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RESIDENTIAL SERVICE CHARGE MANAGEMENT

Porters' Salaries, Pensions & VAT

Background

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It is not uncommon to come across a block of flats where a porter, caretaker, or concierge is employed to carry out various duties. But what if a landlord structures the employment of those members of site staff in such a way that VAT needs to be added to the service charge account on top of the salaries? This paper discusses the treatment of VAT on the salaries of such site staff and whether or not a landlord is able to recover the VAT from its leaseholders via the service charge account.

The Pensions Act 2008

Under the Pensions Act 2008, every employer in the UK must offer certain staff membership of a pension scheme and contribute towards it; this is called 'automatic enrolment'. This includes a landlord who employs site staff to provide services to the residents of a block of flats. Automatic enrolment has only come into effect in respect of small businesses very recently, which means that landlords who employ site staff now have to offer a pension scheme to those members of staff.

Most managing agents tend to be more involved in the employment relationship than their landlord/resident management company clients, and we have come across some managing agents who have set up a subsidiary company in order to take over the employment responsibilities for all of their clients. This has certain advantages such as only having to arrange one group pension scheme, rather than one pension scheme for each block of flats where site staff are employed.

Ingram v Church Commissioners For England [2015] UKUT 0495(LC)

This case before the Lands Chamber of the Upper Tribunal concerned a block of flats known as The Water Gardens in London, W2. A lessee (Mrs Ingram) challenged the landlord for including certain items of VAT within service charge demands over 3 financial years. The managing agent in this case employed the porters via a subsidiary company, charged VAT on top of the salaries as well as a fee for taking on the employment responsibilities.

For illustration purposes, let us assume that four members of site staff are employed at a block of flats, each on a salary of £25,000 per annum. The total charged to the service charge account in respect of salaries would therefore amount to £100,000 per annum. In *Ingram*, the managing agent charged an "HR fee" for human resources services that would typically be provided by an HR department, calculated as 15% of the total salaries for all site staff employed; VAT at 20% was then charged on top of the salaries and on top of the HR fee. Rather than charging £100,000 to the service charge account, the landlord would charge a sum in the region of £138,000 per annum which includes the salaries, HR fee, and VAT. Taking into account the sums involved, it is understandable that a lessee would want to ensure that their landlord is charging VAT on the correct basis or not charging VAT at all if the service falls into any exempt category for VAT purposes.



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At first instance, the First-Tier Tribunal rejected the lessee's challenge and held that the relevant items of VAT were recoverable. Permission to appeal the decision of the First-Tier Tribunal was granted by the Upper Tribunal because the VAT treatment of service charges is not straightforward and not well understood. The issue that arose at appeal was whether the relevant items of VAT included in the service charges fall within an extra statutory concession set out in VAT Notice 48 paragraph 3.18 and therefore should not have been included in the service charges.

Attached to this paper is an extract of VAT Notice 48, which details various scenarios in which the extra statutory concession may apply (i.e. when VAT does not need to be charged). Paragraph 3.18 of VAT Notice 48 deals with the concession for all domestic service charges. Some guidance on that concession is given in VAT Notice 742: Land & Property, Section 12, a copy of which is also attached to this paper. Both of these VAT notices are referred to in detail throughout the judgement in *Ingram*.

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

MT Site Staff Ltd

During 2015, we set up a pension scheme for site staff employed at the blocks of flats that we manage. We set up our own subsidiary to take advantage of the cost savings, so that we operate one group pension scheme for members of staff at all of our managed blocks of flats rather than a separate pension scheme for each individual block. This has involved transferring the employment of each member of site staff from the landlord/resident management company to MT Site Staff Ltd. We sought advice from an accountant who has experience in these matters, (Peter McKay of Nicholsons, Chartered Accountants - email peter@nicholsons.biz) and met with a representative of HMRC; consequently, we have structured the employment arrangement in such a way that VAT does not need to be charged on top of salaries. We are therefore able to pass on the substantial cost savings to lessees at our managed blocks.

Conclusion

Since automatic enrolment has come into effect, we anticipate that more and more managing agents are going to offer alternative employment arrangements that are a step away from the traditional arrangement of the landlord/resident management company employing site staff. Depending upon how such alternative arrangements are structured, other managing agents may be obliged to charge VAT on top of salaries, which may give rise to an argument from their lessees that any VAT charged in addition to salaries has not been reasonably incurred for the purposes of s.19 of the Landlord & Tenant Act 1985. As HHJ Robinson did not express any view about that argument, we will have to see how the First-Tier Tribunal deals with any such disputes in due course.

Should you wish to discuss this article further, please contact Michael Maunder Taylor:
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