tribunal must accord the landlord what, in other contexts, is described as a margin of appreciation. As I have said there may be a number of outcomes, each of which is reasonable, and it is for the landlord to choose between them"

44. In order to understand the Tribunal's role in deciding reasonableness it is also necessary to consider the scope of its jurisdiction. Section 27A(1) of the 1985 Act provides that an application may be made to the tribunal "for a determination whether a service charge is payable" and section 27A(3) makes similar provision for service charge costs which it is intended will be incurred in the future. "Payability" relates back both to section 18 of the Act which defines "service charge" as an amount "payable" by a tenant of a dwelling as part of or in addition to the rent and also to section 19 where relevant costs

"shall be taken into account in determining the amount of a service charge payable" only to the extent that they are reasonable (sic).

45. In *Williams and others v Aviva investors Ground Rent GP Ltd and another* [2023] UKSC 6, Lord Briggs JSC considered the ambit of the Tribunal's jurisdiction under section 27A. The central issue in the case was the question whether section 27A(6) is capable of ousting the landlord's contractual discretion to apportion service charge costs between lessees and instead confers that discretion on the Tribunal. Ultimately the Supreme Court found that section 27A(6) did not have that effect. In the course of discussion Lord Briggs said the following:

> "12. Against that backdrop of detailed statutory control of the recovery of service charges from residential tenants, section 27A provides for a generously worded jurisdiction of the FtT to determine whether a service charge is payable (section 27A(1)) or would be payable if specified costs were incurred (section 27A(3)). Although there is detail about payability in terms of payer, payee, amount, timing and payment method, and in subsection (4) about when the FtT's jurisdiction may not be invoked, nothing is said expressly about the principles which the FtT is to apply in determining payability. The natural assumption is that the FtT would decide by reference to common law principles of contractual liability, subject to the detailed scheme for statutory control laid down in the immediately preceding provisions of the 1985 Act.
>
> ....
>
> 14. Generally speaking, the making of a demand upon a tenant for payment of a service charge in a particular year will have required the landlord first to have made a number of discretionary management decisions. They will include what works to carry out or services to perform, with whom to contract for their provision and at what price, and how to apportion the aggregate costs among the tenants benefited by the works or services. To some extent the answers to those questions may be prescribed in the relevant leases, for example by way of a covenant by the landlord to provide a list of specified services, or by a fixed apportionment regime. But even the most rigid and detailed contractual regime is likely to leave important decisions to the discretion of the landlord, such as whether merely to repair or wholly to replace a

defective roof over the building, with major consequences in terms of that year's service charge.

15. Speaking again generally (and this is a necessary predicate in construing a statutory provision applicable across a wide range of landlord and tenant relationships), the jurisdiction of the FtT under section 27A(1) to decide whether a service charge demand is payable will extend to the contractual and/or statutory legitimacy of these discretionary management decisions. Thus, where the service charge enables the landlord to recover its cost of performing its repairing obligations under the lease, the replacement of a roof may give rise to questions whether replacement fell within the landlord's repairing obligation (or rather whether it was an improvement) and whether, if it was a repair, the costs incurred satisfied the statutory reasonableness test in section 19. But, leaving aside section 27A(6) for the moment, it would not be a part of the FtT's task to make those discretionary decisions itself, let alone for the first time. It would be too late, on an application under section 27A(1), and there would be no warrant either contractually in the lease or in the statutory regulatory regime under the 1985 Act for it to do so.....

16. On an application under section 27A(3) in relation to a prospective service charge the FtT might well be invited to exercise its jurisdiction before the landlord made the relevant discretionary management decisions, but the jurisdiction would not thereby be enlarged from that described above merely because of the timing. Ignoring section 27A(6) for the moment, the FtT would still be limited to ruling upon the contractual and statutory legitimacy of the landlord's proposal, coupled with a *Braganza* rationality review if necessary, which is really an aspect of the testing of contractual legitimacy. And the landlord would have to furnish the FtT with a sufficiently detailed plan of its proposals (including the relevant discretionary management decisions) to enable the FtT to rule prospectively upon the lawfulness of the service charge demand if the proposed works were carried out: see *Kensington and Chelsea Royal London Borough Council v Lessees of 1—124 Pond House* [2016] L&TR 10 [2015] UKUT 395, paras 66—67"

46. Accordingly, before the Tribunal can consider whether costs have been or will be reasonably incurred, it must first be satisfied that its jurisdiction is properly engaged. In

other words, does section 27A permit the Tribunal to resolve the issues that the applicant has brought before it? In *Kensington and Chelsea Royal London Borough Council v Lessees of 1—124 Pond House* [2015] UKUT 395, the council sought a determination that they had complied with the consultation requirements under section 20 of the Landlord and Tenant Act 1985. However, because the Tribunal cannot give mere declaratory relief, an application was made under section 27A(3) for a determination that, if costs were incurred, they would be payable. In effect, this was a device to engage the Tribunal's jurisdiction. The Tribunal made the determinations sought, but only on the basis that a specific description of the works to be carried out to each of the many properties concerned was available. Putting it another way, the Tribunal would not have had jurisdiction if the ambit of the works had not been described and if there had been insufficient information for the Tribunal to consider that it would in due course be able to make a determination about payability.

Jurisdiction and Prima Facie Case

47. In our view the same considerations apply to section 27A(1). Before the Tribunal can decide an application under either section 27A(1) or (3) it must be satisfied that the question before it engages issues of payability under section 18 of the 1985 Act relating to the contractual or statutory legitimacy of the service charge costs. It may not (per *Williams v Aviva*) make declarations *solely* about a landlord's management decisions. A tribunal will need to be satisfied that an application by either a landlord or a lessee gives sufficient information for the Tribunal to consider that it would in due course be able to make a determination about payability.

48. Even if an application meets that threshold, then on behalf of the respondents it is said that there is a burden on the applicants to demonstrate that they have a prima facie case in support of the application. We agree, but consider that what amounts to a prima facie case in such a broad jurisdiction will vary from application to application. In this case, we consider that, as a minimum, the lessees must show:

(a) That their challenge is not a challenge simply to the *way* in which a landlord has reached its management decisions. That is because such a challenge would not engage section 27A at all;
(b) That their challenge sufficiently articulates an alternative course for the landlord so that a Tribunal could consider that, if that alternative course were adopted, it

would be reasonably arguable that costs incurred would be saved. That is not to say that the burden lies entirely on the lessees to establish unreasonableness: but they must make a coherent case at the outset.

49. If the Tribunal could be satisfied that its jurisdiction was engaged then it would go on to decide the contractual and/or statutory legitimacy of the costs being incurred, the reasonableness of the costs, and ultimately their payability. In this case, those considerations include an assessment whether the risks inherent in making a fundamental change to the employment structure at BR and SGW would be outweighed by the benefit in costs and general management at the developments. The risks to be measured include both the tax risk and the management risk.

50. On that basis, we are wholly satisfied that the burden lies on the applicants to demonstrate both (i) that the Tribunal's jurisdiction is engaged by these applications and (ii) that they have made out a prima facie case on payability. If they have done so, then it is for the landlord to meet those allegations as per *Yorkbrook Investments Ltd v Batten* (1986) 18 HLR 25 and *Enterprise Home Developments LLP v Adam* [2020] UKUT 151 (LC). The first question the Tribunal must address therefore is whether both of these tests - jurisdictional engagement and prima facie case - have been met.

51. The BR and SGW applications were both made on 3rd September 2019. As already noted, each application seeks a determination for the service charge years 2018 and 2019 "and ongoing." The grounds for each application were that the costs of R&R employing staff increased by 20% (ie, the standard rate of VAT) as at 1st November 2018 and "the Applicant asserts that these are not relevant costs which should be taken into account in determining the service charge for the said, or any, period, in that they were not reasonably incurred..." Although the wording suggests that the ambit of the applications was open-ended, Mr Sissons confirmed at the hearing that a determination was sought only in respect of 2018 and 2019.

52. Little further detail of the applicants' case was provided at that stage. However, the bases for the applications were set out more fully in the applicants' statement of case which was provided after a period of about 8 months during which the applications had been stayed to allow the parties to negotiate. In the statement of case, the applicants assert that

"The relevant costs of VAT on such part of amounts paid to the Management Agent as represents staff salaries....were not reasonably incurred" because (and here we paraphrase):

(a) The first, second, eighth and ninth respondents failed to consider the impact that using staff employed by the Managing Agents would have on the level of Maintenance Expenses.

(b) Each landlord ought to have taken specialist advice in respect of the VAT implications (especially following the decision in *Ingram*) and that specialist advice should have been sought at the outset and before any managing agent was appointed.

(c) A reasonable cost-efficient approach would have been for the freeholders and/or the immediate landlords of the applicants to have employed the staff directly, rather than paying the managing agent to use staff employed by the managing agent.

(d) Alternatively, the outcome of the respondents' decision to procure the supply of site staff through R&R was not a reasonable one.

53. The assertions in (a), (b) and (c) do not engage the Tribunal's jurisdiction. The Tribunal does not regulate the process by which a landlord reaches its decisions. Moreover, the applications as framed also require the Tribunal to consider the process whereby the landlords reached their decisions, with the benefit of hindsight. As Lord Briggs observed in *Aviva,* "it would not be part of the FtT's tasks to make those discretionary decisions itself, let alone for the first time, it would be too late, on an application under section 27A(1), and there would be no warrant either contractually in the lease or in the statutory regulatory regime under the 1985 Act for it to do so..."

54. Assertion (d) above, however, relates to the *outcome* of the respondents' decisions and therefore comes much closer than (a) (b) or (c) to engaging the Tribunal's jurisdiction. We are satisfied - albeit only on balance, and just about - that the question whether the respondents' decision to procure the supply of site staff was or was not reasonable does engage the Tribunal's jurisdiction. Therefore, the next stage will be to consider whether the applicants have made out a prima facie case in relation to that question. But we are bound to say that the decision to proceed to that next stage was a borderline one. Our ambivalence

emanates from a real concern that the costs outcome is simply governed by fiscal law, as opposed to any complaint about the standard or provision of services.

55. Mr Rainey submitted that the applicants had not discharged the obligation to make a prima facie case. He contended that the applicants' case which the respondents were to meet was ambulatory and inconsistent. He said that the statements of case maintained that the applicants did not propose any change in arrangements which would require the respondents (or any of them) to change the managing agents and that the landlords would continue to employ R&R as its agent to "amongst other matters human resource, payroll, training, health & safety, etc., manage the day-to-day deployment of the on-site staff which would just be business as usual with no additional incurred cost." He pointed out that this was also how Dr Soo had put it when he said in his statement: "We are not changing anything. We are not seeking a change. We are seeking something that could mitigate the impact of VAT."

56. However, during the course of the hearing, that apparent clarity became clouded, when, during evidence, questions were put to the witnesses by Mr Sissons and propositions made positing different arrangements from the original proposal. However, it was never clear what the alternative looked like. As Mr Rainey put it "we don't really know what their case might be and nor do they."

57. On behalf of the applicants it is said that it is for the respondents to develop a suitable model as they hold the necessary information to do so and the ultimate responsibility for the provision of services. This discloses a misunderstanding of the nature of a prima facie case. We have already examined some of the pre-application correspondence between the parties. Before the applications were lodged, in their letter dated the 23rd August 2019, the respondents had clearly set out their concerns about changing the employment arrangements for staff. In summary they were:

(a) That there are seven companies which are in a "landlord" relationship for VAT purposes;
(b) That they had investigated the possibility of jointly employing staff to address the challenge of efficient deployment across the developments but had concluded that it was too unwieldy to be effective;

(c) That there were serious employment issues around staff being employed by unconnected joint employers: both as to its integrity as a model which would withstand challenge, and also because the additional costs would wipe out any VAT savings.

In our view, a prima facie case should have addressed these concerns in principled terms and not simply rejected them on the basis that the respondents should find a solution.

58. Another way of expressing the threshold requirement is to say that the applicants must provide a "realistic case," that is, one which, given the facts and the law, carries some degree of conviction and which is more than merely arguable. As already explored, this test captures two elements: firstly, that it is firmly tethered to the requirement of reasonableness and secondly - as with other disputes about reasonableness, of the kind which this Tribunal routinely considers - it directs focus to the actual content of the proposal.

59. In the context of these applications, we could only be satisfied that the initial realistic case was satisfied where the proposed arrangements:

(1) Were realistically capable of being implemented; and
(2) If implemented, were likelier than not to achieve a tax saving which would then accrue for the benefit of the tenants; and
(3) Were to be preferred to the existing arrangements when taking into account other, non-tax, factors, such as the risk of disturbing existing arrangements.

60. Mr Sissons contended that the lessees cannot possibly be under an obligation to explain to their landlords how to perform their covenants. He said it is the landlords that are responsible for providing the services and the landlords that have all the resources, the information and the expertise to produce the required detail: model employment contracts; health and safety policies; pension models; training plans; and so on. In our view, even if that is correct, it does not absolve the lessees from an obligation to make a clear and reasoned case why a change in staff employment arrangements which had successfully subsisted for many years, should and could be implemented. This case is very different from most of the applications received by the Tribunal where the issues are usually more easily

articulated and more obviously involve challenge where a prima facie case can relatively easily be discerned.

61. In our view, the proposals must have sufficient content for a landlord to have formed a view of the arrangement. It seems to us that there is a continuum between proposals which are entirely hypothetical and those which are completely worked out. Somewhere along this continuum is a dividing-line between proposals which the landlord can reasonably refuse to consider and those which it cannot. We do not need to draw that line in this case because the proposals in this case are, in our clear view, clearly on the wrong side of that line.

62. As they stand, the models do not meet, even on a realistic case basis, the "implementability" part of the test. The Applicant has not shown, even as a realistic case, that either of the 'models', as placed before the Tribunal, and as discussed by competing cohorts of experts, were realistically capable of being implemented. There always were and still are far too many steps remaining to be done, and far too many potential obstacles. That being so, it cannot be said that it was unreasonable for the Respondents to adopt the stance which they did.

63. The failure is partly attributable to evidential inadequacy. The 'models' are really only models at a high and generalised level. Standing back, each 'model' expresses little more than a desired outcome. Neither 'model' is planned or worked out in anything other than the sketchiest outline so as to show how the desired outcome will, in the real world, be accomplished. This is despite the fact that the Applicants were positively encouraged by the Respondents to come up with implementable arrangements, but did not do so.

64. As mentioned, two models of employment were explored at the Tribunal hearing: the Direct model, where the freeholder employs all estate and block staff and supplies these services directly to the occupational tenants, and the Joint model, where estate and block staff are jointly employed by the freeholder and individual block landlords.

65. If the applications call on us to weigh up the likelihood of either of the employment models actually achieving their intended taxation outcome (which includes weighing-up the

likelihood of their surviving any challenge by HMRC) then this is a further reason that we do not consider that the applications engage our jurisdiction. This Tribunal's powers, resources and expertise are not directed towards resolving questions as to the reasonableness of decisions about taxation.

66. However, we do not decide the case on that basis, not only in deference to the extensive evidence and submissions which we have read and heard, but also so as to give assistance to landlords and tenants involved in similar disputes. Accordingly, we turn now to the central issue whether the landlords were unreasonable in their refusal to change the employment structure to either the Direct or the Joint model.

The Leasehold Structure

67. In order to understand part of the respondents' objection to the Direct employment proposals, it is necessary to look in more detail at the title structure of the Estates. From the time that the concurrent leases were granted, the structure has been as set out in the following paragraphs.

68. At SGW, there are 10 blocks, A – K.

(i) In respect of 6 blocks, B-G, there is a single concurrent headlease of the whole block, 6 headleases (Blocks B-G) are owned by R9;

(ii) A single concurrent headlease was granted for Blocks H and J which is owned by R8.

(iii) The only exceptions to this tripartite structure are blocks A, H and K, which include some affordable/shared ownership units. For Blocks A and K there is a single concurrent headlease of the whole of the block granted by R1 to a group company, R5.

(iv) R11 has a headlease of affordable housing units (and associated common parts)

a. Admiral and Armada House (Block A);

b. Hanover and Hobart House (Block H) and Kingfisher House.

R11 then sub-lets its units on shared ownership occupational leases.

69. At BR, there are 17 blocks, A – T (but no O or R blocks):

(i) 5 blocks (K,L,M,N,P) do not have any concurrent headlease;

(ii) Block G contains only AHUs and is demised to R11;

(iii) Blocks F, K, L, M, N, Q + T each contain shared ownership units which are sub demised to R11, R13 or R14 and then in turn demised to occupational shared ownership lessees.

(iv) There are concurrent headleases of the remaining blocks. R8 holds the (single) headlease of blocks B, C and D. The remaining concurrent headleases are owned by either R5 (blocks A, E, F, H, J and S) or R3 (Q and T), both companies in the Berkeley Group.

(v) Additionally for BR, the Battersea Reach Estates Company Limited (BRCL) provides the Estates services.

70. On behalf of R1-R7 it is said that in order for the Direct model to succeed, the freeholder must have unfettered, daily access to the blocks for cleaners, maintenance, operatives etc. Mr Sissons contends that the grant of concurrent headleases does not absolve or release R1 and R2's liability to provide services. In that respect Mr Rainey says that there is an essential fallacy which underlies that submission as it confuses or conflates *liability* or *enforceability* of covenants with the right to enter land to carry out work.

71. Counsel provided detailed and helpful submissions on the issue. However, we consider that it is unnecessary for us to decide who is correct. No disrespect is intended to either party but the intricacy of the arguments and the suggested devices that might need to be employed (whether by lease variation or the grant of licences), simply militate to the conclusion that the position is far from straightforward and possibly a recipe for future litigation. There are real risks involved in adopting the Direct Employment model. These include both a risk of future litigation about rights of access and responsibility for the discharge of obligations and a further risk of serious disruption to services in one or more blocks. These are not risks that it would be unreasonable for a landlord to seek to avoid.

Employment

72. So far as the Joint model of Employment is concerned it is the applicants' case that there is no valid conceptual objection to a contract of joint employment. Mr Sissons says that this is supported by authority and cites in particular *Viassystems* [2006] ICR 327 cited in *Cairns v Visteon* [2007] ICR 616. The applicants also contend that the practicalities of

joint employment should not necessarily cause difficulty and that there is nothing artificial or uncommercial about the respondents collaborating to discharge their contractual obligations by providing a jointly employed pool of staff on site. Whilst it is acknowledged that there is a cost involved in the participation of R8 and R9 as employers, it is said that the costs relied upon by the respondents are overstated.

73. The respondents on the other hand, submit that the Employment Appeal Tribunal has been consistently sceptical of the notion that an individual can have multiple employers at the same time. In support of that proposition, they cite a number of cases and most recently *FBU v Embery* [2023] EAT 51 where Bourne J emphasised that dual employment will be "*unusual*" or "*exceptional*".

74. This Tribunal is not in a position to reconcile an employment law issue of this nature. However, it does take the view that, as a matter of practicality, there will inevitably be challenges where there is more than one employer. For example, there may be a lack of consensus about important issues affecting both the employees and lessees. This could cause severe disruption and is a real and not a fanciful possibility. We consider that joint employment must incorporate an inherent risk that it may not succeed.

The Management Risk

75. R&R is the managing agent of both Estates. The Tribunal was told that their role is to give a full service to lessees and this is provided through a complement of on-site staff. The services provided to the Estates are comprehensive and are detailed in management agreements.

76. In evidence Mr Daver explained that R&R are employed by subsidiary companies within The Berkeley Group Holdings plc to provide services on the Estates. In addition, he said that R&R are employed by other companies who hold intermediate block interests in the Estates including Fairhold Athena Limited and Fairhold Holdings (2005) Ltd. Finally, R&R hold management agreements in relation to the affordable housing units or blocks with Notting Hill Home Ownership Limited at SGW and with Notting Hill and Wandle Housing Association relating to BR.

77. The number of staff and their precise roles vary slightly from year-to-year, but at SGW for the period 2018/22 there was a staff complement of between 36-38, whilst at BR the total number ranged between 34 and 36.

78. The on-site staff at both Estates are employed by R&R, being a subsidiary company of Rendall & Rittner Operations Limited, itself a subsidiary company within the Rendall & Rittner Group. Human resources, payroll, pensions, training and senior management are delivered by Rendall & Rittner Operations.

79. As an expert Tribunal we are very used to dealing with applications where the core of the complaint by the lessees is that the management of the property is inadequate and that as a result there has been a breakdown in communications, a lack of transparency, a failure to carry out routine and major works, poor provision of services and excessive service charge costs.

80. None of those complaints are made in this case. Quite the opposite. Although Dr Soo commented that there is "always room for improvement" he did not elaborate on this statement. In our view, R&R provide a high-quality service which is good value for money. That this is not contested by the applicants is of significance because the premise for the applicants' proposals is that the management arrangements currently in place would not need to be disrupted to give effect to the plan to move the employment of staff from R&R to the respondents instead.

81. Expert evidence was given on behalf of the applicants by Mr Neil Maloney FRICS FIRPM. It is important to note that the property expert reports were exchanged sequentially, and that Mr Maloney had the opportunity of seeing the respondents' experts reports before finalising his own report. The decision to order sequential exchange was in deference to the applicants' submission that the landlords inevitably had better access to relevant management information at the Estates. Despite this, Mr Maloney did not directly address a number of important issues highlighted in the other expert reports. In evidence he said that he was instructed late, and that his report was something of a rushed job for a number of reasons.

82. Mr Maloney did not accept that both SGW and BR are complex sites. We do not agree. As already intimated, we consider that the Estates are challenging and require expert management.

83. Each of the property management experts considered the "models" proposed to accommodate the transfer of employment. The premise of Mr Maloney's opinion is set out at paragraph 11 of his report. In his view, if R1 and R2 were to directly employ staff, although "they would need to 'control' the employment of these on-site staff members," no physical change to the staffing level would be needed as R&R would continue as previously. Alternatively, and in any event, he suggested that R1 and R2 are already effectively in control of the staff since ultimately, they are the landlord. Although this is correct, and although we are satisfied that there is a high level of oversight of the work of R&R with a particular focus on health and safety, we do not find that R1 and R2 have any practical involvement in the day-to-day running of the Estates.

84. Mr Maloney's view is that the implementation of either the Direct or Joint model would not effect any change to the management of the site or its cost. He puts this as follows:

> "I have little doubt that the landlord(s) will continue to use a competent agent to assist them in delivery of the liabilities under the lease (running closer to the ARMA summary at Appendix 13) and with their current employees "overseeing" the current responsibilities and liabilities that they assert are passed on to R&R, now administering that review for the Landlord(s) instead"

85. As to the management costs, Mr Maloney's report was based on an unsupported proposition that R&R would continue to undertake extensive management responsibilities but that, where part of their current function was transferred elsewhere, they would automatically reduce their management fee. There was no evidential basis for that inference and in evidence Mr Daver was clear that if there were a change in the current arrangements then R&R would have to review its charging regime.

86. Mr Maloney expressly disagreed with the expert reports of Mr Seifert, Mr Channer and Mr Platt in respect of additional costs. He rejected their view that a transfer of responsibilities would involve a substantial increase in costs in respect of any of the

following: TUPE, payroll, employers & public liability, professional indemnity, managing agent, site facilities, other landlord liabilities, legal and HR support or Health and Safety. He also disagreed with the other experts about the level of set-up costs.

87. By contrast, the three experts engaged by the respondents concluded that additional costs would indeed be incurred as the result of the change of employer to either direct or joint employment. Each of the experts approached this in a different way. With respect, we merely summarise part of each report below.

88. Mr Charles Seifert FRICS was instructed on behalf of R1-R7. In his report he identified staff cost VAT as a percentage of the overall 2019 service charge. At BR this was 3.13% and at SGW it was 3.78%. Before addressing the additional costs, Mr Seifert observed, and we agree, that, because staff employment is a core part of many managing agents' business models, they can benefit from a number of efficiencies in delivering the service at scale across their portfolio of properties under management.

89. He set out details of the potential issues that might arise in the event that a change was effected to the existing approach of providing all staff centrally, to deliver services to blocks and to the estate. The benefits included standardisation of service quality, resilience in the delivery of service, flexibility and managing agent efficiencies. He concluded that in the event that the landlords adopted either of the proposed models of employment this would result in additional costs, duplication of roles, a loss of economies of scale and a potential reduction in the standard and level of service delivered. We agree.

90. Mr Seifert undertook an analysis of additional costs in the implementation of a change in employment and then in ongoing running costs. He conducted the exercise in respect of each model but, by way of illustration, his conclusions on direct employment were expressed in respect of three scenarios which he called "full" (9 additional members of staff), "medium" (7 additional members of staff) and "low" (5 additional members of staff). He calculated total one-off set up costs (including back-office costs) to be £193,104 (full) or £161,244 (medium) or £124,299 (low). As to ongoing operational expenditure he calculated these as £839,961 (full), £729,802 (medium) and £586,146 (low). Each of these figures exceed the expected VAT saving of £406,086 by a significant margin. Further calculations in respect of the Joint model disclosed even higher expenditure. At the hearing the level of

the likely costs was challenged as being overblown. We do not accept that challenge. Since the exact model of employment has not been settled on, it is inevitable that the experts' assessment must be speculative. Mr Seifert's figures were never intended to be exact but they are based on careful research and experience and for that reason we accept them as reflecting costs that might possibly be incurred.

91. Mr A Channer BSc MRICS was instructed on behalf of R8. He took a different approach to the calculation of additional costs in respect of each of the models under consideration. He made his estimates by assessing the overall costs of staffing provision together with the additional costs that he believed would be incurred in making a change and then by calculating the extra amount payable by a putative individual leasehold. In order to reach his conclusion, he carefully analysed and factored-in one-off costs, current costs and likely future costs. For the Joint model he applied an 11% risk-implicit potential VAT saving. His conclusion on that basis is that rather than there being a tax saving for reduced VAT there would instead be an additional cost to the leaseholder of £65.52. He was also of the view that there would be set-up costs which in themselves would outweigh the benefits of any change. In his view no benefit would be seen for the first 2-4 years following implementation.

92. Mr Jeff Platt BSc FRICS FIRPM was instructed on behalf of the ninth respondent. His approach to the task was to assume that he was estimating an initial budget for 2019 on a development identical to SGW, except that the on-site staff providing the services directly to Blocks B-G were to be employed directly by Fairhold. In his report, Mr Platt primarily addressed the "mixed" model of employment, which in the event was not pursued. But overall, he analysed a number of matters including staffing levels, concierge services, the SGW development management team, estate operations and cleaning. He concluded that should the joint employment model be pursued, the current cost of staff salaries to the lessees would increase from a current budget figure of £1,975 per annum to £2,537 per annum. In addition, Mr Platt estimated that set-up costs of this model in year 1 would be £181,962.

93. So far as the Direct model was concerned, Mr Platt had insufficient information to provide a costs analysis but considered that the costs would be likely, as a minimum, to mirror joint employment. However, he also expressed severe doubts about the ability of the

freeholder to provide services without lease variations, which he believed would entail unnecessary complexities and risk that would not be worth taking. As he put it in paragraph 151 of his report "I cannot foresee any reasons why the Freeholder would diversify from its property development business to take on the landlord obligations and management functions in respect of buildings it has already (to all practical intents and purposes) disposed of, with no financial return for providing those services, whilst owning those significant risks."

94. As to the joint employment model he rejected Dr Soo's assertion that a change to joint employment would be achievable at minimal additional cost. In his view any additional cost of 12.5% or more would totally wipe out any VAT saving. Broadly speaking, he said, additional annual costs in excess of £135,000 would lead to an increase in service charges for SGW lessees. His conclusion was that the implementation of a joint employment arrangement would result in an estimated annual net detriment of £120 per lessee per annum. In addition to the annual costs, he also said that the set-up costs in themselves would outweigh the benefits to the leaseholders for the first 2-3 years of any joint employment.

95. Finally, Mr Platt had been instructed to comment on best practice in the property management sector. In his view there are real practical advantages in the current arrangement. In summary he observed that all on-site staff work across all Blocks providing services to all residential and commercial leaseholders at SGW. This arrangement avoids duplication of staff providing services to different areas, of management and back-office services, it provides economies of scale, flexibility, cover for holidays, sickness, vacancies etc. and provides staff recruitment and retention benefits. We agree.

96. At the hearing Mr Maloney ultimately accepted that there would be start-up costs in the change to either the Direct or Joint model but maintained that these had been overstated by the other three experts. So far as additional staff and ongoing costs were concerned, he said that it would be sufficient to employ a single full-time employee who ought to "comfortably be capable of taking on any tasks which cannot properly or effectively be performed by R&R". He said that the employee together with a secretary would cost £100,000 per annum. He did not factor-in any other ongoing cost.

97. As to the impact of changes in the management arrangement, his conclusion is at paragraph 12.5.4 of his reports, where he said that "therefore, based on many years of experience in property management and careful review of the title structure, the lease covenants, the existing staff provision and the proposed alternative arrangements, I do not consider that there is any appreciable risk that the management or quality of service on the sites would suffer as a result of a change in the employment status of the staff."

Conclusion on Management Risk

98. We consider that Mr Maloney is mistaken in his belief. We are satisfied on the evidence of the other three experts that the proposed changes both entail a real risk of an increase in costs to the lessees and pose a threat to the good provision of management at the sites of the kind which was acknowledged by the applicants in their evidence. It is a risk that we do not consider it would be unreasonable for a landlord to refuse to take.

99. Mr Maloney's conclusions are based on limited information. He did not separately address the position for Direct and Joint models. His presentation and review of the proposed models was strategic rather than detailed. He did not rigorously explore the cost implication of adoption of either of the two models. He did not respond to the issues raised in the other expert reports despite the fact that they had been provided to him in advance. We think that the explanation for his failure lies in the limitation of his instructions and the time available to him to consider the issues. This in itself is telling. These are complex Estates which benefit from sophisticated management. It is not a simple matter to formulate a change in management arrangements which have successfully been in place for in excess of 10 years.

100. The Tribunal concluded that a reasonable Landlord would not be persuaded by the applicants' proposals to adopt either management model. We were unable to resolve the question of "why change?" an effective and functioning management service, given the lack of detailed and substantive justification offered in support of any change and the significant negative implication to the Landlord and Leaseholders should the property management fail.

The Tax Risk

101. We turn now to the tax risk. We start with a reflection that the applications are before the FtT Property Chamber. Although we sat with a judge of the Tax Chamber, we need to be satisfied that we are the appropriate forum to consider issues relating to VAT.

102. In tax terms, this is a very sketchy case. There is no document, or suite of documents, which set out, in the sort of detail which can properly be interrogated or assessed, the proposed steps to be taken, their sequence, the likely time for each to be taken, the likely cost, the likely risks, and the contingency plans to be taken, if any of the steps should fail, or should take longer than expected, or cost more than expected, or encounter some other difficulty - such as being challenged by HMRC.

103. Mr Sissons captured this very succinctly in his closing submissions. In his words, we are not past 'the ideas stage'. We agree. No-one had moved out of the sphere of the tentative, the provisional and the exploratory. Even if a realistic case had been shown as to implementability, the proposals still fail at the next stage. Disregarding any practical, financial, or administrative impediments which might exist to implementation per se of either of the models there remain, in our view, a series of ineradicable risks as to the second and third parts of the test - tax saving, and preferability.

104. We consider there are three categories of risk which even if viewed individually are fatal to the applicants' case:

(1) There was and is a real, non-trivial, risk of HMRC interest in the arrangements, as an impermissible species of tax avoidance and/or abuse of rights;
(2) There was and is a real, non-trivial, risk of HMRC challenge to the arrangements on either of those bases;
(3) The outcome of such a (hypothetical) challenge cannot be reliably predicted.

105. We have no regard to the risk of HMRC arbitrarily, capriciously or irrationally taking an interest in and/or challenging the arrangements (which came to be referred to as 'stochastic' risk). The best that can be said is that this risk, if it even exists, is ubiquitous, in the sense that it affects all taxpayers equally. It does not shift the analysis in this case one way or the other.

106. Nor do we have regard to the fact that the VAT rate could be reduced by the UK Government (which would in turn have a corresponding impact on the overall fiscal benefit to be obtained). The standard rate of VAT does change from time-to -time but it has not changed since 2011. We proceed on the footing that the standard rate will remain as it is for the foreseeable future. Equally, other changes in tax law generally are entirely imponderable. No-one has pointed to any imminent change, nor any proposed change under consideration.

107. We have no regard to whether the respondent landlords are unduly sensitive to reputational risk, or institutional risk from their shareholders, if they are ultimately found to have engaged in impermissible tax avoidance. Insofar as those affect matters of corporate governance, they are ones for the respondents' directors. They cannot be realistically challenged in this jurisdiction.

108. The outcome is that it cannot be said, with the degree of certainty which would satisfy any reasonably prudent taxpayer, or which would satisfy us, that the intended VAT consequences would even probably follow.

109. In his closing submissions and in response to questions from the Tribunal, Mr Wong put the prospects of either model being ultimately successful in achieving the aim of saving VAT at 60%. He is to be commended for his willingness to grasp the nettle and enter what has been referred to as 'the percentages arena'. His is a best guess, but it is one which is founded on his specialist and extensive knowledge and experience. Put another way, his best guess is that either model, if it should ever be developed and be implemented, is likelier than not to succeed, but not by much. On Mr Wong's assessment, for every five times the model is implemented, it succeeds on three occasions but fails on two. On any view, in Ms Shaw KC's words, "it is hardly a ringing endorsement". We agree.

110. Also, it is important to note that figure is "if implemented", and so this would be after a trouble-free implementation. Thus even 60% has to be taken as the high-water mark of success. Looked at before implementation, which is the actual situation we are in, the chances of success would inevitably be lower because of the implementation risk i.e. the chances of things going wrong when translating a concept into reality. Even if a model were

implementable, we do not consider that any reasonable landlord would press on with implementing it on these figures.

111. Hence, the second limb of the test - tax saving - is not met, even as so to cross the initial realistic case threshold which would have made it unreasonable for the landlord to decline to consider the proposals. Those findings are sufficient to dispose of the applications. But it may be helpful to the parties and any reader of this decision if we set out in some greater detail our findings in relation to some of the matters which were in issue.

The Respondents' Failure to seek non-statutory clearance

112. "Non-statutory clearance" is a long-established mechanism which operates according to guidance published by HMRC. A taxpayer can approach HMRC for a 'ruling' in relation to its individual circumstances. Rulings are taxpayer-specific. They are not ordinarily meant to operate on an industry or sector basis. If HMRC wanted to make industry-wide changes, it would do so by way of a published Notice.

113. HMRC is not bound to give a ruling. According to HMRC, non-statutory clearance will not generally be given in relation to (i) hypothetical transactions, (ii) where the point is already covered by notices or other published guidance, or (iii) in relation to perceived tax planning or transactions which, in HMRC's view, are for the purposes of avoiding tax.

114. Where a ruling can properly be obtained, within the four corners of the HMRC scheme, it is nonetheless important, if the ruling is to be useful (ie, if it can be relied on so as to bind HMRC) that the taxpayer must give HMRC "all the necessary information". The scope of this "necessary information" is more fully set out in a checklist in Annex D of the online guidance.

115. Clearance can be sought by writing a letter to "Written Enquiries". However, unless a submission meets the requirements of Annex D, a response from Written Enquiries will not amount to a binding ruling. Nor will a response constitute non-statutory clearance unless it clearly - whether expressly or by necessary implication - approves the arrangements. Contrary to the Applicants' evidence, treating a letter from Written Enquiries as giving approval because it does not expressly disapprove of proposed arrangements is not the correct approach. Similarly contrary to the Applicants' evidence, treating a letter from

Written Enquiries as a final and conclusive response because the taxpayer has said to HMRC 'please contact me if you need to know anything further', and HMRC does not ask for anything further is not the correct approach.

116. An important part of obtaining non-statutory clearance is that the taxpayer "should have put all his cards face upwards on the table": *R v Inland Revenue Commissioners, ex p. MFK Underwriting Agencies Ltd* [1990] 1 WLR 1545 at page 1569. There, a Divisional Court consisting of Bingham LJ and Judge J (as they each then were) explained this as follows:

> "This means that he must give full details of the specific transaction on which he seeks the revenue's ruling, unless it is the same as an earlier transaction on which a ruling has already been given. It means that he must indicate to the revenue the ruling sought. It is one thing to ask an official of the revenue whether he shares the taxpayer's view of a legislative provision, quite another to ask whether the revenue will forgo any claim to tax on any other basis. It means that the taxpayer must make plain that a fully considered ruling is sought...... Fairness requires that the exercise be on a basis of full disclosure. HMRC will decline to be bound by its rulings unless the taxpayer has given HMRC all the relevant facts and draws attention to all the issues. For example, HMRC expects you to provide information on any relevant and related transactions."

117. The landlords say that they are under no obligation to seek non-statutory clearance and even if they were obliged to do so it would be expensive and in any event the prospects of obtaining non-statutory clearance are unknown but not guaranteed to be favourable. We agree with all of these propositions.

118. There is nothing of genuine evidential weight which permits us to make any finding as to the likelihood of non-statutory clearance being granted in relation to either of the models. Neither our view, nor (respectfully) that of the competing experts can be anything more than hypothetical against the background where in fact, there is no finally formulated model. Furthermore, there is nothing in the evidence to show that it was unreasonable for the respondents not to have sought non-statutory clearance.

119. For the same reasons, we do not consider that an earlier step potentially open to the respondents, that of taking a “sounding” or an indication from the “Customer Compliance Manager,” would have yielded any different outcome.

HMRCs Likely approach to the scope of exemptions

120. It is common ground that "the grant of any interest in or right over land or of any license to occupy land..." is an exempt supply: Schedule 9 Item 1 of the Value Added Tax Act 1994. In this case the models which seek to mitigate or remove the incidence of VAT on the tenants all rely on 'coupling' or 'aggregating' the supply of otherwise VAT-able services on the back of the exempt supply of land so to as bring the services within the scope of the exemption.

121. There is a realistic possibility that coupling the services with the supply of land in such a manner would attract HMRC attention. Firstly, HMRC take an active and vigilant interest in monitoring the scope of exemptions as witnessed by the many reported cases in the Tax Tribunal and on appeal where the dispute is one as to the scope of a particular exemption. Secondly, a number of Tax Tribunal cases show that HMRC take an active interest in monitoring allegedly composite or aggregated supplies to ensure that services are not being artificially aggregated to procure more advantageous VAT treatment. This is an aspect of a wider ‘abuse of rights’ doctrine which seeks to bar artificial arrangements which do not reflect economic reality and are set up with the sole aim of obtaining a tax advantage: *Newey v Revenue and Customs Commissioners* (C-653/11) [2013] STC 2432.

122. Moreover, there is a realistic possibility that coupling the services with the supply of land in order to render them exempt would not, if challenged by HMRC, have an outcome which is predictable with any degree of certainty. This is for a number of reasons.

123. Firstly, the general judicial approach to the scope of exemptions is an interpretative one. Even if an exemption has to be construed strictly, it nonetheless does not have to be given the most restricted or narrow meaning it can bear, but a meaning which it can fairly and properly bear in the context in which it is used. The need to assess context itself often introduces inherent uncertainty in the VAT treatment of transactions, and generates disputes which reach the Tax Chamber.

124. The second, narrower, point, is more specific to this exemption, both in terms of retained EU law and domestic law. The governing authorities on the interpretation of this exemption lay down general principles, but the application of those in any individual case is nonetheless fact-sensitive. As is remarked in De Voil on *Indirect Tax (Service Charges)* "the position is likely to depend on the facts of any particular case." We agree.

125. The applicants submitted a supplementary skeleton argument, dealing with a single tax issue, namely the VAT treatment of services required for the upkeep of the relevant building or estate. Here, reliance is placed on what is said to be the principles derivable from *Levob Verzerkeringen BV v Staatsecretaris van Financien* (Case C-41/04) as explained by the ECJ in *Mesto Zamberk* (Case C-18/12), especially at Paragraph [28], and said to capture the situation where supplies are made by two different suppliers:

> "There is a single supply where two or more elements or acts supplied by the taxable person to the customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split ... There is also a single supply where one or more elements are to be regarded as constituting the principal supply, while other elements are to be regarded, by contrast, as one or more ancillary supplies which share the tax treatment of the principal supply."

And from *Card Protection Plan Ltd v Customs and Excise Commissioners* (C-349.96):

> "A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied"

126. Two points can be made: The first is that *Levob* and *Card Protection Plan* articulate general principles. The challenge in any particular case is how to apply those principles to the facts. The facts have to be things which actually exist in the real world; not constructs or models which have not passed the ideas stage. The difficulty here is that the parties do not even agree the relevant principles, let alone the likely application of those principles to either of the models.

127. The second is that the very volume and weight of authorities is strong evidence that the question of the treatment of VAT on the service charges is likely to be problematic.

HMRC's likely approach to avoidance

128. Subject to the above remarks about our conclusions, the necessarily hypothetical nature of the exercise, and the scope of our jurisdiction, we consider whether there is a risk that HMRC would consider any of the models to reflect impermissible tax avoidance.

129. It is important to understand the concept. A succinct description of avoidance was given by the FtT in *Tower 1 Saint George Wharf Ltd v HMRC* [2022] UKFTT 154 (TC) at Paras. [59]-[60] (albeit in the context of SDLT and not VAT). The Tribunal said:

> "59. In general, it may be said that it is not tax avoidance to accept an offer of freedom from tax which Parliament has deliberately made, but that it is tax avoidance to adopt a course of action designed to conflict with or defeat the evident intention of Parliament by taking advantage of a fiscally attractive option afforded by the tax legislation without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in tax liability (*Inland Revenue Commissioners v Willoughby* [1997] 1 WLR 1071 at 1079B-G, 1081B-D).
>
> 60 It may also be said that where there are two ways for a taxpayer to carry out a genuine commercial transaction, it is natural for the taxpayer to choose the way that will involve paying the least amount of tax, and that the taxpayer by making that choice cannot for that reason alone be said to be acting with a main purpose of avoiding tax (*Commissioners of Inland Revenue v Brebner* (1967) 43 TC 705, 718H-I). However, it follows from the previous paragraph that a taxpayer in this situation may well be acting with a main purpose of avoiding tax if the chosen way conflicts with or defeats the evident intention of Parliament. The mere fact that the taxpayer is carrying out a genuine commercial transaction does not mean that no means adopted for effecting that transaction can ever be tax avoidance."

130. The Judge continued:

> "66. Where there are two ways for a taxpayer to carry out a bona fide commercial transaction, one of which involves tax avoidance and one of which does not, and

where the taxpayer chooses the way that involves tax avoidance, then tax avoidance will be at least one of the purposes of adopting that course, whether or not the taxpayer has a subjective motive of avoiding tax (Willoughby at 1079C-D, 1081B-D)"

131. Accordingly, it cannot be said what likelihood of a challenge there is; but the likelihood is certainly real, and not trivial. The principal feature attracting attention would be the continuing involvement of R&R, because HMRC would - in our view, inevitably, ask why the model had been implemented in the way that it had, where the only apparent benefit to the taxpayer was the saving of VAT.

The role of the FtT in dealing with an extra-statutory concession

132. In *Michael Prince and others v HMRC* [2012] UKFTT 157 (TC), Judge Colin Bishopp, the then-Chamber President, decided that the Tax Chamber of the FtT had no jurisdiction to consider the meaning or effect or application of an extra-statutory concession (in that case, ESC A19). That is not to say that a decision about the scope or applicability or application of an ESC would not be beyond challenge, but such a challenge would not obviously be within the scope of the jurisdiction of the Tax Chamber, nor, in our view, a fortiori, this Chamber, but (perhaps) would be a public law challenge by way of a claim for judicial review in the Administrative Court.

133. In 2015, the Upper Tribunal (Lands) Chamber issued its decision in *Ingram v Church Commissioners* to the effect that ESC 3.18 did not extend to staff costs where the staff are employed by a managing agent who invoices the lessor for those services. With deference to the Upper Tribunal, we are of the view that the decision, insofar as it sought to discuss or examine the meaning of effect of ESC 3.18 was given *per incuriam*. This is not because section 27A imposes a restriction on what may be considered in deciding payability but for the reason already set out: the scope, meaning, and effect of the ESC were not justiciable in this Tribunal, any more than they would have been in the Tax Tribunal. *Ingram* rested in the Upper Tribunal, and did not go to the Court of Appeal. HMRC had not been a party in *Ingram*, and so neither Tribunal in *Ingram* had the benefit of any submissions made to it by HMRC.

Assessment by HMRC

134. HMRC has a limited window in which to make an assessment. An assessment may not, in the majority of cases, be made more than two years after the end of the prescribed accounting period or notification concerned, but can be made up to four years after the end of the prescribed accounting period: see Value Added Tax Act 1994 section 77(1)(a). Here, it is said that disclosure of the arrangements to HMRC would be made by way of voluntary disclosure alongside the VAT return for the first accounting period in which the arrangements were operative. Voluntary disclosure alerts HMRC to the arrangements, which otherwise it might not have discovered, and has the potential benefit of depriving HMRC of an argument that the arrangements were 'concealed'.

135. It is said that HMRC could launch a wide-ranging enquiry and if they did so then lengthy and detailed correspondence between the VAT technical team at HMRC and the respondents' professional advisers can realistically be expected to ensue. It is tolerably clear that any inquiry by HMRC, regardless of scope, has the potential to be searching, prolonged, and correspondingly expensive.

136. The 'worst case scenario' would be one in which HMRC would regard the supplies as non-exempt and would assess the provider of the supplies to a sum of VAT payable to HMRC. Even for one period, that would be a substantial sum. It is likely though that HMRC would take more than one period to inquire into the arrangements and to decide what to do. If that happens, there could be assessments for two, or more, accounting periods.

The Likely Progress of any appeal

137. If the assessed person chose not to pay the tax, then it would have a right of appeal. As explained, if the challenge were to the scope of ESC 3.18 it may lie in the Administrative Court and not the Tax Tribunal. But if it were in the Tax Tribunal, resolution of an appeal would take at least some months, and perhaps even longer. Thereafter, a decision at first instance could itself be subject to an appeal to the Tax and Chancery Chamber of the Upper Tribunal, or even the Court of Appeal. Any appeal, even to the FtT would be expensive. One estimate given at the hearing was £250,000 to resolve a case at first instance.

138. We mention a general point here, namely that if there is a delay in invoicing or notifying the lessees that VAT charges have been incurred and will form part of a future

service charge invoice as a result of delays in resolving an HMRC challenge or determination, then the respondents may fall foul of the provisions of section 20B of the Landlord and Tenant Act 1985. This is a notoriously difficult section and there is extensive authority on the question of when costs are "incurred" for its purpose. We regard the possible impact of section 20B as being a further risk.

Conclusion on Tax Risks

139. We are wholly satisfied that the risk that HMRC might not accept the validity of either model in achieving an employment shift where VAT would no longer be payable is a real and tangible risk. We do not consider that it would be unreasonable for a landlord to decline to take such a risk.

140. We are conscious that it is important that we reconcile any differences between our approach to the VAT issues in this case from the Upper Tribunal decision in *Ingram v Church Commissioners*. In this case we are not concerned with the question of whether *Ingram* was correct in its conclusion on the staff costs issue as it was agreed that, so far as HMRC are concerned, any doubt has been resolved by VAT Information Sheet 07/18 of 7 September 2018. However, we observe that the decision was made in the absence of evidence from a VAT expert or submissions from specialist tax counsel and it is possible that the outcome of the case might have been different had that not been the case.

141. In this context we have in mind the House of Lords decision in *Trustees of the Nell Gwynn House Maintenance Fund v Customs and Excise Commissioners* [1999] 1 WLR 174. That case concerned the VAT treatment of an arrangement whereby trustees of a block of luxury flats paid for its day-to-day management and maintenance, including staff salaries, out of a fund. The leading speech was given by Lord Slynn of Hadley who considered the scope of the exemption (which was then to be found in Schedule 6 Group 1 Item 1 of the Value Added Tax Act 1983), and the Extra-Statutory Concession. At page 184D-E, he said:

> "The parties agreed that this provision would exempt the provision of maintenance services if made by the lessor to the lessee; the services could be part of the grant of the leasehold interest. [...] The supplies of services (in our case maintenance services standard rated) the leasehold interest (exempt) would be treated as one composite supply of services (exempt supply). It would seem that since 1 April 1994 by a

concession made by the commissioners the exemption would be treated as applying to maintenance services provided by others if they would have been treated as exempt if supplied by the lessor."

142. As Lord Slynn recognised, and as we were reminded, the ESC did not apply in *Nell Gwynn*, because the relevant events antedated 1 April 1994. Hence, what he said was, strictly speaking, obiter but nevertheless it is a persuasive statement. Had the Upper Tribunal been aware of the decision we consider it possible that the outcome of *Ingram* and the conclusion expressed at Paragraph 44(4) of the Upper Tribunal's decision would not have been the same.

143. So far as any proposition that the charging of VAT is susceptible to a reasonableness challenge is concerned, it is important to be specific about the words used in the Upper Tribunal decision. At paragraph 45 Judge Robinson said:

> "[...] Given that the standard rate of VAT is 20%, this could potentially 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 section 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".

The Upper Tribunal did not decide the issue one way or the other and it is clear that there was no intention to do so.

Conclusion and Decision

144. As will have become apparent, we have decided that the applications must fail. We summarise our reasons below.

145. Save in one respect, the applications do not engage the Tribunal's jurisdiction under section 27A of the 1985 Act. A substantial part of the applicants' challenge is a challenge to

the way in which the landlords had reached their management decisions and not to the outcome of those decisions.

146. Insofar as the challenge is to the outcome of those management decisions so that the question of whether the VAT costs had been reasonably incurred is engaged, we do not consider that the lessees made out a "prima facie" case for the Tribunal to consider. By this we mean that they failed to make a coherent initial case as to an alternative course for the landlord to adopt and for the Tribunal to consider either at the outset of the application or at any time thereafter.

147. Despite those findings, we went on to consider whether the landlords had acted unreasonably in incurring the VAT costs. For the reasons already set out in this decision, we are satisfied that the VAT costs were reasonably incurred. We consider that both the management and tax risks involved in changing the arrangements for the employment of staff were such that it was not unreasonable for a landlord to refuse to do so.

148. Additionally, we are satisfied that the set-up costs for any new model of employment would extinguish the benefit of the VAT savings for at least 2 years. We are also satisfied that the ongoing costs of running a new model of employment would, even on the applicants' case, be more expensive that the current arrangements and on that basis it is not unreasonable for the landlords not to implement a new scheme.

149. We find as a fact that even if there had been an agreement that a new model of employment should be put in place, that the change would have taken between 1 and 2 years from November 2018 and therefore could not have been implemented during the two service charge years challenged in these applications. The finding was based on the evidence of Mr Maloney and confirmed by Mr Platt. The applicants contended that the respondents ought to have made arrangements for the change of the model of employment in advance of 2018. We do not agree. From the very outset of the leases, the managing agents had employed the staff. Until 2018 no complaint or challenge was made to that arrangement. No challenge was made to that arrangement following the *Ingram* case. No complaint or challenge was made to the decision of the managing agent and landlord not to account for VAT on staff salaries. Insofar as we are able on the available materials to make any findings, we do not consider that it can realistically be said that the Respondents should have been

making inquiries, or changes, to their practices in response to *Ingram* and before the 2018 clarification. Even HMRC took three years from the release of the Upper Tribunal's decision in *Ingram* to issue its clarification guidance. The application would fail on this basis alone.

150. Accordingly, the applications are dismissed. The Tribunal has yet to deal with the applications under section 20C of the 1985 Act and the parties are invited to agree directions as to the further conduct of that part of the case.