

VAT and Rent Reviews for Secure Agricultural Tenancies in Scotland

Background

This note reports on the result of the judgment in the recent English case of *Mason v Boscawen*. In his judgement Mr Justice Lewison held that, for the purposes of the English 1986 Agricultural Holdings Act, the word “rent” includes any element of VAT charged to the tenant on the underlying rent.

The likely consequence of this is that whenever the VAT rate changes, as it did in December 2008 (and will in all likelihood again in January 2010) the three years cycle contemplated by the rent review provisions under the 1986 Act will be reset, thus preventing on each occasion any subsequent review for a further three years. In the words of Mr Justice Lewison himself this is “*an inconvenient result*” and “*an example of the law of unintended consequences*”.

Whilst the judgement is not binding in Scotland, the wording of section 13 of the Scottish 1991 Agricultural Holdings Act is sufficiently similar to its English equivalent that it is difficult to see why the case would not be followed if the same point came before a Scottish court.

It is important to stress that the consequences of this judgement are only relevant for Scottish farm tenancies where:

- there is a secure agricultural tenancy regulated by the Agricultural Holdings (Scotland) Act 1991
- the landlord has “opted to tax” for VAT on the land and hence is obliged to charge VAT on the rent.

Implications

The formal process of rent review requires the party seeking a variation of the rent (landlord or tenant) to serve a formal written notice on the other party at least one year (but not more than two) before the contractual expiry date of the lease or any anniversary of that date. Once the rent has been reviewed, at least another three years must elapse before the rent can be reviewed again except in limited circumstances, none of which apply to a change in VAT rate

The result of VAT change on 1st December 2008 which reduced the rate of VAT from 17.5% to 15% was to vary as at that date the rents of those tenants whose landlords charge VAT on

their rents. The consequence of this is that if, say, the lease in question has a Martinmas (28th November) expiry date then the next date at which the rent can be reviewed is 28th November 2012 provided notice is given prior to 28th November 2011.

If the VAT rate were to change again in say, January 2010 then the rent could not be reviewed until 28th November 2013 provided notice is given prior to 28th November 2012.

In the case of a lease with a Whitsunday (28th May) expiry date the consequence of the VAT rate change in December 2008 would be that the next date at which the rent could be reviewed would be 28th May 2012 and 28th May 2013 (if the VAT rate changes again in January 2010). In each case the requisite notice would need to be given.

Assessment

It has been suggested in some quarters that in order to avoid the outcome that a change in VAT automatically results in a change in the rent payable under a tenancy, a landlord could decide to increase or decrease the value of the underlying rent to offset exactly the change in the VAT payable. Notwithstanding whether such an approach would work, such a change would firstly require an agreement with the tenant (who is likely to have little incentive to do so) and secondly would have had to have been agreed at the time of the change of rate. This is so that at no point in time was the rent payable under the tenancy greater or lesser than the previous rate. It is not anticipated that this would have been feasible given the short notice with which the VAT change was introduced; whether it could be deployed to anticipate the rise due on 1 January 2010 is another matter. However it remains difficult to see how it could be in the tenant's interest to agree such a change.

Mr Justice Lewison stated that *"the consequences of this conclusion, if correct, make it urgent for legislation to be rapidly passed if recent political events are not to have the effect of causing an inadvertent and possibly prolonged agricultural rent freeze"*.

He also granted leave to appeal although it is understood that no appeal has been taken.

There is little doubt that the implications of this case could have serious consequences for landlords of agricultural holdings who have opted to tax. If you find yourself in a position where you may be affected by this judgement please do get in touch to discuss this further.

Gillespie Macandrew – February 2009

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