

Item 5

Policy paper

Revenue and Customs Brief 6 (2018): VAT exemption for all domestic service charges

Published 7 September 2018

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1. Purpose

This brief, along with [VAT information sheet 07/18](#), explains:

- when the Extra Statutory Concession (ESC) 3.18 VAT: exemption for all domestic service charges may be applied
- what property management and similar companies must do if they have wrongly applied the concession and, as a result, not declared the correct amount of VAT due, or recovered an incorrect amount of input tax

2. Readership

Anyone seeking to rely on ESC 3.18 and anyone that is affected by someone who relies on it. This includes:

- property management companies
- housing associations
- developers
- property owners
- landlords
- anyone offering similar services connected with residential dwellings

3. Background

Customs and Excise Brief 03/94 issued February 1994 introduced ESC 3.18. The concession applies only when residential leaseholders and freeholders pay a mandatory service charge for the same common services on a common estate. Its purpose is to allow the same VAT treatment of these service charges for all of those living on the estate.

The concession came into effect from 1 April 1994. If a landlord is contractually obliged to provide services to all occupants of a common estate, they may choose to use the concession to treat these supplies, when made to a freeholder, as exempt from VAT.

Leaseholders and tenants are exempt from paying VAT on these charges as the charge is directly linked to an exempt supply of an interest in land. Freeholders do not have this link, so for them, these charges are normally taxable at the standard rate of VAT.

Landlords often use property management companies or companies offering similar services, to fulfil their legal obligations to the occupants of an estate. The property management company obtains goods and services on behalf of the landlord and charges a management fee for providing such a service. This management fee is taxable at the standard rate of VAT and is not covered by ESC 3.18. Property management companies, or similar, cannot use the concession.

The Upper Tribunal (Lands Chamber) decision of 15 September 2015 in the case of Mrs Janine Ingram (2015) UKUT 0495(LC) confirmed HMRC's view of how the concession operates.

HMRC knows of a number of property management and similar service companies who provide goods and services to landlords of residential buildings, but are not correctly accounting for VAT. These companies cannot use the concession to:

- treat their supplies as if made to the occupant rather than the landlord
- recharge costs borne on behalf of the landlord, back to the landlord
- recharge staff or personnel costs to the landlord

4. Action needed

From 1 November 2018, all property management companies, and companies supplying similar goods and services in similar situations, who have not correctly applied ESC 3.18, must correctly account for VAT, as explained in [VAT information sheet 07/18](#).

The content of this brief, [VAT information sheet 07/18](#) and updated section 12 of [Land and property \(VAT Notice 742\)](#) cancels and replaces any guidance or advice that HMRC has previously provided on this subject.

5. Further information

[VAT information sheet 07/18](#) provides guidance on:

- applying ESC 3.18 on or after 1 November 2018
- the direction of a supply made by the various parties and the relevant liability of that supply
- common scenarios that arise when you apply ESC 3.18

See updated [section 12 of Land and property \(VAT Notice 742\)](#) for further guidance.

If you require further help contact the [VAT: general enquiries helpline](#).

Policy paper

Revenue and Customs Brief 10 (2018): VAT - cost share exemption

Published 31 July 2018

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1. Purpose of this brief

This brief explains a further change to HMRC's policy following legal judgments on the cost share exemption (CSE).

[Revenue and Customs Brief \(3\) 2018](#) detailed previous changes which have been added into guidance. Paragraph 5 of that brief explained that HMRC was still considering the impact of the judgments on:

- the test for directly necessary services which enables cost share group (CSGs) to ignore certain non-qualifying supplies for the CSE
- the social housing sector

This brief is about HMRC's conclusions on the test for directly necessary services.

The review of the use of the CSE by social housing associations has not been completed, so there is no change to the guidance at this time.

2. Readership

UK businesses who are thinking of implementing or have already implemented a cost share group (CSG), and have used HMRC's guidance in the previous Cost Sharing Exemption manual CSE3720 to CSE3840 on directly necessary services.

Accountants, consultants and others who provide VAT advice to the businesses above.

3. Background

The CSE allows persons who carry on activities covered by certain exemptions to join together to form a CSG so they can acquire services and recharge their members for their use of the services at cost without incurring any additional sticking VAT.

This exemption allows small providers who cannot afford to acquire assets on their own account to benefit from the same overall VAT position as larger providers who can afford to purchase the assets themselves. The circumstances where the CSE applies are fully explained in the VAT Cost Sharing Exemption manual [CSE 1010](#).

Luxembourg has a rule where residual costs used by a CSG could be treated as qualifying for exemption under the CSE if up to 30% of those costs were also used by the members to make taxable supplies. The UK has a similar test but with a lower percentage of 15%. This is referred to in this brief and the former guidance as the 'directly necessary' test.

The Advocate General in *Commission v Luxembourg* (Case C-274/15) said that the CSE could not be used for such costs and this was confirmed by the Court in its judgment. The current tests for directly relevant services are therefore withdrawn from 15 August 2018.

This means some CSGs will have to register for VAT if they go above the current registration threshold, however they may not need to do this before 31 December 2018 because of the transitional arrangements in [paragraph 5](#).

4. Changes to HMRC's policy

The Court in its judgment held that the CSE was not restricted to CSGs whose members exclusively carried on exempt or non-business activities. Services which are bought by the CSG for mixed use could qualify for the CSE, but only to the extent that they were directly necessary for exempt or non-business activities by the members of the CSG.

HMRC is therefore introducing guidance on a suitable apportionment calculation which may be used where it is practicable to do so, and the conditions for its use can be met.

Apportionment of the recharge of costs by the CSG to its members will be allowed if the CSG can carry it out fairly and keep records necessary for HMRC to verify the calculation. Full details are in the updated VAT Cost Sharing Exemption manual pages [CSE3850](#) to [CSE 3895](#).

HMRC reserves the right to refuse the exemption:

- if the records to justify the apportionment used have not been kept
- in any case of avoidance or abuse

5. Transitional arrangements

CSGs that have correctly used the previous guidance can continue to use the previous tests for directly necessary services until 31 December 2018, to give them time to make sure the correct records are set up and kept.

The previous tests are set out in the VAT Cost Sharing Exemption manual pages [CSE 3720](#) to [CSE3840](#).

The transitional arrangements cannot be used or relied on in cases:

- of tax avoidance
- where there is likely to be a distortion of competition

Services invoiced or paid for before 31 December 2018 will only benefit from the transitional arrangements to the extent that they're performed before that date (specifically the basic tax point under section 6(3) of the VAT Act 1994 will apply).

Where prepayment or invoices cover services to be performed both before and after that date, then a reasonable apportionment will be needed.

6. Action required

CSGs should read the updated guidance on directly necessary services and consider the impact of the changes to the rules.

[Contact HMRC](#) if you need more information.