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Housing Associations: VAT, other taxes and accounting updates you need to know

22 February 2023

Agenda

- Introductions and virtual housekeeping: Hugh Swainson, Partner
- Year-end preparation overview: Hugh Swainson, Partner
- New auditing standards: Matt Hrycaiczuk, Associate Director
- VAT updates: Kam Chauhan, Director
- Direct tax updates: Luke Savvas, Partner
- Q&A: chaired by Hugh Swainson, Partner

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Year-end preparation overview

Hugh Swainson

Reporting Framework for 2022/23

- Financial Reporting Standard (FRS 102)
- Housing Statement of Recommended Practice (SORP) 2018
- Accounting Direction (2022)
- Other financial reporting requirements (e.g. for subsidiaries)

Sector risk profile (October 2022)

- Inflationary impact on income
 - 7%, risk on arrears, property sales
- Inflationary impact on costs
 - Staffing, energy, supply chain costs
- Borrowing
 - Cost of new borrowing, interest rates on existing variable loans, headroom on covenants
- Regulation and compliance
 - Building Safety Act 2022, Tenant Satisfaction Measures Standard (1 Apr 2023), Fire Safety Act 2021, Decent Homes Standard, Future Homes Standard 2025, Data Protection Act 2018
- Stock quality

Audit impact of sector risks (continued)

- Going concern
 - Updated projections
 - Financial assumptions
 - Risks and uncertainties
 - Mitigations
- Rent arrears
- Impairment
- Compliance
- Fraud risk

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New auditing standards

Matthew Hrycaiczuk

Revised ISA 240: Auditor's responsibilities relating to fraud

- Financial statements free from material misstatement due to fraud
- Greater focus on professional scepticism
- Reference to related parties
- Requirements for discussion re: anti-fraud/whistleblowing procedures/policies
- Actions: Ensure this responsibility is determined and policies are up to date
- [Whistleblowing: Guidance for Employers and Code of Practice \(publishing.service.gov.uk\)](https://www.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/414242/whistleblowing-guidance-for-employers-and-code-of-practice.pdf)

Revised ISA 315 Identifying and Assessing the Risk of Material Misstatement: Key Changes

1. New inherent risk factors: Subjectivity, complexity, uncertainty, change and susceptibility to misstatement due to management bias or fraud
2. New spectrum of risk
3. Separate consideration of inherent and control risk
4. Requiring “sufficient, appropriate” evidence to be obtained from risk assessment procedures as the basis for the risk assessment
5. **More work on design and implementation of controls relevant to the audit**
6. **Significant increase on IT, particularly general IT controls**

Revised ISA 315: Design and implementation of control

- More assessment of controls at planning stage
- Cannot rely on sample testing only for highly automated transactions
- Example – rental review
- More automation – move to control testing rather than sample testing
- Point of data input
- Emphasis on reconciliations, verifications, physical and logical controls, segregation of duties, larger data sets and use of data analytics
- Gross risk relating to these areas increasing – controls/mitigations to increase to ensure net risk tolerable
- Focus of internal audit programmes follow this

Revised ISA 315: Emphasis on IT controls

- IT governance proportional to the complexity of operations;
- How do you assess knowledge of IT
- Understanding IT systems
- Areas of potential highest risk and associated IT controls
- Generally three key areas:
 - Access management
 - Change management/version control
 - IT operations

Revised ISA 315: Emphasis on IT controls (examples)

- Example 1 – Access management
- Risk: Users have access privileges beyond those necessary to perform their assigned duties, which may create improper segregation of duties.
- Control: Access for terminated or transferred users is removed or modified in a timely manner.
- Documentation: Would we expect this process to be documented?
- Audit test for implementation: Review of active users against the current employee list

Revised ISA 315: Emphasis on IT controls (examples)

- Example 2 – Change management
- Risk: Inappropriate changes are made to database structure and relationships between data
- Control: Repairs tickets include the date the ticket was raised; this data is used to assess performance against targets. It should not be possible to change this date manually.
- Documentation: Would we expect this process to be documented?
- Audit test for implementation: Review of underlying database access and check as to whether manual intervention is possible.

Revised ISA 315: Emphasis on IT controls (examples)

- Example 3 – IT Operations
 - Risk: Data backup – Financial data cannot be recovered or accessed in a timely manner when there is a loss of data
 - Control: Financial data is backed up on a regular basis according to an established schedule and frequency
 - Documentation: Due to the risk associated in this area would expect formal documentation
 - Audit test for implementation: Review of log of backups/copies of backup files

Revised ISA 315: How you can prepare and what are the benefits

Preparation

- Formal documentation of controls around accounting and information processes
- Evidencing data flows, understanding of different steps
- Discussion with your auditor
- Consideration of audit timetable (interim work)

Benefits of Preparation

- Understanding own information flows and risk assessment
- Efficient audit process
- Reduction in additional audit costs

“Organisations automating at least 25% of internal controls paid 27% lower audit fees on average”

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VAT implications

Kam Chauhan

Construction services

- The VAT liability will depend on the specific circumstances:
- New build residential – zero-rated
- New build commercial – standard rated
- Conversion of commercial to residential – zero-rated
- Conversion of existing property into additional flats – reduced rate
- Property empty for more than 2 years – reduced rate
- Refurbishments – standard rated
- In all cases professional fees – standard rated

Design and Build structure

Under such a structure, the professional fees take on the VAT liability of construction services

- Important that the structure is set up on a commercial basis otherwise risk of challenge

For example:

- Contractual terms between the parties
- D&B Co has the wherewithal to make the supply – staff, premises
- Mark up or management fee for services
- D&B co enters into engagement with third-party contractors
- Suppliers raise appropriate invoices
- D&B Co issues invoices to HA

Commercial property

If development includes commercial property, consider the option to tax

- Converts exempt rent into standard rated
- Doesn't apply to residential property
- Taxable supply allow for recovery of input tax
- OTT must be exercised and notified at correct time
- HMRC no longer issuing acknowledgement letters
- Important the OTT is correctly notified from the outset

VAT Recovery

Where VAT is incurred either on property costs of the general running of the Association, consider basis for VAT recovery

- Direct attribution
- Overhead and Mixed-use development costs are subject to partial exemption recovery method
- Standard method based on turnover – doesn't always produce a fair and reasonable result
- Most instances better off with special method – variety of methods
- Many Associations use a sectorised method based on individual projects – either unit numbers, floor space or mixture
- Need to consider case by case; approval needed from HMRC
- If any non-business activity, further restriction of VAT recovery is necessary

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Direct tax update

Luke Savvas

Reminder of the main direct tax exemptions

- Housing Associations can have different types of structures and types of entities, and often a group with all these entities – this determines the corporation tax status.
- Tax reliefs apply but in certain situations where tax can arise on different types of income.

Co-operative HAs (CCB Societies) tax reliefs (s642-3 CTA10 Pt13/Ch 7):

- Rents received from members are disregarded for Corp Tax. Warning if other commercial rental income?
- Exempt from CT on chargeable gains when disposing of property which has been/is occupied by a tenant of the association
- Interest payable by the association is disregarded

Still tax on other income received, such as bank deposit interest

Reminder of the main direct tax exemptions continued

Charities, main exemptions - (Part 11 of CTA 2010 for Companies/Charitable Trusts at Part 10 of ITA 2007)

- Interest (bank deposit and other forms of interest)
- Rent
- Primary Purpose trading income*
- Capital Gains (s256 TCGA 1992)

Must be income/gains applied for charitable purpose

FITs – taxable as ‘miscellaneous income’ but HA’s can get relief for interest, often negating a tax charge

New Residential Property Developer Tax (RDPT) – exemption for non-profit registered HA’s and wholly-owned subs

Property transactions and trading

- If chargeable gain then exempt as a charity or exempt as a co-op if an association tenant property
- Can be a fine line between capital gains treatment and trading.
- If a charity is trading in property, then is it part of your primary purpose?
- Care when structuring JVs with developers and structuring – unexpected tax costs

Design and Build Trading Subsidiaries planning

- Reduce corporation tax to nil by Qualifying Charitable Donations (potentially!)
- But watch distributable reserves and mismatch with accounting profits
- Potential Corporation Tax issues on the transfer of property to a subsidiary, arising from the appropriation of properties to and from stock – can constitute a taxable chargeable gain

Property transactions and trading continued

May sell to a developer as a gain and may not trade but watch...

- s755 ITA 2007 - Charge to tax on gains from transactions in land
- Overage etc. may not be exempt!
- Planning with drafting contracts?

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Q&A

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Thank you for attending