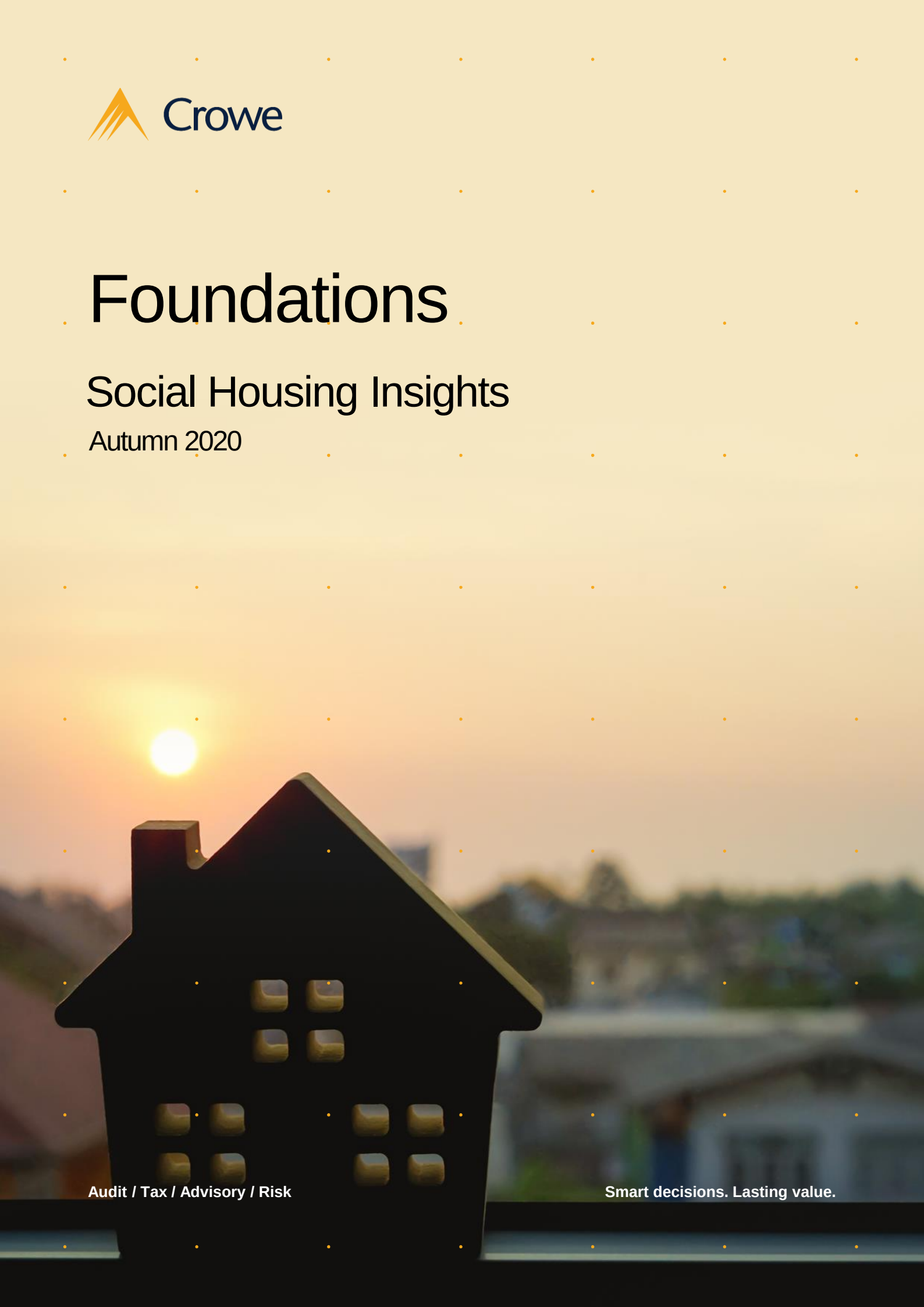
Crowe

Foundations

Social Housing Insights

Autumn 2020



Audit / Tax / Advisory / Risk

Smart decisions. Lasting value.

Since our last edition of Foundations, the transformation across the housing sector has been profound.

Housing Associations have almost overnight moved customer service centres into a virtual environment and implemented homeworking across the majority of the workforce.

All survived the lockdown and had restarted repairs and maintenance, developments and sales but now Housing Associations are having to revisit business plans in light of the real likelihood of a second lockdown.

This is calling for Housing Associations to think differently about many aspects of their operations and strategy, including developments and property portfolios. We have discussed in this edition the tax implications of changing tenure mix and converting surplus offices and shops.

We are also seeing lessees negotiating lease incentives due to current market conditions and FRC have responded to this with an exposure draft on amendments to financial reporting standards concerning COVID-19 related temporary rent concessions. We have outlined the proposals for you to be aware of in FRED-76 and also the tax impacts of rent reductions and deferment.

Also in relation tax we have highlighted guidance on VAT treatment of call options and zero rated online advertising.

The Coronavirus Job Retention Scheme (CJRS) has been a vital response to COVID-19 to keep the economy going and protect jobs but this comes to an end this month.

In July Catalyst Housing Association announced that it would repay £280,000 of furlough grant and not make any further claims. Ian McDermott, chief executive of Catalyst, said: “The government was clear that this was taxpayers’ money designed to ensure employers who could not afford to pay wages could protect the employment of as many people as possible rather than make mass redundancies. With the benefit of hindsight, we now know that we did not fall into that category and would not have made anyone redundant as a consequence of lockdown. It would be entirely wrong to keep the money and use it for a different purpose.”

HMRC have stated that they have received over 8,000 reports of abuse of the scheme and are looking into 27,000 cases of suspected high risk/high value cases. We understand they are proceeding with at least 2 criminal prosecutions. Navin Sharma, Employment Tax Assistant Manager, has outlined the steps to staying compliant.

COVID-19 has had a positive and transformative impact on everyone’s willingness to use technology which will have long lasting benefits, although I think the most used phrase of the year has been “I think you are on mute!”.

Sadly, cybercriminals are taking advantage of our growing demand for information and online presence and we have seen a significant increase in fraud and cybercrime. Housing Associations need to protect themselves and ensure systems are resilient to attack and staff are trained to be aware of the risks. Jim Gee, Head of Forensic Services, has provided six things which Housing Associations need to do at the current time.

Our risk management and assurance frameworks have also had to be reconsidered in light of the pandemic and new ways of working. Richard Evans, Head of Risk and Assurance, has discussed how uncertainty impacts on the Assurance framework.

Amongst all of this BREXIT has not gone away and Housing Associations need to be business ready. We are regularly updating our website pages with useful information as the deal/no deal situation develops.

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Providing assurance in uncertainty

Internal Audit's response during COVID-19

Changes brought on by the COVID-19 crisis have created a range of new priorities and risks for housing associations. In all cases this has affected the delivery of the services and operations in some form, albeit throughout the pandemic there has been a continued need to continue support for residents and maintain development programmes.

Housing associations have continued with many of their activities, making adaptations as necessary. This has included moving online and remote ways of delivering services. Where this is not possible, there has been the rapid redeployment of PPE and revised processes to continue to deliver services whilst seeking to manage the risks to staff and residents.

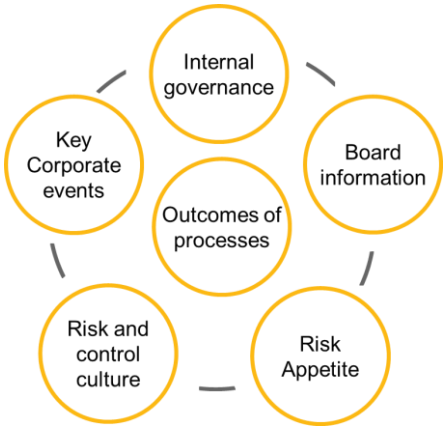
The current uncertainty presents a huge range of challenges to both the housing association and internal audit. It may be tempting for an organisation grappling with the challenges of operating in crisis mode or adapting to new ways of working to deprioritise the assurance process. However, it is precisely that level of uncertainty which drives risk and the need for independent challenge and assurance.

More generally, the changes in organisational activities and priorities resulting from the COVID-19 crisis mean that some audits in the internal audit plan may no longer be relevant whilst some new priority areas for internal audit emerge.

Importantly, where internal audit teams are working to a risk-based audit plan which is periodically refreshed, then many of the functions and processes due to be audited are still in place and the risk-based reasons for the audit are still valid. If the circumstances allow it then by following an adapted audit delivery approach some audits can still go ahead providing valuable insight and assurance. In determining the role of internal audit at this time, there are a number of areas to inform the focus of the work:

- **In some areas of operations risk profiles have changed drastically,** predominantly increasing but in some areas reducing due to activities not taking place (such as with teams being furloughed). As a result internal audit needs to change its focus to the emerging risks.
- **New short term audit plans need to be drawn up** to include these risks posed by COVID-19. Whilst a number of aspects of the longer term plan may remain, coverage and the plan itself should be focussed on the immediate and medium term horizon.
- **Internal Audit should not be afraid to challenge either decisions and/or approaches to risk mitigation**. Internal Audit can use the insights gained from its work across the organisation to highlight potential areas of risk for the executive team to consider.
- **Internal Audit can support the horizon scanning process** by engaging with peers and sector groups to identify what is working and the challenges the organisation is encountering. Also, Internal Audit can act as a filter for information to support management, the Audit/Risk Committee and Board.
- **It is widely anticipated that there will be an increase in the risk of fraud** in a period of economic uncertainty combined with changes in working practice. Internal Audit teams have a critical role in raising awareness, strengthening preventative controls and at times, taking on increased checks on basic functional activities.
- **Its potentially a time to temporarily modify the internal audit approach** – organisations need to maximise value without the resourcing impact of the full audit process. Adopting an agile approach – potentially with short sharp dipstick reviews and/or substantive testing of payments being processed.

The areas in the diagram below summarise the scope of internal audit in line with the Institute of Internal Auditors Revised Code of Internal Audit Practice which, whilst developed prior to the pandemic, is still relevant.



This provides a useful framework for focussing internal audit in the current period, as outlined below:

Internal Governance – For example, to consider any changes to financial/ non financial delegations of authority and how they are applied.

Key Corporate Events - There may also be instances where the current control processes and responses need to change – for example, there may be reduced financial thresholds for delegated authority and a need for enhanced due diligence monitoring of key suppliers.

Board Information - It is not expected that all decisions will be perfect but there is a need to be able to support the decisions which are/were made, including the data behind them.

Outcomes – what would the outcomes of the processes look like during this period? Will these have changed, and if so what would this look like in terms of data and outputs? For example, for an apprenticeship programme with residents, should the outcomes be revised and how can they be assessed?

Risk and Control Culture/ Risk Appetite – assurance regarding how this is being applied, what changes have taken place and any changes in observed behaviours, both now and in a "Return to Office" situation.

Internal Audit Delivery

The key adaptations in audit delivery we have adopted during this period include:

- **Rethink and re-prioritise** – in line with the earlier points, ensure that the work is focussed in the right areas. Rotational assurance is unlikely to be appropriate, whereas areas which were previously low risk may need to escalate in priority.
- **Greater flexibility** – there is a need to be more sensitive to the other priorities auditees have at this time. At times, adopting an 80/20 rule of assuring the systems which can be assessed with caveats as the assurance being provided.
- **More extensive use of technology** – this can include building on the technology already in place such as secure file transfer, utilising video conferencing and screen sharing, as well as adding new technology to support the audit process. There is also a need to be drive to embrace data analytics to focus the testing strategies.
- **Recognise the interim nature of the period -** Following the intensity of the initial crisis response to COVID 19, organisations have adjusted to ways of working and challenges. During this period it is critical to focus on how systems and processes have changed and to recognise that we are still operating in a crisis environment. This is not the "new normal" and the approach to the internal audit should reflect this.

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Environmental, Social and Governance (ESG) Reporting

Housing associations' social purpose and impact is significant and we have seen investor interest continue to be strong and growing even through COVID-19. However, there is an increasing need for the UK social housing sector to clearly highlight and report on its strong Environmental, Social and Governance performance.

The Department for Business, Energy and Industrial Strategy (BEIS) has made it mandatory for large companies and limited liability partnerships incorporated in the UK to report on their carbon emissions. In our March edition of Foundations, we outlined the requirements, however many RPs established as Community Benefit Societies are exempt.

Earlier this year a working group brought together to develop a proposed approach to ESG reporting for Housing Associations published a white paper for consultation (closed 31 July 2020).

The white paper proposed 10 themes, being: Affordability; building safety; resident voice; resident support; placemaking; staff wellbeing; climate change; ecology; board and trustees; and systems and risk management.

Our response to the consultation agreed that in establishing a credible, meaningful and comparable set of ESG criteria, the sector can deliver an approach to ESG reporting which can be adopted by key stakeholders, including lenders, investors, regulatory bodies and government.

There is already a vast array of metrics, both qualitative and quantitative that exist across all industries and this is an area that is rapidly evolving.

In September five global organisations specialising in sustainability and integrated reporting frameworks and standards declared their intention to work together to create a comprehensive approach to corporate reporting. These are CDP: Carbon Disclosure Project, CDSB: Climate Disclosure Standards Board, GRI: Global Reporting Initiative, IIRC: International Integrated Reporting Council and SASB: Sustainability Accounting Standards Board.

The UK Green Building Council also issued a consultation earlier this year (closed 21 August 2020) to canvas views of property and construction professional on a definition of social value for the build environment sector.

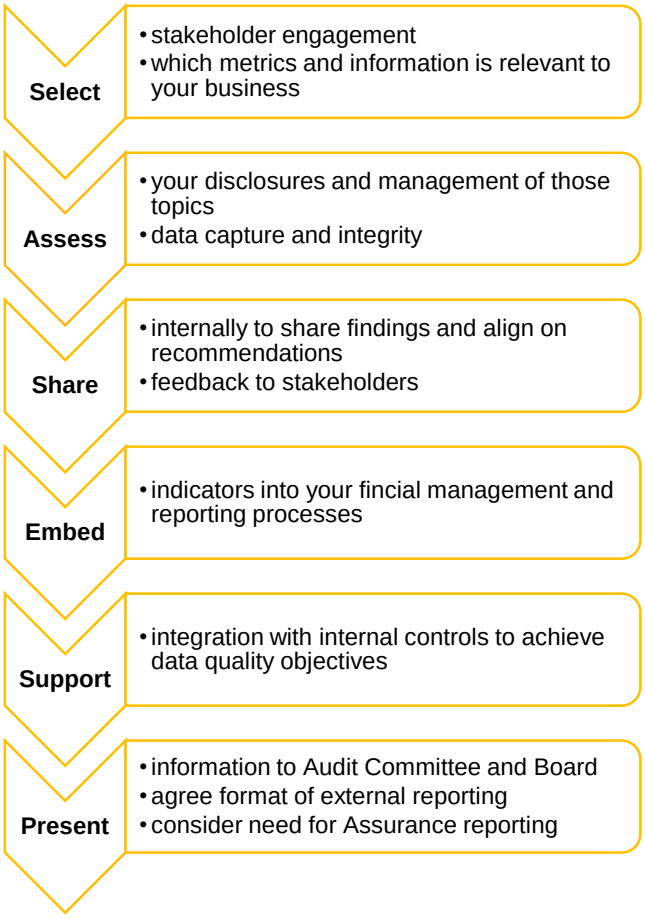
What is clear is that the Housing Associations that measure their environmental risk are better able to manage it strategically and this is particularly important with 2050 Zero Carbon targets to plan for.

However, one of the significant challenges is understanding which ESG factors are truly relevant to the organisation and its stakeholders and how this links to the organisation's wider strategy and risk assessment. Boards must focus on what is important and the factors that are meaningful, material and relevant to the business. Some questions that Boards need to ask themselves include:

- Does the RP have a proper understanding of its stakeholder needs? Are you engaging with stakeholders systematically?
- Is the RP's strategy and business plan in sync with social and sustainability goals?
- Has the RP clearly identified the outcomes and impacts of its sustainability management?

Through the work of our global sustainability practice we have highlighted the need for robust stakeholder engagement when developing performance measurement frameworks.

We have outlined below the key steps to consider when devising non-financial ESG reporting:



Assurance

The white paper proposes for the ESG reporting to be included in the Annual Report and Accounts. There is often a presumption by users of the financial statements that inclusion of information in this form means that the information is "audited".

Currently the responsibilities of the auditor (as set out by the Financial Reporting Council) gives auditors limited responsibility in relation of other information. Therefore, Audit Committees should consider how they will gain assurance over the accuracy of information being reported.

Robust, independent assurance can:

- enhance the credibility of ESG disclosures
- Inform stakeholders of the progress made towards set objectives;
- provide management and those charged with governance comfort over the quality of the information provided.

ESG is a form of Extended External Reporting (EER) which is becoming increasingly common and there is growing demand for assurance engagements in relation to it.

The International Auditing and Assurance Standards Board (IAASB) is responding to this demand for assurance engagements by developing non-authorative guidance in addressing commonly encountered challenges with applying ISAE 3000 (Revised) Assurance Engagements Other than Audits or Reviews of Historical Financial Information in EER engagements.

Crowe Global responded to the consultation in July 2020 welcoming a consistent approach to these types of engagement.

A RP's business is deeply intertwined with ESG concerns. It makes sense, therefore, that a strong ESG proposition can create value. RPs need a robust framework in which to realise that value.

The Housing Finance Corporation is organising a webinar, to be hosted by Trowers & Hamlins on Monday 19th October 2020, 2.30pm for housing associations looking to gain insights into ESG and how it relates to the sector. The webinar "Myth-busting ESG: what's in it for me?" You can find more details on THFC website.

The launch of the final White Paper and ESG to be titled "Sustainability Reporting Standard" will take place at the end of October/early November. Over 60 organisations have currently registered their interest in becoming an Early Adopter and there is still time to register you interest on the website. Optivo were the first RP to publish a report in August following the proposed new ESG metrics.

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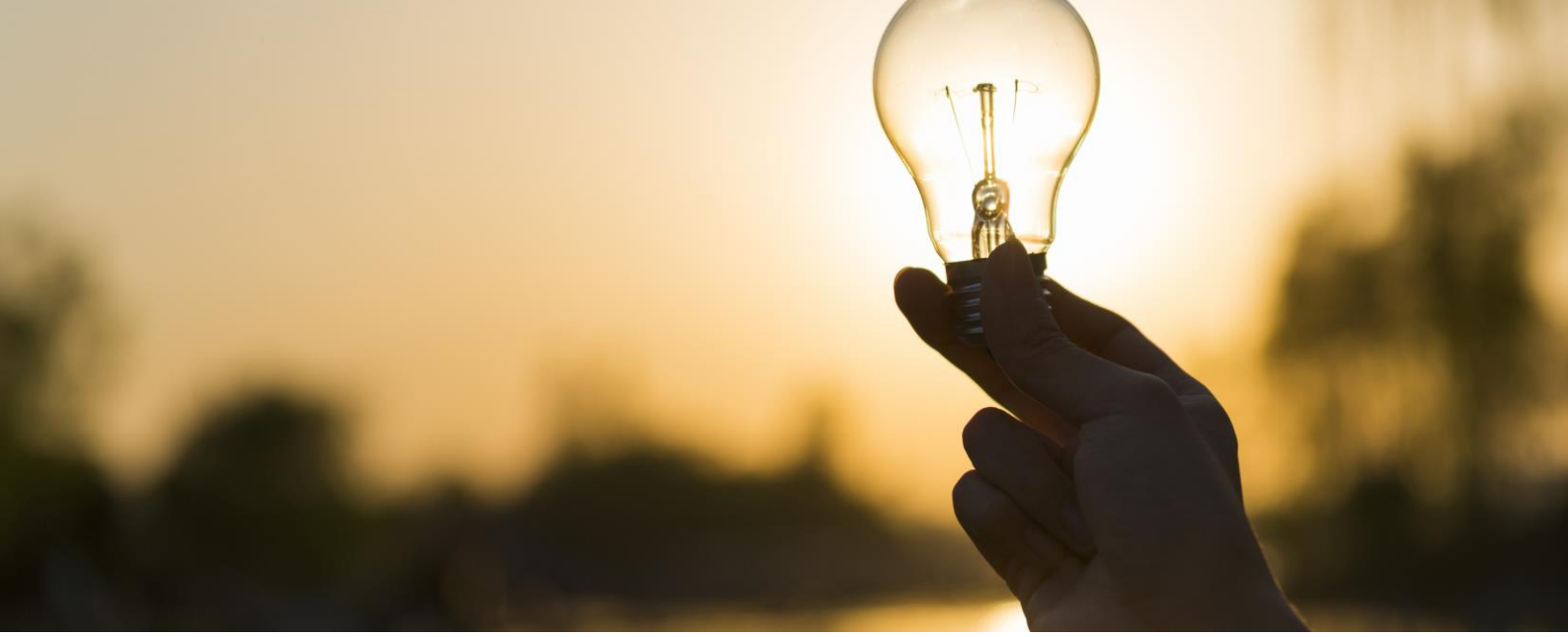

Housing Associations: Don’t forget tax if you are considering changing the tenure mix

Over the last couple months, an already uncertain market for shared ownership and open market sales has become even more challenging.

As a result many housing associations have been reassessing the tenure mix they were proposing for developments in progress. Changing the tenure mix can alter the tax treatment greatly, and an association may find itself facing a large, unexpected tax bill. It is essential that any tax adjustments are taken into account when plans are being reassessed.

Take an example where a housing association has paid £5 million plus £1 million of VAT for some land on which it was planning to construct 75 units for shared ownership and 25 units for rent.

The first-tranche sales of shared ownership units are zero-rated for VAT. Renting is exempt from VAT. This means that the development as a whole is intended to generate both zero-rated and exempt income and any VAT incurred on the development as a whole is partly recoverable.

Most associations in this position will have agreed a VAT recovery method with HMRC based on each development’s unit numbers or floor area. This means the association would have been faced with a VAT cost of around £250,000 on this scheme.

At this point, the association would probably have considered the options available to buy the land more VAT-efficiently. However, these options usually mean paying elsewhere. There may be additional legal, SDLT, or financing costs, or a need to compensate the buyer for additional costs that they will suffer. Over the last few years, advising on similar schemes, we have found that the most efficient option has often been simply to stick to the original plan and suffer some VAT cost.

What if the current market conditions mean that the association has now concluded that it should change the tenure mix to 25 shared ownership and 75 for sale? This will come with a substantial VAT cost and it is essential that this is taken into account in any modelling.

How much of the VAT previously recovered will have to be repaid to HMRC will depend on a number of factors. If a property is moving from being all for sale to being partly or fully for rent, then potentially any VAT incurred in the last six years may have to be repaid to HMRC. This would include not only VAT recovered on buying the land but also on any professional fees incurred.

Where the property was always intended to be mixed tenure, but that mix is now changing, the effect should be less dramatic. VAT incurred in the last ten years is now potentially repayable, but the effect tapers over time. In the above example, the VAT repayable to HMRC will probably not be as much as £500,000, but is still likely to be in six figures.

If some units were intended for open market sale there is further complication. In order to avoid non-primary purpose trading in a charitable housing association, the land for these units will often have been sold at an early stage to a non-charitable subsidiary. If these units will now be for rent, they will be sitting in the wrong entity. Selling them back to the association may not be that straightforward, especially if the subsidiary would make a loss and has no reserves.

What strategies are available to mitigate this situation?

If an association has not yet acquired the land and is now getting nervous about its proposed tenure plans, it is worth looking again at the potential strategies to acquire land VAT-free. Recently we have seen sellers be a lot more open to these strategies without demanding an increase in the price.

If the group has a design-and-build company, use it for every new build project – even if this intended to be 100% for shared ownership. If a scheme then converts to rent, at least then you do not have to repay VAT recovered on professional fees. We see time and time again, groups not using their design-and-build company to its full capacity.

Commercial developers in this situation would often set-up a new company and sell any unsold units to this. The developer preserves its full VAT recovery. The new company acquires its units VAT-free and can rent these for a while until the market picks up. Housing groups have traditionally been reluctant to do this. Loan covenants and other governance issues are unlikely to make this easy, and any strategy involving changing the ownership of a property needs to consider whether SDLT would be due. However, those facing a large VAT cost may need to look at this again.

For some, it may now be as stark a choice as sale or rent. Rent-to-buy models are providing popular in many areas. In our experience, these typically allow between 80 and 90% of VAT incurred to be recovered.

Tax should never be the driving factor for a housing association to make a decision on what properties it is developing. However, if financial models do not take account of the tax impacts of changing plans, they could lead to costly decisions being made.

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Converting surplus offices and shops

It is becoming increasingly clear that the current pandemic is leading to a permanent change to the working, shopping and leisure habits of many people.

Most office-based staff do not want to return to commuting to a central head office full time, even once there is a cure or vaccine for COVID-19. The consensus seems to be that most housing associations, and many other organisations, envisage teams of currently office-based staff, will arrange to be in the office one or two days a week, but work remotely the rest of the time. Personal circumstances and business needs will vary, but it seems clear that a smaller office footprint will be required by most organisations in the future.

With our shopping and leisure habits as well, COVID-19 has accelerated some trends that were already in progress. Large department stores and shopping centres were already struggling to remain viable in the face of on-line shopping. Some high street shops have shut for good; although with more people staying locally during the working week and proposals to change the tax system to level up on-line and high street shopping, I wonder if long term, the traditional high street might pick up again.

What has certainly not changed is the continuing need for affordable housing and community facilities. With non-residential units no longer required, housing associations will be looking to see what they can do with some of this surplus property.

The good news is that the VAT system generally encourages converting surplus space to another use – especially by housing associations.

Services to convert a non-residential building (or just part of a building) to dwellings are normally subject to VAT at only 5%. However, when these services are provided to a Registered Provider (RP), or the equivalent in other parts of the UK, these services are zero-rated.

In a similar way to design-and-build for new build, further VAT savings can be achieved by procuring services through a “design-and-convert” contract.

Converted units are treated similarly to new build units. So the first tranche sale of a shared ownership unit created out of an office would be zero-rated, enabling increased VAT recovery by the association.

Some examples

1. A RP takes the lease of an empty ground floor shop, which it believes will make some good units for mobility impaired tenants. If the owner has opted to tax, the RP can certify it intends to convert this to flats and no VAT will be chargeable on any premium.

2. The RP has a design-and-build subsidiary. The lead contractor will charge 5% VAT to the subsidiary, with professionals charging VAT at 20%. All of this VAT should be recoverable by the subsidiary, which should charge no VAT to the RP on its design-and-convert service.

3. A RP owns a first floor office on a high street for which it now struggles to find tenants. It decides it would make a good shared ownership unit. No VAT should be incurred on the conversion, other than on white goods and carpets. The first tranche proceeds are zero-rated, in the same as if it were a new build project.

4. A RP acquires a shopping centre which it will demolish and then build new homes for rent. The owner will almost certainly have opted to tax, but the RP may be able to agree to serve a certificate so that no VAT needs to be charged on the land sale.

What about our own offices?

Many organisations are talking about reconfiguring their offices to deal with the new ways of working. There are likely to be more hot desks and meeting areas, and much less paper filing and individuals offices. The costs of these works will be subject to VAT, and for most organisations only a tiny percentage of this VAT can be recovered.

Some associations may conclude that they have simply do not need all of the office space they have. What you do with surplus space is likely to have VAT implications. If it has been less than ten years since you moved in or undertook a major refurbishment, VAT you recovered in the past may need adjusting.

If you are going to let out surplus office space to a third party, there is the potential to opt to tax and charge VAT to your new tenant. This should enable additional VAT to be recovered, potentially going back ten years, but you will need to consider carefully whether VAT will be a cost to potential tenants.

If you are thinking of turning the surplus area into some sort of community facility, HMRC may consider this is a 'non-business' activity if you charge nothing for this. Existing VAT recovery calculations and agreements may need to be revisited.

Organisations with several offices may now decide to rationalise these. A payment to surrender a lease early, or to vary the lease in order to hand back some floors, will be subject to VAT if your landlord has opted to tax.

Some are considering setting-up new local hubs where individuals can work closer to home, but still enjoy the access to technology and social benefits of office working. The more that facilities, rather than physical space, predominate, the more likely charges are automatically subject to VAT.

Housing associations are frequently pioneers in changing the ways new homes are created. Fortunately this is one area where VAT should not get in the way of these ambitions.

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This article first appeared in Social Housing magazine

Furlough claim accuracy

The Coronavirus Job Retention Scheme (CJRS) was extended to October 2020 in order to protect jobs.

With the amount employers can claim reducing each month from July and employers required to gradually start to make contributions towards workers' wages.

Since 1 August 2020 - employers are no longer able to claim CJRS grants towards employer NIC and Pension costs.

From 1 September 2020 - the CJRS wage claim support will reduce to 70% of employee wages, or £2,187.50 (whichever is lower) – the employer will still need to pay the 80% (or £2,500).

From 1 October 2020 - the CJRS wage claim support will reduce to 60%, or £1,875 (whichever is lower) – the employer will still need to pay the 80% (or £2,500).

The vast majority of employers have complied by the government's rules, however it is alleged that some have abused or taken advantage of the system. HMRC state that they have received almost 8,000 reports of abuse of the scheme as of 7 August 2020. This may have been as a result of claims submitted for staff who have continued to work, or by not paying staff the amounts claimed, for example. HMRC has built in steps to detect fraudulent claims, but they are also actively searching for those that have defrauded the scheme. It has been suggested that as much as a third of employees have been asked to work while furloughed. HMRC has encouraged employees to submit anonymous reports to HMRC where their employers are fraudulently making claims.

As the legislation on CJRS is new and complex, it is likely that many employers will have made innocent mistakes when calculating and submitting their claims, particularly at the start of lockdown as the rules of the scheme were evolving and many CJRS calculator software packages could only calculate the most straightforward claims.

How to stay compliant

Contacting HMRC directly to notify them of an error is likely to reduce any penalty compared to waiting for HMRC to carry out an inspection, whereby they are likely to apply more significant penalties, even if the errors are innocent. HMRC has already created a facility to allow businesses to pay back over-claimed amounts for the CJRS and if you use this to fully correct any errors, there is no need to make a further disclosure to HMRC.

Where errors resulting in over-claims are due to employers being careless, it is expected that employers will at least have to pay the overpaid amounts back to HMRC as an effective clawback by retrospectively taxing them as Income Tax or Corporation Tax at the rate of 100%, along with interest. It is anticipated that where HMRC believe over-claims have deliberately been made to misuse the scheme, penalties will be applied alongside interest. In extreme cases, the government will pursue arrests for fraudulent claims.

Employers were previously given 30 days to amend claims where they had knowingly or mistakenly committed furlough fraud. An amendment to the Finance Bill recently extended the period to 90 days. Therefore, any errors for recent claims should be considered as soon as possible.

Now that many employees are starting to return to work on either a flexible or full time basis, employers should be checking their claims to ensure they have not over-claimed or made any errors. Where employers are still submitting claims on a regular basis, errors can easily be offset against future claims. However, if an entity has no more claims to make but has made an error in previous claims, we would recommend getting prior calculations checked before considering if HMRC should be notified of any errors.

In summary

Given that the government undoubtedly intend to maximise clawbacks from those that have over-claimed, now is the time for employers to ensure that claims under CJRS are accurate and that detailed evidence is retained to prove eligibility to claim the grant. HMRC stated from the outset that they will be carrying retrospective compliance checks on furlough claims made, and require employers to keep all CJRS furlough records for six years.

During an inspection on CJRS procedures, HMRC are likely to expect to see evidence such as:

- amounts paid and claimed in respect of each furloughed worker
- communications with employees notifying them they were being furloughed
- calculations for claims for furloughed workers
- procedures in place to bring back furlough workers.

As HMRC is already taking action with regard to incorrect claims, we recommend that employers seek a second opinion to check the accuracy of their claims. Given that HMRC has allowed 90 days to fix any errors, this should be made a priority to ensure claims are accurate.

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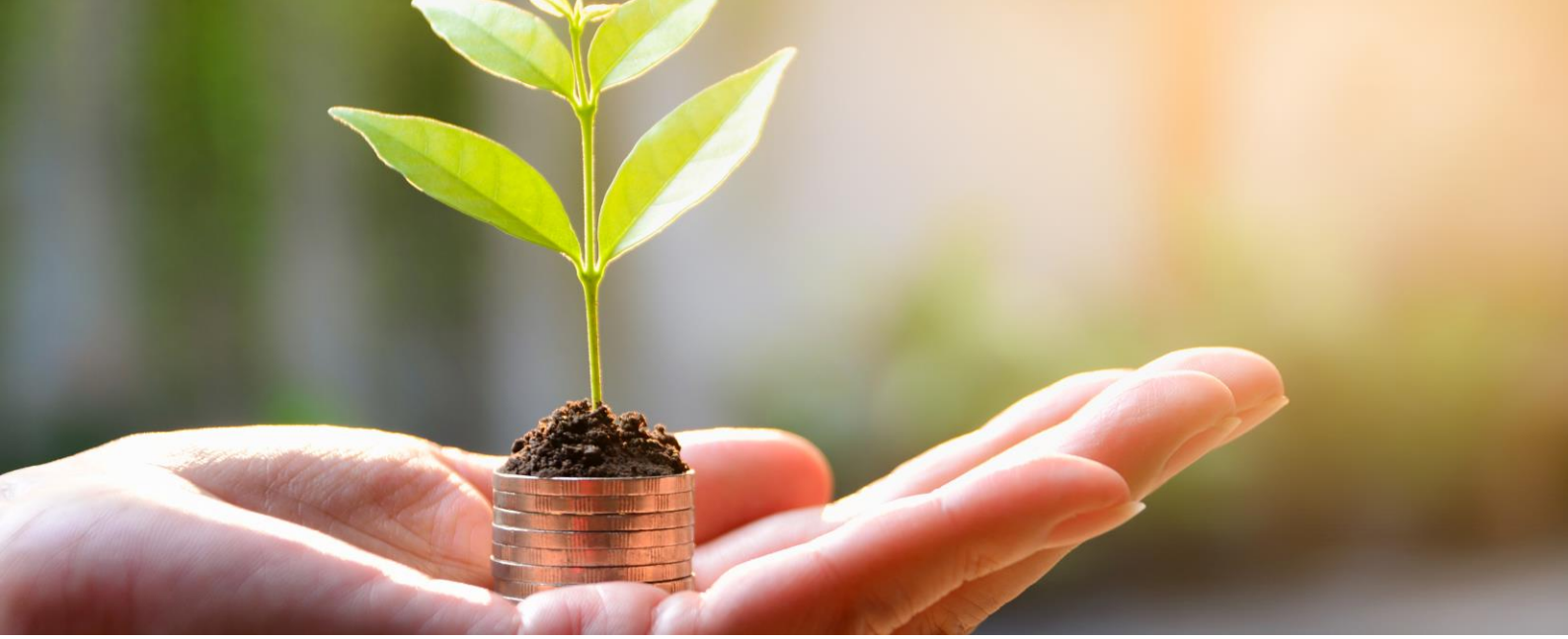

VAT treatment of call options on property confirmed

The value of land can change dramatically overnight as a result of decisions such as whether it can be used for residential development; whether a new road, train station or school will be built nearby; or whether a major business will relocate to the area.

Such decisions can take years to confirm, so potential buyers will often seek to take an option to buy the land for a certain price once this certainty has been achieved.

HMRC has historically seen these call options as being the supply of an interest in land and this is set-out in its published guidance. The consequence of this is that the VAT treatment is the same as if you sold the land. Unless specific provisions apply that make this taxable, or the landowner has opted to tax, the payment made for the call option will be exempt from VAT.

In recent meetings with industry representatives, HMRC had indicated that it had changed its view, although no formal changes to guidance have yet been made. This change of approach was outlined by HMRC's counsel in the recent case of Landlinx.

Landlinx Estates Limited First-tier Tribunal

Landlinx had acquired an option to acquire a horticultural nursery site once planning had been granted. It agreed to relinquish this option for a payment of £1,425,000 which it treated as being exempt from VAT. HMRC assessed for VAT of £237,500.

HMRC conceded that under English land law, Landlinx had acquired an interest in the land. However, it argued that it had not acquired the right to dispose of the property as owner, and so the grant of the option was not a supply of land for VAT purposes. If it was not a supply of land, it did not fall to be VAT-free for any other reason, so must be subject to VAT.

Secondly, HMRC argued that even if it was wrong on the first point, and the grant of an option is exempt from VAT, it does not follow that a payment to release such an option is exempt. The landowner did not acquire any new right in the land as a result of this action.

The tribunal disagreed. A landowner does make a supply of an interest in their property when they grant a call option. This is exempt, subject to the option to tax. Following previous case law on lease surrenders, the tribunal also held that if granting an option is an exempt supply of land, releasing one must also be exempt, subject to the option to tax.

The tribunal noted that HMRC's analysis would lead to very different tax treatments between someone buying a property for £1 million and someone paying £100,000 for the right to buy it for £900,000. It felt that this could not have been the intention of legislation.

Confirmation of the policy

Over the past few months those seeking to negotiate call options have had to deal with the difficult situation of HMRC's actual policy on call options being at odds to its published policy, a fact that not all advisers, or indeed HMRC officers, have been aware of.

The decision provides welcome confirmation of the established position on call options for property sales. A note of caution is that judgments of the First-tier Tribunal do not create legal precedent binding on other parties. It is to be hoped though that this decision will be accepted by HMRC so that such transactions can go ahead with both sides confident that the VAT treatment will not subsequently be challenged.

Update – *at the time of going to press, HMRC has confirmed that it does not intend to appeal this decision and has withdrawn from some other cases that were stood behind Landlinx. It therefore appears that HMRC's official published policy can now be relied upon.*

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The risk of cybercrime for social housing organisations

Cybercrime is one of the problems or our age, together with fraud now representing over 40% of all crime in the UK.

And we now have a real spike in cybercrime resulting from cybercriminals trying to exploit the current COVID-19 health and economic emergency. Most organisations have taken action of some kind but tell us their biggest challenge is knowing where to target their limited resources (and spend) to make a realistic improvement in resilience to the rapidly evolving cybercrime threat.

The nature of the problem

Cybercriminals have taken advantage of the growing demand for information by loading malicious software into tracking maps, government reports and health fact sheets. New websites with variations on ‘coronavirus’ in their internet addresses have also exploded, with many of them masking online scams. Some cybercriminals clearly think that ‘all their Christmases have come at once’ - an anxious population, vulnerable people at the highest risk, and masses of disinformation awash on social media. All of this equates to a massive opportunity to prey on people and organisations and attempt to defraud them while they are at their most susceptible.

Phishing attacks have increased, seeking to exploit anxiety about the virus and bogus websites purporting to offer information about the progress of the virus, its symptoms and how to protect yourself against it. This has been compounded by organisations setting up new ways of remote working at a pace which does not always allow effective cyber security arrangements to be put in place. It is also the case that some organisations do not have an adequate level of visibility of their third party suppliers of technology-related services, or enough knowledge of the extent to which they are properly protected or not.

What you can do

Organisations need genuine, specialist advice on how to protect themselves in the current climate. The last 20 years has seen expertise concerning technology become a very wide spectrum of specialisms, and deep knowledge is required especially around cybercrime - the person who understands how to keep networks running may not be the right person to advise on protection against cybercrime.

Over the last two years Crowe have invested in a cutting edge capacity to protect its clients against this ever growing threat. There are six things which social housing organisations need to do. They need to:

1. **Understand their cybercrime vulnerability**. This can be measured on the free Cybercrime Vulnerability Scorecard tool, which Crowe developed on the basis of joint research with Europe's largest forensic research centre at University of Portsmouth – go to www.crowecybercrime.com.

2. **Undertake an internal vulnerability assessment** – Crowe can provide you with the specialist diagnostic hardware which looks inside your network and systems for weaknesses.

3. **Undertake an external vulnerability assessment** – Crowe can look at your domains to see if your emails can be spoofed. We look for out of date, unsupported software, open ports which can be hacked, and known vulnerabilities which haven't been resolved. We can provide the same view of your organisation that a cybercriminal might have – if you understand the risk you can better protect yourself against it.

4. **Scan the Dark Web** (where much cybercrime is organised and planned) for indications that your organisation may be targeted – Crowe can also search the Dark Web (the part of the Web which cannot be searched using normal search engines) for compromised emails and passwords (normally for sale at $2 each)

5. Ensure that they **have the capacity to manage an attack if it happens**. Does the organisation know who would manage an attack with access to what information and in accordance with what pre-existing policies? Cybercrime scenario-based training can be important in this context.

6. **Have the capacity to (quickly) investigate what has happened** to mitigate any damage or data loss, and to recover. This includes reporting what has happened to the Information Commissioner's Office and limiting reputational damage.

Social housing organisations have been gradually tightening up their protection against cybercrime as the threat has become more apparent in recent years. However, sadly some have still not done enough. Those currently providing protection also need to be challenged. Some organisations may think that simply spending lots of money is enough – it isn't if the right things have not been done. An **independent review** of cybercrime protection usually reveals weaknesses which still need to be remedied – just like an audit might find discrepancies in accounts. It is good when these weaknesses are found, because they can then be removed.

Cybercrime is mostly undertaken by cybercrime businesses and they will, like any business, focus on where there is the greatest reward for the least effort and cost. Organisations need to think about what might make them attractive targets (or not) and put in place proportionate defences. Getting the best, specialist, professional advice is the essential first step.

These are challenging times for all of us. Except perhaps for those illegitimate ones who seek to exploit the current climate of uncertainty and isolation. There has never been a stronger imperative to protect ourselves against the constant threat of the cybercrime. Our crisis must not become the cyber criminals opportunity.

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Tax impacts of rent reductions and deferment

RPs may be agreeing rent holidays with their commercial tenants. This can have VAT and SDLT consequences.

With many commercial premises being locked down and tenants facing financial distress, landlords have been agreeing rent-free periods, rent reductions and rent deferrals. These can have VAT, corporation tax and Stamp Duty Land Tax (SDLT) impacts on both the landlord and tenant.

Due to current restrictions, many offices, shops and other commercial buildings are standing empty with tenants unable to use the buildings and most facing substantial losses of income. A significant number of tenants have been in discussion about reducing, deferring, or suspending entirely their rent during this period.

Property is a long-term investment and many landlords are accepting that this may be the best strategy available to them. However, to safeguard their investment, landlords may require the tenant to agree to something in return for any 'rent holiday'. This can have tax consequences for both parties.

Agreements are taking many forms, but three options seem to be the most popular.

Changing the rents due

Firstly, there is the fairly informal route with the parties agreeing certain rents do not need to be paid on time, or at all. In some cases, this has been achieved by moving to a turnover-based rent.

The impact on profits will feed through to both parties' corporation tax returns, but otherwise where the change merely relates to the timing or non-payment of the rents there are limited tax impacts of this approach.

When the tenant entered into the lease, the SDLT charges would have been calculated by reference to future higher rents. Although these have reduced, it will not be possible to obtain an SDLT refund.

Where the lease is converted to a turnover-based rent, the SDLT and direct tax position will depend on whether the change amounts to a variation of the existing lease or whether the change is sufficient to mean that as a matter of property law, there has been a surrender and re-grant of a lease.

Where the lease is treated as varied and no payments are made directly for the variation of the lease then for SDLT purposes the variation is treated as an acquisition and disposal of a chargeable interest and SDLT will be calculated accordingly. Where consideration is also paid directly for the variation, then the variation is treated as the acquisition of a chargeable interest so subject to SDLT. It would also be subject to VAT if the landlord has opted to tax.

From a direct tax perspective, where the lease is varied and no payment is made directly for the variation then the impact should be limited to the quantum of the rent payable (and its associated deduction) and the timing of recognition in the accounts.

Where there is a surrender and re-grant of the lease, there are SDLT reliefs which should apply meaning that the leases do not count as consideration for one and other. There is also overlap relief in respect of the rent payments, where SDLT has already been paid under the original lease.

However, this relief can only reduce the rents to zero for the purposes of the calculation, so if the new lease has lower rents due, it is not possible to claim a refund for the earlier SDLT paid. For direct tax purposes, a surrender and re-grant will result in a capital gains disposal event and depending on the length of the lease in place, this may well be a wasting asset. Where the lease is used by a trading business it should, however, be possible to roll-over any gain realised into the new lease granted so no cash tax impact.

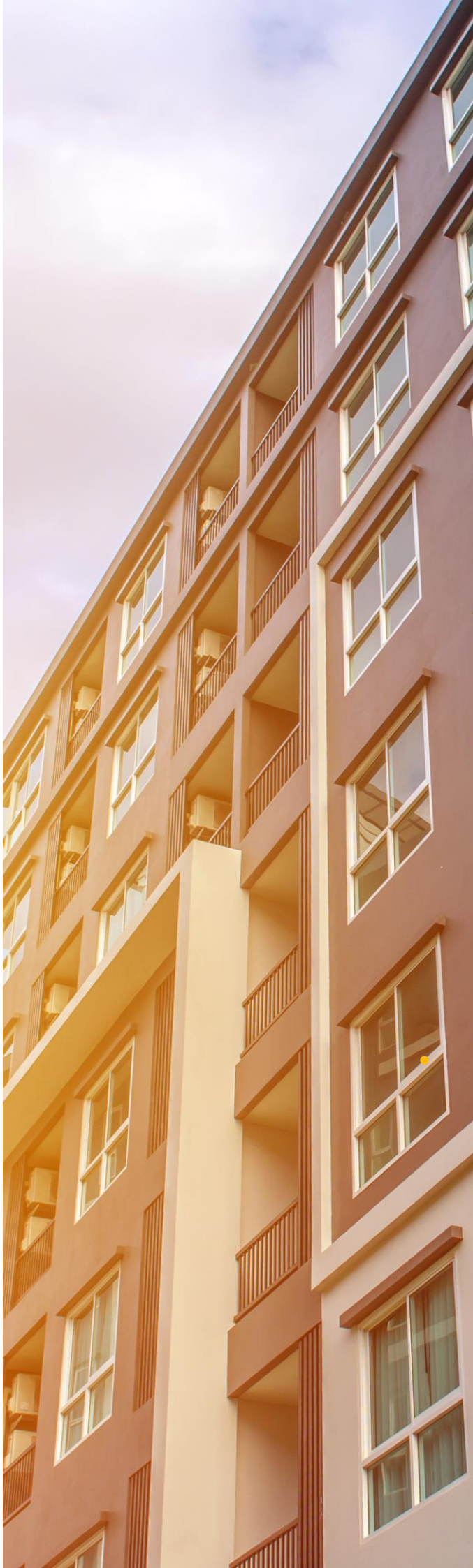
Alternatively it is possible to apply ESC39, provided the qualifying conditions are met, which means that no disposal event takes place at the grant of the new lease, instead the leases are treated as merged. Where the original lease was less than 50 years, a calculation of the 'unwasted' base cost up to the date of the new lease will need to be undertaken.

Waiving a break clause

Secondly, a landlord may agree to a rent holiday on condition that the tenant waives its right to exercise the next break clause. Arguably this is 'barter transaction' for VAT. The landlord is providing consideration by waiving some cash it would otherwise be entitled to, in return for the tenant giving up a right to terminate what might be an onerous lease.

From a direct tax and SDLT purposes, the impact of waiving a right to exercise the next break clause should be limited. Depending on the previous likelihood of that break being exercised, it may well alter the timing of the deductions by the tenant.

If the landlord is providing consideration for a service from the tenant, the next question is what the service is from a VAT perspective. If the tenant is giving up an interest in property, then this is exempt from VAT unless the tenant opts to tax the property.



Extending the lease

Finally, some landlords are agreeing to a rent-free period of six to eighteen months, provided that the tenant extends their lease for the same period. This would normally require the existing lease to be surrendered and a new lease granted.

In these circumstances, the documentation more clearly implies that there is a barter transaction, as the tenant is giving up one land interest in return for another. The surrender of the first lease to the landlord would be exempt, unless the tenant opts to tax.

As noted above, there is a specific SDLT relief for surrenders and re-grants of leases. Although the landlord will be receiving the rents over a longer period, there is not recalculation of the SDLT charged on the original lease.

The accounting for this may be complex. Any premiums, rent-free periods or other inducements that were being amortised over the life of the lease will now have to be accounted for when this lease is surrendered. Although no money is changing hands, there could still be an accounting profit or loss as a result. In addition for corporation tax purposes, there will be a capital gains disposal event, although as noted above roll-over relief may well be available.

Dealing with uncertainty

Although the treatment of rent-free periods at the commencement of leases is now well established, rent holidays in the middle of leases have not needed to be considered on this scale so far. With other priorities at the current time, it may be many months before HMRC can provide their view on this.

Landlords will also need to aware as due to the spreading of rent free periods over the life of the lease, they may well find themselves with taxable income having not received any cash rent.

In the meantime, many landlords and tenants are taking a prudent view. Tenants who are normally able to recover all of the VAT they incur have been exercising the option to tax to ensure that any transaction they may have made is not exempt and they can preserve full VAT recovery. Landlords and tenants have been issuing VAT-only mirror invoices to each other for the amount of any rent reduction.

Revenue & Customs Brief 11/20

Following our article and webinar on this subject HMRC issued Revenue & Customs Brief 11/20 providing their comments on the VAT and SDLT position. This commentary is limited, but is in line with expectations.

From a VAT perspective, HMRC confirm that if a tenant agrees to do something in return for the landlord reducing, deferring or changing the calculation of the rent due, then this could be a supply by the tenant for VAT purposes. However, HMRC consider in most cases where the parties have agreed to move to a turnover-based rent, to monthly rents, to remove a break clause, or to extend the lease, there would not be a supply by the tenant.

If landlords and tenants have taken a cautious approach and issued VAT invoices to each other thinking they have made a supply in these circumstances, but now consider that this was incorrect, they should correct this in the normal way (in practice, in most cases the net effect will have been nil and there is nothing to correct).

From a SDLT position, the guidance merely confirms that SDLT can arise depending on the form of the transaction and consideration given.

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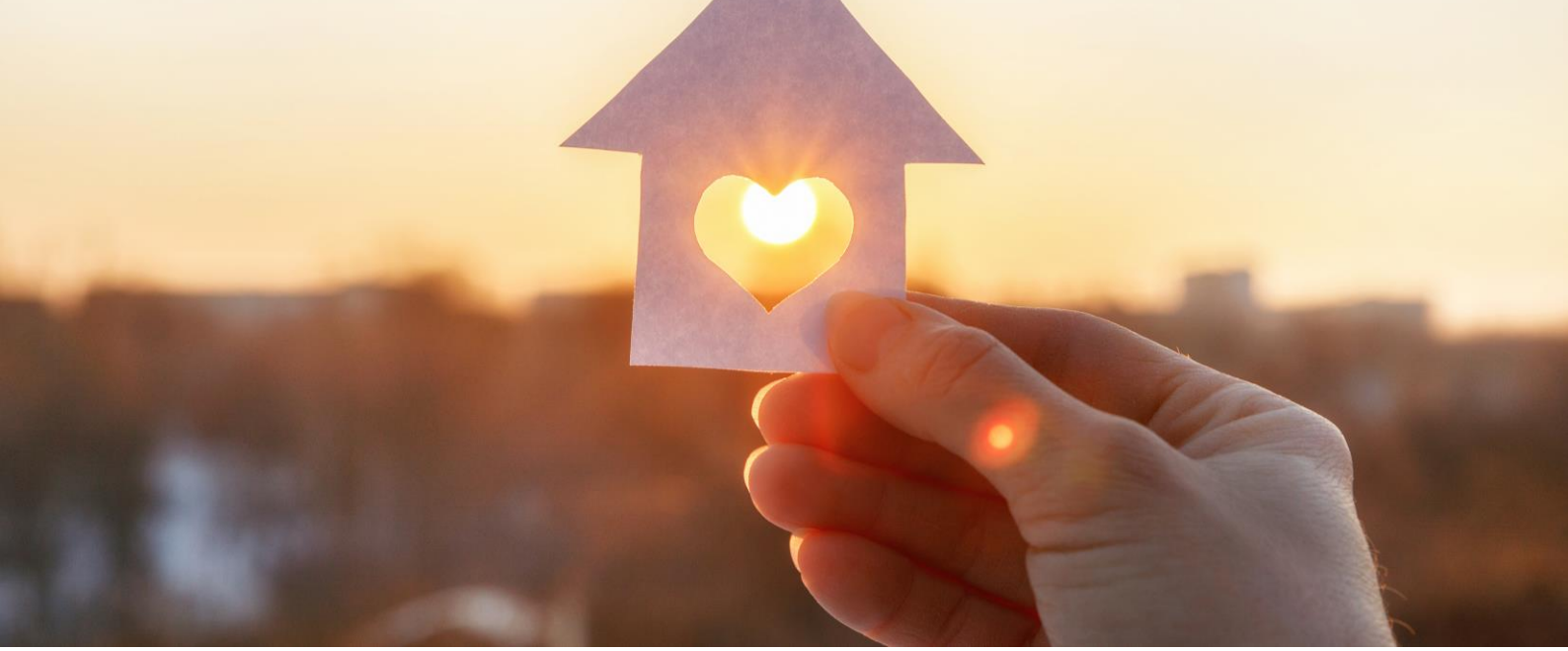


FRED 76 COVID-19 relegated rent concessions

Many lessees have been granted temporary rent concessions as a result of the COVID-19 pandemic.

These arrangements can include the forgiveness of a portion of or all lease payments for an agreed period (i.e. a temporary rent reduction or rent holiday).

FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland does not explicitly specify how to account for changes in lease payments that result from rent concessions and the Financial Reporting Council (FRC) believe there are different views about how the requirements of FRS 102 shall be applied to such changes, specifically those arising from forgiven payments in operating lease agreements. This has the potential for entities to account differently for changes in lease payments that have arisen under similar circumstances, which could be unhelpful to users of financial statements.

FRS102 currently states:

"A lessee shall recognise the aggregate benefit of lease incentives as a reduction to the expense recognised [in accordance with paragraph 20.15] over the lease term".

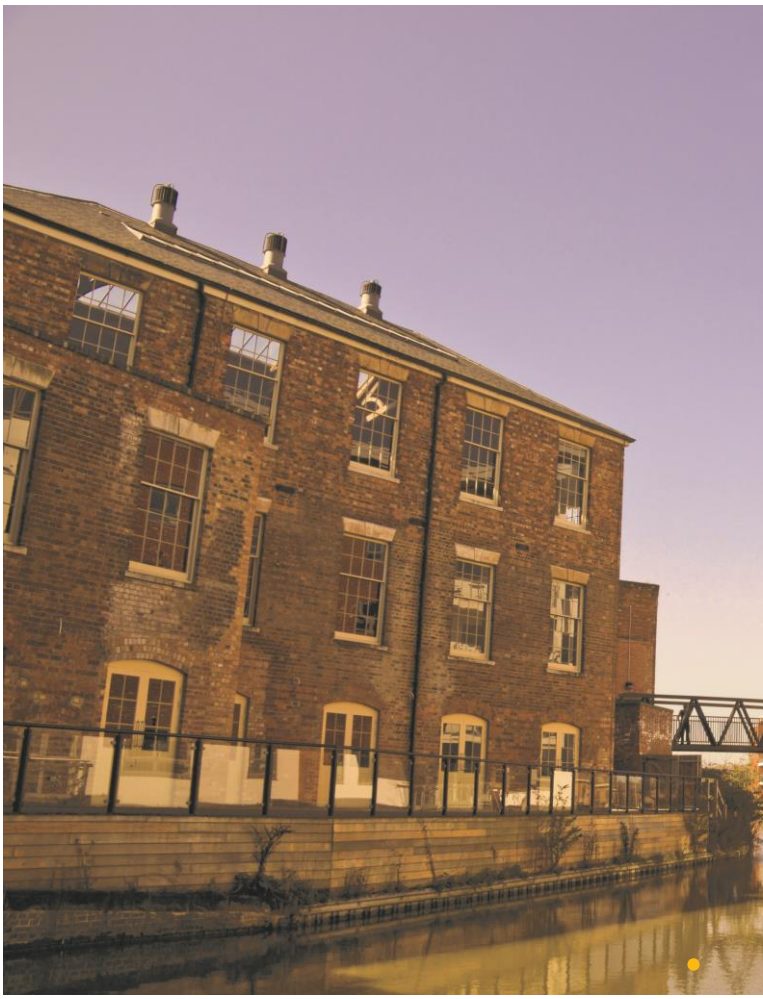
FRED 76 proposes amendments to Section 20 Leases of FRS 102 to require entities to recognise changes in operating lease payments that arise from COVID-19-related rent concessions over the periods that the change in lease payments is intended to compensate. This means that the benefit is taken immediately in the period for which the lease payments are reduced rather than spreading over the life of the lease.

The requirements apply only to temporary rent concessions occurring as a direct consequence of the COVID-19 pandemic and within a limited timeframe (payments originally due on or before 30 June 2021).

The treatment is intended to reflect the economic substance of the benefit of these concessions and their temporary nature, and improve the consistency of reporting for users of financial statements.

It is proposed that the amendments are effective for accounting periods beginning on or after 1 January 2020, with early application permitted.

Please note that this treatment is still in exposure draft form, consultation on FRED 76 closed on 1 September 2020 and we are expecting amendments to be published shortly.



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Start the conversation

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About us

Crowe UK is a national audit, tax, advisory and risk firm with global reach and local expertise. We are an independent member of Crowe Global, the eighth largest accounting network in the world. With exceptional knowledge of the business environment, our professionals share one commitment, to deliver excellence.

We are trusted by thousands of clients for our specialist advice, our ability to make smart decisions and our readiness to provide lasting value. Our broad technical expertise and deep market knowledge means we are well placed to offer insight and pragmatic advice to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.

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