

HMRC Provides Clarity on VAT and Stamp Duty Land Tax (SDLT) Treatment of the Most Common Lease Variations

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KEY POINTS

- COVID-19 has caused a rise in variations of commercial leases; and
 - HMRC has published a briefing paper to help landlords and tenants comply with appropriate tax legislation by providing guidance on VAT and SDLT treatment of common lease variations for commercial properties.
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COVID-19 has impacted cash flows and practical arrangements for landlords and tenants across the country: one of the knock-on effects of such significant disruption is that there has been a rise in variations of commercial leases with landlords and tenants under pressure to adapt to the current circumstances. Variations may be necessary for the survival of the businesses of both parties, but care needs to be taken to ensure that landlords and tenants comply with applicable tax legislation

Her Majesty's Revenue and Customs (HMRC) has published a briefing paper¹ setting out guidance on the appropriate Value Added Tax (VAT) and Stamp Duty Land Tax (SDLT) treatment of common lease variations for commercial properties to aid parties in applying the correct tax treatment. Although there have not been any relevant changes to either VAT or SDLT legislation, HMRC recognises there has been a need to vary lease terms where tenants are suffering loss of income or change the timing of payments made under their lease.

VAT

Landlords and tenants can vary lease terms between them, and the market is seeing variations by way of a period of reduced rent, a rent-free period or providing a rent deferment.

The starting point for clients to be aware of is that if a lease variation is agreed by the landlord, and the tenant agrees to do something in exchange for the variation (e.g. building works on the property), then this could be considered as a payment for a supply by the tenant to the landlord. As such, the tenant would be making a supply (e.g. the new works), and the rent reduction or equivalent, which is granted by the landlord, will be the value of that supply. Whether the supply is taxable or exempt will depend on the nature of the tenant's supply, but the salient point is that VAT may become payable.

If, however, all the tenant is doing is agreeing to accept the normal responsibilities of a tenant, (e.g. paying rent), this will not constitute a supply by the tenant for VAT purposes. Similarly, if the tenant makes no payment, or pays only a

¹ <https://www.gov.uk/government/publications/revenue-and-customs-brief-11-2020-vat-and-stamp-duty-land-tax-when-existing-leases-between-landlords-and-tenants-are-varied/revenue-and-customs-brief-11-2020-vat-and-stamp-duty-land-tax-when-existing-leases-between-landlords-and-tenants-are-varied>

token sum, then there is likely to be no VAT supply arising from the variation. It is therefore crucial to establish in what scenarios the tenant will be deemed to be doing something in exchange for the lease variation, and HMRC have provided some illustrative examples.

- **The rental amounts are reduced, but there are no other changes** – the tenant will not be making a supply, as they are merely agreeing to continue to pay rent under the revised lease terms. Where the landlord has opted to tax, the landlord will need to revise the VAT payable on the rent amount due.
- **The lease is extended, or there is a variation to a break clause in the existing lease** – the tenant will not be making a supply simply by agreeing to pay extra rent under an extended lease. Where the landlord has opted to tax, the landlord will need to revise the VAT payable on the rent.
- **The terms are changed, and in exchange the tenant agree to more than paying the rent during the lease (e.g. building works)** – the tenant's supply of building works would be a taxable supply of construction services, and the landlord's supply will be the usual supply of land under a lease, so an exempt supply, unless the landlord has opted to tax.
- **New leases** – if a new lease is agreed with new terms, the tenant is not making a supply to the landlord just by agreeing. The standard VAT rules will apply to the new lease, so exempt unless the landlord has opted to tax.

SDLT

Any variations to the terms of an existing lease, or the grant of a new lease, could also impact the SDLT payable.

HMRC have reassured parties that if a tenant gives nothing in return for agreeing to the changes there will not be any SDLT liability.

However, a variation may trigger an SDLT liability and a requirement to file a land transaction return with HMRC in the event of:

- an extension to the term of the lease (which can typically result in a surrender and re-grant and should be considered carefully before being implemented), although note that overlap relief may be available for any rent on which SDLT has already been paid;
- the grant of a new lease, which begins after the end of the current lease term (a reversionary lease) – SDLT due will become payable on the date of signing or grant of lease, not the start of the lease term;
- an agreement by a tenant to carry out work on behalf of a landlord (e.g. in return for the landlord agreeing to reduce the rent payable); and
- the payment of a lump sum by either party in return for changes being made to a lease, or in return for the surrender of a lease.

With all variations or amendments to a commercial lease, we recommend both landlord and tenant get in touch with their Katten attorney to discuss any tax consequences arising as a result of lease variation.

CONTACTS

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