

Richard Thomas Paul Mason v The Honourable Evelyn Arthur Hugh Boscawen



No Substantial Judicial Treatment

Court

Chancery Division District Registry (Bristol)

Judgment Date

18 December 2008

Case No: 7BS90941

High Court of Justice Chancery Division Bristol District Registry

[2008] EWHC 3100 (Ch), 2008 WL 5245793

Before: The Honourable Mr. Justice Lewison

Date: 18 December 2008

Hearing dates: 8th December 2008

Representation

Mr. Martin Rodger QC (instructed by Burges Salmon LLP) for the Claimant.

Mr. Leslie Blohm QC (instructed by Foot Anstey Hancock Caffin Solicitors) for the Defendant.

Approved Judgment

The Honourable Mr. Justice Lewison

1. What counts as “rent” for the purposes of a notice to pay given under [Schedule 2 of the Agricultural Holdings Act 1986](#) (“the 1986 Act”) as a prelude to the service of an incontestable notice to quit? That is the short but difficult question posed on a reference in the course of an arbitration arising out of the service of a notice to quit alleging failure to comply with a notice to pay. The problem arises because the landlord has opted to charge VAT on part of the rent. Does the VAT element itself count as rent? If it does not, then the parties agree that the notice to pay demanded too much and is therefore invalid. If it does, then the tenant has a separate argument that the notice was unclear and is invalid on that account.

2. The facts are not in dispute. Mr Mason is the tenant of a farm at Great Trewirgie, Probus, Cornwall. The tenancy is an annual tenancy originally granted in 1988. The property comprised in the tenancy consists of a dwelling house, buildings and 225 acres of agricultural land. Under the terms of the tenancy the rent is payable by quarterly instalments in arrear on the usual quarter days. The initial rent was £7,875 per annum, and that is the sum that the tenant agreed to pay under the express terms of the tenancy. By clause 3 (2) the tenant also agreed to pay the land tax and “all other taxes rates charges assessments and outgoings whatsoever whether parliamentary parochial local or of any other description which are now or may hereafter be assessed charged or imposed upon the Farm or the owner or occupier in respect thereof”.

3. On 25 April 2001 the landlord informed the tenant that he had decided to add VAT to his commercial and agricultural rents. Because Mr Mason's holding included a dwelling house, not all the rent was potentially subject to VAT. In the result, 90 per cent of the rent was subject to VAT but the remaining 10 per cent was not. Rent invoices were sent regularly to the tenant. A typical invoice (of which I was shown some examples) distinguished between the basic rent and the VAT. Thus the invoice sent in relation to the rent due on 29 September 2006 set out the amount demanded as follows:

Description	Net	Vat %	Vat £	Total
Agricultural rent (Vatable element) 29/09/2005	£4702.50	17.50	£822.94	£5525.44
Agricultural rent (Non Vatable element)	£522.50	0.00	£0.00	£522.50
Total	£5225.00	£822.94		£6047.94
Amount now due				£6047.94

4. Mr Mason did not pay the rent due on 29 September 2006. On 8 November 2006 the landlord's agent wrote to him enclosing a Notice to Pay "relating to the full amount outstanding". The same letter also noted that insurance of £535 was also due on 29 September and had not been paid. The accompanying Notice to Pay was in the form prescribed by The [Agricultural Holdings \(Forms of Notice to Pay or to Remedy\) Regulations 1984](#). It gave notice that the landlord required the tenant to pay within two months of the date of service of the notice "the rent due in respect of the above holding as set out below". The particulars of the rent not paid were given as follows:

"£6047.94 Rent inclusive of VAT"

5. This sum was the same sum as the total demanded by the invoice which Mr Mason had received for the rent due on 29 September. Mr Mason did not pay the amount demanded within the two month period. Consequently the landlord served notice to quit on 9 January 2007. The notice to quit stated that it was given on the ground set out in [Case D of Schedule 3 to the Agricultural Holdings Act 1986](#) namely that:

"At the date of the giving of the notice you have failed to comply with a written notice dated [8 November 2006] served on you by your landlord which required you within 2 months of service of the notice to pay rent due in respect of the Holding."

6. On 5 February 2007 Mr Mason demanded arbitration on the reason stated in the notice to quit. The effect of demanding arbitration is to suspend the operation of the notice to quit until the conclusion of the arbitration. On 13 June 2007 Mr CC Wreford-Brown FRICS FAAV was appointed as arbitrator. The parties have nevertheless agreed to refer to the court, under section 45 of the Arbitration Act 1986 the following two questions of law:

“(a) Whether, where a Notice to Pay Rent purportedly served pursuant to [Schedule 3, Case D of the Agricultural Holdings Act](#) seeks to include as rent due such sum as may have been payable by the tenant to the landlord by reason of the exercise by the landlord of his right to elect to waive the exemption from Value Added Tax pursuant to Schedule 10, para. 2, Value Added Tax Act 1984, the notice is an invalid notice.

(b) Whether the Notice to Pay Rent served by the Defendant on the Claimant on 8th November 2006 was an invalid notice because it was not sufficiently clear.”

7. Mr Martin Rodger QC argued the case for the tenant; and Mr Leslie Blohm QC argued the case for the landlord.

8. As Mr Rodger said, the right of the tenant of an agricultural holding to challenge a notice to quit by giving a counter notice under [section 26\(1\)](#) of the 1986 Act is taken away when the notice falls within one of the cases in [Part 1 of Schedule 3 : section 26\(2\)](#). Nor can the tenant apply for anything like relief against forfeiture. He cannot be given a second chance. This is why a notice to quit relying on one of these cases is often called an “incontestable” notice to quit. Thus where a notice to quit is served in reliance on a notice to pay rent the tenant's only defence is to contest at arbitration a question relating to the reason stated in the notice to quit for its having been given: [Article 9, Agricultural Holdings \(Arbitration on Notices\) Order 1987](#). The question referred to arbitration therefore relates to the accuracy of the reason stated in the notice to quit. Because of the draconian effect of a valid notice to quit relying on one of these cases strict compliance with the statutory provisions is required, and the preliminary notice must be accurate: *Pickard v Bishop (1975) 31 P & CR 108*, 112. However, immaterial misdescriptions or inaccuracies which do not have the potential to mislead will not invalidate a notice: *Dallhold Estates (UK) Pty Ltd v Lindsey Trading Properties Inc [1994] 1 EGLR 93*, 97E-98K.

9. It is not the existence of arrears of rent but the tenant's failure to comply with the notice to pay rent which provides the basis for termination of the tenancy under Case D. A notice to pay rent which demands a greater sum than that which is actually due will be invalid: *Dickinson v. Boucher [1984] 1 EGLR 12*. The purpose of the notice is to tell the tenant precisely what he must do in order to avoid the loss of his tenancy. Accordingly a demand for a greater sum of rent than the rent properly due invalidates the notice. This much is common ground. So the first question is: did the notice to pay overstate the amount of rent due? It plainly did not overstate the amount due on 29 September 2006. The amount due had been specified in the invoice sent at that time, broken down into rent and VAT; and the notice to pay merely repeated the total amount. So the question can be further refined: was the whole of the amount due “rent”?

10. I should first sketch the provisions of the [Value Added Tax Act 1994](#) (VATA) in so far as they are relevant to the question. VAT is charged on the supply of goods or services in the UK. The grant of a major interest in land is a supply of goods: [VATA Schedule 4 para 3](#). A major interest in land is the fee simple or a tenancy for a term certain exceeding 21 years: [VATA s. 96](#). Anything which is not a supply of goods but is done for a consideration, including the grant of a right, is a supply of services: [VATA s. 5 \(2\)](#). Thus the grant of an annual tenancy counts as a supply of services. At the relevant time VAT was charged at the rate of 17.5 per cent on the supply of goods or services by reference to the value of the supply: [VATA s. 2 \(2\)](#). However, the Treasury has power to increase or decrease that rate by not more than 25 per cent: [VATA s. 2 \(2\)](#). As is well-known, in order to alleviate the effects of recession the rate of VAT has recently been decreased by The [Value Added Tax \(Change of Rate\) Order 2008](#) with effect from 1 December 2008 from when VAT became chargeable at

the rate of 15 per cent. Simultaneously with announcing the decrease in the rate of VAT, the Chancellor of the Exchequer announced the Government's intention to increase it again in 2010. The value of a supply is determined by [section 19](#). [Section 19\(2\)](#) provides:

“If the supply is for a consideration in money its value shall be taken to be such amount as, with the addition of the VAT chargeable, is equal to the consideration.”

11. However, certain supplies are exempt supplies. These are listed in [Schedule 9](#). Subject to certain irrelevant exceptions, the list of exempt supplies includes the “grant of any interest in or right over land”. Thus the grant of an annual tenancy is, in principle, an exempt supply. At the relevant time [Schedule 10](#) contained provision for an election to waive the exemption. It has since been renamed the option to tax and its language has been recast by the [Value Added Tax \(Buildings and Land\) Order 2008](#); but the principle remains the same. In essence the person who makes a supply of an interest in land that would otherwise be an exempt supply may elect to waive the exemption. However no election to waive the exemption may be made in relation to a dwelling. In principle an election, once made, lasts for 20 years: [VATA Schedule 10 para 3 \(5\)](#). It does not, however, bind a purchaser from the landlord. The benefit to a landlord of waiving the exemption (or opting to tax) is that he can recover as input VAT any VAT which he pays in making the supply of the land in question. These provisions have their origin in the [Finance Act 1989](#) which introduced the election to waive exemption in order to comply with a decision of the [ECJ \(EC Commission v United Kingdom \[1988\] STC 456\)](#) that the UK had incorrectly implemented the relevant directive.

12. Where a supply takes the form of a supply of services, for which payment is made periodically, there is a supply whenever a payment is received or an invoice is issued, whichever is earlier: [VAT Regulations 1995 reg 90](#). In the case of a lease of land which is treated as a supply of goods, there is a similar rule: [VAT Regulations 1995 reg 85](#).

13. A registered VAT trader who makes a taxable supply to a taxable person in the UK must provide that person with a VAT invoice, usually within 30 days after the supply: [VAT Regulations 1995 reg. 13](#). The VAT invoice must contain a number of prescribed matters including the gross total amount payable, excluding VAT; and also the amount of VAT chargeable: [VAT Regulations 1995 reg. 14](#). That is why the rent invoices took the form that they did.

14. [Section 89 of the VATA](#) deals with changes in the rate of tax. It provides:

“(1) Where, after the making of a contract for the supply of goods or services and before the goods or services are supplied, there is a change in the VAT charged on the supply, then, unless the contract otherwise provided, there shall be added to or deducted from the consideration for the supply an amount equal to the change.

(2) Subsection (1) above shall apply in relation to a tenancy or lease as it applies in relation to a contract except that a term of a tenancy or lease shall not be taken to provide that the rule contained in that subsection is not to apply in the case of the tenancy or lease if the term does not [refer] specifically to VAT or this section.

(3) References in this section to a change in the VAT charged on a supply include references to a change to or from no VAT being charged on the supply (including a change attributable to the making of an election under paragraph 2 of Schedule 10)."

15. The word "refer" in [section 89\(2\)](#) does not appear in the Act as enacted; but was omitted by mistake. [Section 89\(3\)](#) has since been amended by the [Value Added Tax \(Buildings and Land\) Order 2008](#) ; but the amendment is a drafting amendment rather than one of substance. I quote it in its unamended form.

16. VAT that a taxable person pays on the supply of goods or services to him is called "input tax"; and VAT that is paid to him on goods or services that he supplies is called "output tax": [VATA s. 24](#) . A taxable person is entitled to deduct the whole or part of his input tax from his output tax: [VATA s. 26](#) . At the end of an accounting period a taxable person must pay VAT. The amount he pays is the difference between his output tax and the input tax that he is entitled to deduct: [VATA s. 25](#) . As Ms Hazel Williamson QC explained in [Hostgilt Ltd v Megahart Ltd \[1999\] STC 141](#) , 143 (in a passage subsequently approved by the [Court of Appeal in Debenhams Retail plc v Sun Alliance & London Assurance Co Ltd \[2005\] 3 EGLR 34](#)):

"There is a policy described as "fiscal neutrality" along the line of supply. As long as a party is making taxable supplies it can set off the tax it pays on any input into its business against the tax which it charges on any output. It can either pay the difference to, or reclaim the difference from, Customs and Excise. The only person who eventually gets fixed without any potential set off is the end consumer who is not making taxable supplies. This can be a party not making supplies at all or a party making exempt supplies, or, complicatedly, partially exempt supplies, a situation which applies in the areas of financial services, banking and the insurance industries. To anyone making taxable supplies, the imposition of VAT is irrelevant; to anyone not doing so, it is an expense such that the taking of supplies under a VATable transaction creates additional cost and makes the supply consequently more expensive."

17. Next I must outline the relevant provisions of the 1986 Act. The 1986 Act was last amended by The [Regulatory Reform \(Agricultural Tenancies\) \(England and Wales\) Order 2006](#) , which came into force on 19 October 2006. The basic security of tenure conferred by the 1986 Act is achieved by providing that most tenancies and licences for an interest less than a tenancy from year to year take effect as annual tenancies, and that fixed term tenancies for two years or more continue from year to year; and then restricting the landlord's right to serve and enforce a notice to quit. Some licences and tenancies are not protected. In some cases this was Parliament's deliberate choice: for example a grazing or mowing licence granted for less than a year, or a letting to a person who holds an office under the landlord. But in other cases, notably a tenancy for a fixed term exceeding one year but less than two, the lack of security of tenure has generally been thought to be the result of parliamentary oversight: [Gladstone v Bower \[1960\] 2 QB 384](#) .

18. Many agricultural tenancies come into existence as a result of verbal agreements. So the 1986 Act makes provision for either party to require the other to enter into a written agreement embodying all the terms of the tenancy: [section 6](#) . The written tenancy must make provision for all the matters specified in [Schedule 1](#) . These include the rent reserved; the incidence of liability for rates (including drainage rates); a right of re-entry and

a tenant's covenant against alienation without the landlord's consent. They do not include any obligation on the part of the tenant to pay taxes (or VAT). If the parties cannot agree, either of them may refer the terms to arbitration. [Section 6 \(3\)](#) provides:

“Where it appears to the arbitrator on a reference under this section that, by reason of any provision which he is required to include in his award, it is equitable that the rent of the holding should be varied, he may vary the rent accordingly.”

19. [Section 7](#) gives the Minister the power to prescribe model clauses. The current regulations are the [Agriculture \(Maintenance, Repair and Insurance of Fixed Equipment\) Regulations 1973](#) (as amended). If the tenancy agreement effects substantial modifications to the model clauses either party may require the terms to be varied so as to bring them into conformity with the model clauses. If they cannot agree then either party may require arbitration. If the arbitrator decides that the terms are not justifiable he may vary them in such manner as he thinks reasonable and just: [section 8 \(3\)](#) . [Section 8 \(4\)](#) provides:

“Where it appears to the arbitrator on any reference under this section that by reason of any provision included in his award it is equitable that the rent of the holding should be varied, he may vary the rent accordingly.”

20. [Section 13](#) provides for increases in rent consequential on the making of improvements by the landlord (or in some cases improvements carried out by the tenant for which the landlord has paid). In such a case the landlord may by notice increase the rent payable by the tenant by an amount equal to the increase in rental value of the holding attributable to the carrying out of the improvement. Any dispute is determined by arbitration.

21. As mentioned, security of tenure is achieved by providing for tenancies to take effect as periodic tenancies. [Section 33](#) provides for the consequences of a resumption by the landlord of possession of part only of the holding either as a result of the service of a notice to quit part of the holding in circumstances permitted by [section 31](#) or in exercise of a power contained in the tenancy. In such a case [section 33 \(1\)](#) entitles the tenant to a reduction in rent. In default of agreement the reduction is determined by arbitration.

22. Since an annual tenancy will continue indefinitely unless and until determined by notice to quit it is necessary to make provision for periodic adjustments to the rent. This is done by [section 12 and Schedule 2](#) to the 1986 Act. [Section 12 \(1\)](#) entitles either landlord or tenant to demand that the rent be referred to arbitration. However, [paragraph 4 of Schedule 2](#) limits the frequency with which such a demand may be made. It provides:

“(1) Subject to the following provisions of this Schedule, a demand for arbitration shall not be effective for the purposes of section 12 of this Act if the next termination date following the date of the demand falls earlier than the end of three years from any of the following dates, that is to say—

- (a) the commencement of the tenancy, or
 - (b) the date as from which there took effect a previous increase or reduction of rent (whether made under that section or otherwise), or
 - (c) the date as from which there took effect a previous direction of an arbitrator under that section that the rent should continue unchanged.
- (2) The following shall be disregarded for the purposes of sub-paragraph (1)(b) above —
- (a) an increase or reduction of rent under section 6(3) or 8(4) of this Act;
 - (b) an increase of rent under subsection (1) of section 13 of this Act or such an increase as is referred to in subsection (3) of that section, or any reduction of rent agreed between the landlord and the tenant of the holding in consequence of any change in the fixed equipment provided on the holding by the landlord;
 - (c) a reduction of rent under section 33 of this Act.”

23. Other paragraphs of the [Schedule](#) provide for other changes in rent to be disregarded for this purpose. Thus [paragraph 6](#) provides:

“Where under an agreement between the landlord and the tenant of the holding (not being an agreement expressed to take effect as a new contract of tenancy between the parties) provision is made for adjustment of the boundaries of the holding or for any other variation of the terms of the tenancy, exclusive of those relating to rent, then, unless the agreement otherwise provides—

- (a) that provision shall for the purposes of sub-paragraph (1) of paragraph 4 above be treated as not operating to terminate the tenancy, and accordingly as not resulting in the commencement of a new contract of tenancy between the parties, and
- (b) any increase or reduction of rent solely attributable to any such adjustment or variation as aforesaid shall be disregarded for the purposes of paragraph (b) of that sub-paragraph”

24. If the landlord serves notice to quit to determine the tenancy, then in principle the notice to quit does not have effect unless the Agricultural Land Tribunal consents to its operation. Consent can only be given on certain specified grounds. However, the consent of the tribunal is not required if the notice is given in reliance on one of the “Cases” specified in [part 1 of Schedule 3](#) to the Act. The relevant case for present purposes is Case D, which is:

“At the date of the giving of the notice to quit the tenant had failed to comply with a notice in writing served on him by the landlord, being either—

(a) a notice requiring him within two months from the service of the notice to pay any rent due in respect of the agricultural holding to which the notice to quit relates, or

(b) a notice requiring him within a reasonable period specified in the notice to remedy any breach by the tenant that was capable of being remedied of any term or condition of his tenancy which was not inconsistent with his responsibilities to farm in accordance with the rules of good husbandry,

and it is stated in the notice to quit that it is given by reason of the said matter.”

25. It is common ground that the question whether the notice to pay overstated the amount due depends on the meaning to be given to the word “rent” in Case D. If the VAT is part of the rent, then it did not overstate the amount due. If, on the other hand, the VAT is not part of the rent, it did.

26. Mr Blohm referred me to a number of cases in which the meaning of the word “rent” has been considered. The general tenor of these cases is that the word “rent” means the periodic monetary consideration that a tenant pays for the right to possess land:

- i) *United Scientific Holdings Ltd v Burnley BC* [1978] AC 904 , 935: “the mediaeval concept of rent as a service rendered by the tenant to the landlord has been displaced by the modern concept of a payment which a tenant is bound by his contract to pay to the landlord for the use of his land. The mediaeval concept has, however, left as its only surviving relic the ancient remedy of distress” (per Lord Diplock);
- ii) *United Scientific Holdings Ltd v Burnley BC* [1978] AC 904 , 947 “In my view, rent today means the contractual money payment made by a tenant to his landlord in consideration for the use of the latter's land.” (per Lord Simon of Glaisdale);
- iii) *Property Holding Co Ltd v Clark* [1948] 1 KB 630 , 649: “prima facie the rent is the monetary compensation payable by the tenant in consideration for the grant, however it be described or allocated. Alternatively, it may be described ... as the contractual monetary obligation the payment of which is the condition of the right to enjoy the property granted.” (per Evershed LJ);
- iv) *Sidney Trading Co Ltd v Finsbury BC* [1952] 1 ALL ER 460 , 461: “the test for deciding what is “rent” for the purpose of the Rent Restrictions Acts is to ask: what is the total monetary payment to be made by the tenant to the landlord?” (per Lord Goddard CJ)

27. Accordingly, Mr Blohm submits that the word “rent” in the 1986 Act ought to be given its modern meaning as being the total amount of the consideration payable by the tenant in return for the right to possess the land. This would include any VAT payable as the result of the exercise by the landlord of his right to waive the exemption from VAT. This is reinforced by the terms of the [VATA](#) itself. The [VATA](#) does not give the supplier any independent or free-standing right to recover VAT from the person to whom the supply is made. He only has a route to recovery because the VAT is an integral part of the consideration for the supply. This can be seen first in [section 19 \(2\)](#) itself. This requires the supplier to treat monies received as comprising both the price of the goods or services in question and also the VAT element. As Miss Hazel Williamson explained in *Hostgilt Ltd v Megahart Ltd* :

“Because the obligation to pay VAT is on the supplier, the supplier is obliged to treat monies received as comprising the price for the goods, which is known as the “basic price”, and the VAT element as well. This arises from [Section 19\(2\) of the VAT Act](#)

1994 which provides: “If the supply is for a consideration in money its value shall be taken to be such amount as, with the addition of VAT chargeable, is equal to the consideration”. Depending on the rate of tax the VAT element will be a differing fraction of the total receipt. At present with Value Added Tax at 17.5% that fraction is 7/47ths. Thus, if a VAT registered supplier simply charges £100 to a customer he is obliged to treat 7/47ths of that sum as tax and account for it to Customs and Excise. In order to obtain £100 net of Value Added Tax he must charge £117.50 to the customer.”

28. Likewise in *Wynn Realisations Ltd v Vogue Holdings Inc* [1999] S.T.C. 524 Morritt LJ said:

“First, VAT, where payable, is charged by reference to the value of the supply which, when in money, is to be taken to be such amount as with the addition of the VAT is equal to the consideration: the price is VAT inclusive. This is apparent from section 19(2) of the 1994 Act. It is for that reason that where VAT is not to be included, the parties normally makes express reference to the fact that the price does not include VAT by reference to a number of formulae, of which “exclusive of VAT” is perhaps the most common.”

29. If, therefore, while an election to waive the exemption is in force, a landlord and a tenant agree an overall global sum as rent it is the landlord's responsibility to account to HMRC for the VAT at the end of the accounting period. But the landlord's responsibility is only to account. The money he actually receives from the tenant is his: he does not collect it as agent or trustee for HMRC. For many tenants it makes little difference whether they pay VAT on their rent or not; because they, too, will be able to recover the VAT that they pay as input tax. But the tenant may not be a taxable person. He may, for instance, not be a taxable person because his turnover falls below the VAT threshold. In such a case he has no means of recovering the VAT element of the global rent he has agreed. In addition, if the tenant is not a taxable person, he need not be provided with a VAT invoice.

30. The second way in which the operation of the VATA can be seen is in the provisions of section 89 which deal with changes in the rate of VAT. Where there is a change in the rate of VAT (or a change from no VAT to VAT) there is added to or deducted from “the consideration” an amount equal to the change. This is important for two reasons. First it assumes that the “consideration” for the supply already includes VAT at the old rate. Second, the adjustment has effect only by adjusting the “consideration” for the supply, not by giving the supplier an additional right to recover any increase, or the person receiving the supply an additional right to recover or deduct the decrease. In either case the only legally enforceable obligation is the contractual right to recover the consideration for the supply. And in the case of a supply of the right to possess land, that means rent.

31. Mr Blohm supports this submission by cases in which the effect of VAT on rent has been considered. In *Foreign Property APS v Secretary of State for Health* [2004] 2 P. & C.R. 5 a lease contained special clauses relating to the tenant's liability to pay VAT at a time before the landlord had supplied evidence of an election to waive the exemption. The precise details do not matter. In the course of his judgment Laws LJ said:

“I acknowledge that the respondent must point to a provision in the lease which disapplies s. 89(1) of the Act. Otherwise, whatever one might think of the equity of the position, the statute increases the consideration (*that is the rent*) by the amount of the VAT due following the landlord's election to waive exemption, whether or not the tenant knows of the election.” (Emphasis added)

32. Second is the case of Debenhams Retail (already mentioned). The issue in the case was far removed from the present: namely, whether the VAT element of the price of goods sold in a department store formed part of the “gross amount of total sales” making up the tenant's turnover for the purposes of a turnover lease. Jacob LJ emphasised the importance of context in the interpretation of that phrase and said that what would have mattered to businessmen negotiating the lease was money and that the form that the money took was a secondary consideration. I did not find that case of great assistance.

33. In *Scottish & Newcastle plc v Raguz (No 1)* [2003] EWCA Civ 1070 [2004] L. & T.R. 11 one of the issues that arose was whether the liability of an assignee of a lease to indemnify the original tenant extended to VAT payable on the rent. The indemnity arose under [section 24 of the Land Registration Act 1925](#) . The Court of Appeal held that the indemnity extended to the VAT. Morritt V-C (with whom May and Sedley LJ agreed) said:

“The original lease constituted a contract for a relevant supply by the landlord to the tenant for which the rent covenanted to be paid was consideration. In view of the terms of s. 89(3) it is indisputable that when the lessor opted to tax the supply there was a change in the VAT charged on that supply. That change occurred before the supplies with which this claim is concerned were rendered. Accordingly the express terms of s. 89(1) requires VAT at the relevant rate to be added to the rent as part of the consideration for the supply by the Lessor to the Tenant. In my view it follows that the default of the Tenant in paying the rent including the VAT thereon falls within the terms of the implied covenant because it constitutes a failure to pay the rent “by and in the registered lease reserved and contained” as amended in accordance with s. 89(1).”

34. Raguz is direct authority that, at least in the context of the [Land Registration Act 1925](#) , “rent” includes the VAT element.

35. Mr Rodger's argument takes a very different starting point. He begins with the effect of the conclusion that the rent includes the VAT element.

36. Mr Rodger submits that [paragraph 4 of Schedule 2](#) to the 1986 Act strictly controls the frequency of reviews, upwards or downwards, on a three yearly cycle. A new rent review cycle under [section 12](#) is triggered on “the date as from which there took effect a previous increase or reduction of rent (whether made under that section or otherwise).” Neither party may seek a further variation in the rent until three years has elapsed since any such

increase or decrease. If the VAT payable by a tenant on his rent is itself rent for the purpose of the 1986 Act, the statutory machinery for rent review is liable to disruption by the intervention of [section 89\(1\) of the Value Added Tax Act 1994](#). That disruption will be for reasons entirely unconnected to the factors which arbitrators carefully weigh up when determining rents under [paragraph 1 of schedule 2](#). Any change in the rate of VAT will postpone any increase or reduction in the rent for three years. Thus the recent reduction in the rate of VAT will have the effect of postponing rent review under thousands of agricultural tenancies for three years and if, as the Chancellor of the Exchequer has said, the rate of VAT rises again in 2010, the effect will have been to freeze agricultural rents for at least five years. In some cases, where the recent change in the rate of VAT has taken effect toward the end of the three year cycle (e.g. where the rent was last reviewed as at Christmas 2005), the effect may be to freeze the rent for approaching eight years (i.e. until three years after the rise in VAT projected for 2010). That is such an unattractive consequence that it cannot be right.

37. Mr Rodger submits that [Schedule 2](#) carefully identifies circumstances in which an increase or reduction in the rent is not to trigger the start of a new rent review cycle, but none of those circumstances relates either to a landlord's election to tax, or to a variation in the rate of VAT. Accordingly, he says that the provisions relating to rent in the 1986 Act, particularly those in [Schedule 2](#), demonstrate that "rent" for the purpose of the 1986 Act has a particular characteristic, namely, that it is a sum which is incapable of being varied otherwise than by agreement between the parties, or by the provisions of the 1986 Act itself. "Rent", for the purposes of the 1986 Act, cannot include an element which is capable of being varied by the unilateral act of one of the parties or by the intervention of a third party.

38. This, Mr Rodger says, is supported by considerations of public policy. He points out that the system of security of tenure conferred on agricultural tenants is created in the national interest. This is clear from well-known passages in [Johnson v Moreton \[1980\] AC 37 in which the House of Lords](#) held that parties could not agree to contract out of security of tenure. Part of the system of security of tenure is the right of either party to obtain an up to date rent from time to time. On any periodic review of the rent, the rent might go up or down, depending on (among other things) market conditions and the productive capacity of the holding. If a tenant is deprived of the right to seek a rent review, he might find himself locked in to a rent which is uneconomic, with the consequence that he might be forced to give up his tenancy. That would undermine the purpose, in the national interest, of giving him security of tenure in the first place. Thus the maintenance of the periodic right to a rent review is an important and integral part of the security of tenure conferred on the tenant. It followed therefore that it was contrary to public policy for parties to contract out of the triennial cycle of rent reviews as laid down by the 1986 Act. In this submission Mr Rodger has the support of the decision of the Scottish Land Court in [Moll v MacGregor \[1990\] SLT 59](#) considering the equivalent provisions of the [Agricultural Holdings \(Scotland\) Act 1949](#). In that case the parties had agreed a rent for an agricultural holding which was to vary annually in accordance with the Retail Price Index. The court held that:

"The main purposes of the 1949 Act were to provide for security of tenure, compensation at outgo and a degree of rent control. The rental provisions are thus crucial ones which include a public as well as a purely private element."

39. The court then considered the mandatory language of the statutory provisions (which are analogous to, but not the same as, the equivalent provisions of the 1986 Act) and concluded:

"Having now considered the imperative tenor not only of the 1949 Act (as amended), but also of the subsidiary order governing rental arbitrations, the court conclude that it

is not open to parties, whether under the original lease or any subsequent agreement, to contract out of the statutory rental provisions laid down in the public interest for arbiters to follow. These mandatory provisions, based on the open market criterion discounted for scarcity, were obviously introduced with a view to achieving some degree of consistency in farm renting. Parties can of course still agree on a new rent themselves and provided they act on this it will no doubt be effectively binding between them. What they cannot legally do, however, is to contract completely out of the statutory provisions so that, in the event of disagreement, one side or the other is deprived from having recourse to a rent review at the stated period and on the statutory terms. For that would be to reinstate the mischief which these statutory provisions were designed to remedy.”

40. During the course of the argument it seemed to me that [Schedule 2](#) was not quite as carefully drawn as Mr Rodger suggested. His submission was based primarily on [paragraph 4 \(2\)](#) . It is true that that paragraph lists some circumstances in which a change in the rent is to be ignored in reckoning the start of the three year cycle. One of these is a change in the rent consequent upon an arbitrator's award where either the landlord or the tenant has required an arbitration on the terms of the tenancy (either because there is no written tenancy or because the written tenancy does not conform to the model clauses). These are the provisions of [sections 6 \(3\) and 8 \(4\)](#) which are specifically referred to in [paragraph 4 \(2\) \(a\)](#) . But what happens if, say, the tenant requests the landlord to enter into a written tenancy agreement under [section 6 \(1\)](#) and the landlord does so, in consequence of which the parties agree that it is equitable that there be a change in the rent, without having to trouble an arbitrator? Mr Rodger said in the course of argument that in those circumstances the parties themselves will have agreed a change in the rent, with the consequence that their agreement will postpone the beginning of the three year cycle. In order to avoid this consequence, the parties would have to undertake a wholly unnecessary arbitration. Mr Rodger said that the parties can appoint an arbitrator and place an agreed award in front of him for him to publish. It seems difficult to attribute to Parliament a deliberate intention that the parties should have to go through what is, in effect, a sham arbitration to avoid this unwelcome consequence. The same point would arise if the parties agreed to change the terms of the tenancy to reflect the model clauses and agree a change in the rent in consequence. Again it is difficult to suppose that Parliament deliberately intended that the parties should go through a sham arbitration. By contrast, where the change in rent is attributable to the carrying out by the landlord of an improvement under [section 13, paragraph 4 \(2\) \(b\) of Schedule 2](#) ignores the change in rent whether it is determined by an arbitrator or agreed between the landlord and the tenant. On reflection however, following the hearing, it seems to me that this apparent anomaly is answered by [paragraph 6](#) which applies to an agreement between landlord and tenant “for any other variation of the terms of the tenancy, exclusive of those relating to rent”. In such a case the default position under [paragraph 6 \(b\)](#) is that any increase or reduction of rent solely attributable to the variation is ignored in calculating the triennial cycle. Thus if the landlord and tenant agree on the terms of a written tenancy agreement and a consequential adjustment in rent without the need for arbitration, it seems to me that [paragraph 6](#) puts them into the same position as that in which they would have been if an arbitration had been fought to the bitter end.

41. However, [paragraph 6 \(b\)](#) is only the default position. It applies “unless the agreement otherwise provides”. Thus the Act enables the parties, at least in this respect, to contract out of the three year cycle if they choose to. I need not, I think, decide what precise limits there are to the parties' freedom of contract as envisaged by this paragraph. [Section 7 of the Agricultural Holdings \(Scotland\) Act 1949](#) , which was the section under consideration in *Moll v MacGregor* , did not have the equivalent of [paragraph 6](#) . In my judgment this undermines its persuasiveness as an authority.

42. It also seems to me to be the case that if the parties themselves agree at one of the three year review dates that the rent should remain unchanged (rather than no change having been directed by an arbitrator) that agreement

would not start the three year cycle running again. If, therefore, rents rose or fell in the immediately subsequent year, either party could require arbitration. In that way the rent could be reviewed (in the sense of being looked at again) more frequently than once every three years.

43. The current (ninth) edition of Scammell and Densham's Law of Agricultural Holdings discusses the question whether parties may contract out of the statutory rent review regime. In paragraph 25.47 the current editor (Mr Peter Williams) concludes that there is no public policy reason for the parties not to be able to contract out of the statutory rent formula. The same view was expressed in the previous edition (which was the last to have been edited by Mr Densham himself). In the course of the discussion Scammell and Densham refer to a number of cases. The first of these is *Goldsworthy v Brickell* [1987] Ch 378 . This was a claim to set aside a tenancy granted on favourable terms to a farm manager by his elderly employer on the ground of undue influence. The tenancy agreement included an option for the tenant to purchase the reversion on the death of the landlord and an agreement that the rent (which was well below market value) would remain at the level originally agreed during the life of the landlord without any increase. One of the questions was whether the transaction was manifestly disadvantageous to the employer. Mr Pryor QC, for the tenant, submitted that the provision in the tenancy agreement stating that the rent would remain level was invalidated by [section 8 of the Agricultural Holdings Act 1948](#) (the equivalent of [section 12](#)). Nourse LJ said:

“I think that the judge may somewhat have underestimated the significance of the low rent, even assuming, as I am prepared to do, that Mr Pryor was correct in saying that notwithstanding clause 34 of the tenancy agreement the plaintiff could, under [section 8 of the Agricultural Holdings Act 1948](#) , have obtained an increased rent after three years.”

44. I cannot regard this as endorsing Mr Pryor's submission. It is, in my judgment, entirely neutral.

45. The second case is *J W Childers Trustees v Anker* [1996] 1 EGLR 1 . In that case the tenant was the tenant of two agricultural holdings held of the same landlord under two separate agreements. The parties compromised rent reviews arising under each agreement by agreeing a single composite rent for both holdings. The Court of Appeal held that this agreement did not have the effect of a surrender and regrant. Scammell and Densham refer somewhat gnomically to obiter dicta of Morritt LJ (who gave the leading judgment) but without actually identifying them. I think that what they must have in mind is Morritt LJ's recognition that the whole of the agreed composite rent would have to be paid by the tenant if he wished to avoid the termination or forfeiture of either tenancy. That would be a contractual interference with what would otherwise have been the statutory scheme of security. It provides very slender support for the conclusion advanced by Scammell and Densham.

46. The third case is *Plumb Bros v Dolmac (Agriculture) Ltd* [1984] 2 EGLR 1 . As part of an agreement made between the landlord and tenant of an agricultural holding, the landlord agreed not to seek an increase in the rent for five years. Within the five year period the landlord demanded arbitration in accordance with the statutory triennial timetable. The Court of Appeal held that the demand for arbitration was ineffective because of the agreement. It is true that, as Mr Rodger submitted, the question was argued purely as one of construction of the agreement and the tenancy agreement; and that no one argued that the agreement was invalid as an attempt to contract out of the statutory rent review scheme. However, the actual decision of the Court of Appeal is consistent only with the view that it is possible to alter the frequency of rent review by agreement. This does, in my judgment, provide support for the view expressed by Scammell and Densham.

47. Woodfall on Landlord and Tenant (§ 21.083) says that there is uncertainty whether parties to a tenancy from year to year can provide for reviews of rent at different intervals from those laid down by the 1986 Act or by reference to a different valuation formula. However, the same paragraph expresses the view that there can be no objection to parties to a fixed term tenancy providing for contractual rent reviews during the term.

48. In my judgment, for the above reasons, Mr Rodger's submission that the statutory rent review regime is inviolate and incapable of variation by the parties is not correct. So far as the public policy argument is concerned, I also think that on the facts of the present case it is wide of the mark. This is not a case of parties attempting by contract to disapply the mandatory terms of a statute. Rather it is a case in which one party is exercising a statutory right to waive exemption from VAT given to him by Parliament; and the argument is about the effect which the exercise of that statutory right has. It is difficult to say that the exercise of a right given by statute is contrary to public policy.

49. In a sense, however, this is by the way, because Mr Rodger relies on his contention that the parties cannot contract out of the statutory rent review regime not because they have; but because he says that the inability of the parties to contract out supports an interpretation of the word "rent" which avoids interference with the statutory rent review mechanisms by the unilateral act of the landlord in opting to tax or by the intervention of the Chancellor of the Exchequer in raising or lowering the rate of VAT. However, I do not consider that this argument, even in the limited and slightly oblique way in which Mr Rodger deploys it, is a good one.

50. If, as Mr Rodger submits, the VAT element is not part of the rent, how is the landlord to recover it from the tenant if the tenant refuses to pay? In some tenancy agreements there may be a separate covenant to pay VAT; but many agreements (of which, in my judgment, this is one) contain no such obligation. In the case of a tenancy granted orally, an arbitration on terms would not result in the inclusion of such an obligation. Mr Rodger said that the VAT would be payable by the tenant as an obligation of his tenancy. But I was unable to discern which obligation had that effect unless it was the obligation to pay rent. Mr Rodger also submitted that the [VATA](#) gave the landlord a freestanding right to recover the VAT. However, I do not think that it does. As I have said the rule is that the consideration for the supply is inclusive of VAT. Thus the VAT element is recoverable by the supplier simply because it is part of the consideration for the supply; and if the rate of VAT changes, the [VATA](#) does no more than to provide for a change in the consideration. Mr Rodger told me (and I have no reason to doubt) that because of the uncertainty within the agricultural community about the status of VAT on rents well advised landlords who have opted to tax serve two notices (each in a prescribed form) on a tenant in arrears: the first is a notice to pay and relates to the rent without the VAT element and the second is a notice to remedy (in a different prescribed form) relating only to the VAT element. This does not seem to me to be a rational scheme that Parliament must be taken to have intended. Moreover, if Mr Rodger is right, and "rent" for the purposes of the 1986 Act cannot include VAT irrespective of the terms of the lease, this pair of notices would have to be served on the tenant in arrear even if the lease clearly and explicitly reserved VAT as rent in the *reddendum*.

51. But in any event when the [Agricultural Holdings Act](#) was passed in 1986, grants of land were exempt supplies. At that time there was no possibility of waiving the exemption. In those circumstances it is impossible in my judgment to attribute to Parliament an intention to distinguish between elements of the rent on which the supplier was liable to account to HMRC as VAT and elements of the rent on which he was not liable to account for VAT. The VAT is simply part of the global price for occupation of the land, and its fiscal consequences do not affect its character. So far as the tenant is concerned, he can deduct the VAT element of the rent from his own output tax at the end of the quarter; and he can deduct the rest of the rent from his profits at the end of the year before paying his income tax. This is simply a difference in the machinery for accounting for tax. It does not, in my judgment, mean that different characteristics should be attributed to different parts of the rent.

52. I agree with Mr Blohm that there are a number of strong pointers towards the conclusion that the VAT element is part of the rent:

- i) The modern meaning of “rent” is the total periodic monetary consideration for the tenant's right to possess the land let to him;
- ii) The prima facie rule under the [VATA](#) is that the sum agreed for the supply is inclusive of VAT;
- iii) It is the supplier who has the duty to account for VAT to HMRC;
- iv) Whether the VAT element is specified in a VAT invoice depends on whether the person to whom the supply is made is a taxable person, but “rent” in the 1986 Act must bear the same meaning, whether the tenant is a taxable person or not;
- v) There is no free-standing or independent statutory right to recover VAT. If the VAT is not part of the rent, the landlord has no means of recovering it;
- vi) If an all-inclusive rent is agreed, and the rate of VAT subsequently changes, the amount of the change is added to or deducted from the consideration for the supply;
- vii) The same applies where the landlord and the tenant agree a rent at a time when no VAT is chargeable but VAT subsequently become chargeable. What happens is that the consideration for the grant is increased;
- viii) If the consideration for the supply is characterised as rent, then an increase in or deduction from the consideration must have the same character;
- ix) Those cases that have touched on the question hold that VAT on rent is part of the rent itself.

53. What, then of the consequences for the triennial cycle of rent review that Mr Rodger points out? It would be comforting to avoid the consequences, surely unintended, to which Mr Rodger draws attention. Mr Blohm urged on me an interpretation of the phrase: “the date as from which there took effect a previous increase or reduction of rent (whether made under that section or otherwise)” which would limit the effect of “or otherwise” to reductions or increases of rent by agreement of the parties. Thus if the rent changed, not because of any agreement of the parties, but because the landlord opted to tax (a unilateral act), or the rate of VAT changed (an act of a third party), that change in the rent would not disturb the triennial cycle. He submitted that the events specified in [paragraph 4 \(2\)](#) which are ignored in reckoning the three year period are all concerned with events, and do not deal with consensual arrangements which are not backed up by arbitration. Thus it was permissible to interpret the phrase “or otherwise” in [paragraph 4 \(2\)](#) as being limited to consensual arrangements between the parties. If that phrase is interpreted in this way it would mean that a change in the rent which was brought about by the unilateral action of one party, or by some external event, would not cause the triennial cycle to start again. I cannot accept this submission. First, as noted, [paragraph 6](#) seems to me to apply to a wide range of consensual arrangements made between the parties. So the suggested lacuna is not there. Second, it would require reading words into the statute which Parliament has not included. In my judgment that would go beyond a permissible process of construction.

54. It seems to me therefore that I have to face the consequences of an exercise of the option to tax or a change in the rate of VAT which Mr Rodger describes. Are those consequences so dire that despite what I have found to be strong pointers to the conclusion that the VAT element is part of the rent, I should give the word “rent” the restricted meaning for which Mr Rodger contends? I do not consider that I should. It is of course desirable to avoid inconvenient results, if the statutory language permits. But the [Agricultural Holdings Act](#) does not always permit the avoidance of inconvenient or surprising results. The anomaly of the Gladstone v Bower tenancy is one example. The inconvenient result in the present case is in my judgment simply an example of the law of unintended consequences, when the tax legislation was changed so as to bring it into conformity with European law. Had the point been appreciated Parliament would surely have provided for the imposition of VAT on rent or a change in the rate of VAT to be ignored when calculating the triennial cycle of rent review. The point might have been picked up when the VAT legislation was changed so as to bring in the election to waive exemption. But it was not. Nor was it picked up when the 1986 Act was amended by the 2006 Order. I do not reach this conclusion with any satisfaction. The consequences of this conclusion, if correct, make it urgent for legislation