

Insights

NEW HMRC GUIDANCE ON VAT AND SDLT TREATMENT OF LEASE VARIATIONS

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SUMMARY

During the Covid-19 pandemic, landlords and tenants are increasingly varying their leases to reflect the business difficulties facing tenants. In response, on 29 July 2020 HMRC issued [guidance](#) on which types of lease variations may result in a VAT or SDLT charge. HMRC say that this guidance does not change their policy, but one could question whether this is correct.

The majority of the lease variations we have seen recently have involved a rent reduction. HMRC's guidance makes it clear that a variation consisting solely of a rent reduction will have no VAT or SDLT consequences. However, the situation is less certain where the tenant agrees to do something in exchange.

VAT

For VAT purposes, a tenant's agreement to do something in exchange for a rent reduction may constitute a supply from the tenant to the landlord. HMRC's guidance indicates that an agreement to extend a lease, a variation or surrender of a break clause or an agreement to enter into a new lease will not be a supply by the tenant to the landlord. Only where a tenant agrees to do more than this will it be making a supply to the landlord - HMRC gives the example of a tenant carrying out works on the property for the landlord. The VAT status of the tenant's supply will depend on what the tenant agrees to do.

If the tenant does make a supply to the landlord, the landlord's agreement to reduce the rent will then be treated as a supply by the landlord to the tenant. The value of the two supplies will likely be the same. The VAT status of the landlord's supply to the tenant will depend on whether the landlord has opted to tax the property.

If the tenant's supply to the landlord and the landlord's supply to the tenant are both standard rated, both parties will need to issue a VAT invoice to the other in respect of the mutual supplies.

In our view, whilst this policy gives a practical way of dealing with rent-free periods, one could question whether the technical analysis is correct. Arguably, the landlord's agreement to vary or defer the rent is an exempt supply as it concerns payments or debts.

SDLT

A rent reduction where the tenant gives nothing in return to the landlord will not create an SDLT liability. However, where the landlord and tenant agree to extend a lease or enter into a reversionary lease (a lease that begins when an existing one ends), the tenant may incur an SDLT liability.

Similarly, a tenant's agreement to carry out works for the landlord on the property, or a payment made by either the landlord or tenant for varying the lease or surrendering the lease may lead to an SDLT liability.

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