

VAT grouping consultation – NHF response

Briefing for members

Summary

We have responded to HM Treasury's call for evidence in relation to VAT grouping. The consultation asked for views on questions relating to three specific topics:

- The establishment provisions, primarily a comparison of 'whole establishment' and 'establishment only' bases of including an entity in a VAT group.
- Potential issues arising from the introduction of compulsory VAT grouping.
- Grouping eligibility criteria for entities not included in the current legislation, including limited partnerships.

Our response focuses on the aspect of compulsory VAT grouping as it is this area that would have the most impact on our members if the proposed changes are introduced. We have recommended that the UK does not introduce compulsory VAT grouping for entities that fall within the scope of VATA 1994 s43 as it would create a number of negative impacts for housing associations:

- Increasing irrecoverable VAT costs associated with the development of homes for social/market rent.
- Increased difficulty in utilising the cost sharing exemption.
- VAT costs trapped within the supply chain due to increased use of the option to tax disapplication relief.

At this stage it has only been possible to provide a high level response to the questions raised. For this reason, we have requested a meeting with HM Treasury to discuss this further and give us the opportunity to engage in order to demonstrate the impact on individual housing associations.

A summary of our response

We understand HM Treasury is not at this stage proposing to make specific changes in the three areas outlined. Instead, the call for evidence asks broad questions on the potential impact of aspects of VAT grouping.

As noted in the summary, we have focused our responses on the second section – compulsory VAT grouping – as it is this aspect that will have the most impact on our members should the current legislation be amended.

Topic 1: Introducing an establishment-only approach to VAT grouping

This proposal would see a change from a whole-establishment approach to an establishment-only approach to VAT grouping. Our members do not tend to have an international footprint, so any changes in this area are likely to have minimal impact on the sector.

Topic 2: Compulsory VAT grouping

The NHF believes that members eligible for VAT grouping with the flexibility to form a VAT group and entities are unlikely to gain advantages from compulsory VAT grouping. Indeed, compulsory VAT grouping would remove this flexibility and result in significant increased VAT costs.

A survey of our members highlighted that these added VAT costs could lead to a reduction of 18,621 affordable homes being developed each year. Also, the joint and several liability requirement of VAT grouping would cause various commercial and regulatory issues for the housing association sector. As noted in the summary, we have recommended against the introduction of compulsory VAT grouping.

Topic 3: Grouping eligibility

The use of limited partnerships within the housing association sector is not common practice. We have therefore provided a high level response to the questions raised in relation to this.

Our response in full

National Housing Federation

The National Housing Federation (NHF) is the trade body for housing associations in England. The NHF has over 800 members that own 98% of the sector's housing stock and its remit is to:

- Provide a single united voice for housing associations.
- Help shape national housing policy.
- Communicate the unique social purpose of members.
- Connect members by providing a forum for housing association leaders and staff to share experiences, challenges and good practice.
- Build relationships with politicians and partners that enable the sector to thrive and provide strategic leadership where culture change is needed.

Housing associations

Housing associations are not-for-profit social landlords. In England there are 1,600 housing associations providing around three million homes and support for nearly six million residents. Housing associations may be constituted using various forms of legal entity. Many are community benefit societies, but there are also trusts, co-operatives and companies. They may or may not be registered charities.

Since the 19th century, housing associations have been providing social housing to people who are unable to afford market renting or purchase their own homes. Currently, one in ten people in England live in a housing association home. In 2019/20 a quarter of all new homes in England circa 45,000 were developed by the housing association sector.

In the last decade, the level of government funding provided to the sector has reduced which has resulted in fewer social homes being built as their focus has shifted towards private home ownership. Housing associations have adapted to cope with this reduction in central funding – for example, the sector has undergone a period of consolidation with housing associations coming together and the creation of large corporate groups to reduce overheads and obtain economies of scale.

In addition, the sector has developed a shared ownership model that supports government policy whilst supporting those individuals and families who may ordinarily find it difficult to get onto the housing ladder. The sector has also sought to diversify, generating income from activities such as market rental, housing development for market sale, student accommodation etc., the profits from which are used to cross-subsidise the development of new homes for social rent.

How we approached our response

The NHF reached out to our members and asked them to provide input into this response. Members were encouraged to:

- Provide an overview of how the changes detailed in the call for evidence document could impact their organisation, and/or;
- Complete an online questionnaire – for the sake of simplicity this focused on the impact of compulsory VAT grouping.

We received 65 responses in total from 48 organisations ranging in size from 209,000 housing units to those with 48 housing units under management and with a variety of legal forms and group structures.

The organisations concerned manage 1.28m housing units, which is over 42% of all housing association stock. Therefore, we consider our sample to be reasonably representative of the housing sector as a whole. The results of the questionnaire were used to inform our responses to the questions posed.

Chapter 1: VAT grouping and establishment provisions

There were a number of questions that related to establishment provisions – see a summary of questions on the [consultation document from HM Treasury](#) (starting at page 13). However, the NHF and our advisors RSM agreed that these proposals would have minimal impact on housing associations and responded as such, as set out below.

Impact on housing association sector

Most housing associations will only have a fixed establishment(s) in the UK. It is unlikely that any changes to the whole establishment provisions will have an impact on the housing association sector.

Members did express a concern that the proposed changes could result in them being required to have multiple VAT registrations where the organisation had a number of branches throughout the UK, and we have sought to allay this concern.

General observations

The NHF believes that the impact of such a change on the wider business community would be largely negative. Establishment-only grouping would create intra-entity supplies for VAT purposes, i.e. there would be a deemed supply between the UK and overseas branches of the same company. This would create administrative and accounting difficulties as corporate systems are generally not designed to deal with internal 'supplies' or attribution of costs and VAT recovery to different parts of the same entity.

It would also be necessary for existing VAT groups to reorganise their business structure to address the VAT consequences of an overseas establishment no longer being treated as a member of the VAT group, and deal with the administrative and accounting issues outlined above.

VAT administration already represents a significant additional cost to business and the magnitude of the burden impacts smaller business disproportionately. This added layer of complexity could disadvantage organisations that are considering expanding overseas and in turn stifle growth, not only of the business concerned but the UK economy.

Chapter 2: Compulsory VAT grouping

19% of respondents to our survey do not have a VAT group registration. Of those that do (81%), only 16% include all group organisations. If we were to extrapolate this to the housing association sector as a whole, then we believe that up to 1088 housing associations in England for the reasons stated below could be adversely affected should compulsory VAT grouping be introduced.

16. What benefits or disadvantages could a system of compulsory VAT grouping deliver for businesses? Would this vary between different sectors?

Impact on housing association sector

Benefits

Based on the responses received from our members, combined with our own assessment, benefits for the housing association sector would be limited to the potential removal of VAT costs on intra-group supplies/management charges to a subsidiary which cannot register for VAT on its own because it does not make any taxable supplies.

Disadvantages

Financial impact

Should compulsory VAT registration be introduced this would have a negative financial impact on the sector and the level of irrecoverable VAT would increase significantly:

1. Increased VAT costs associated with the construction of properties for rent

The housing association sector, especially those that have a large development programme, have established development company/companies that are ordinarily VAT registered separately to enable them to utilise the zero rating provisions. This in turn enables them to recover in full all VAT incurred on development costs, in particular legal and professional fees. The VAT on these costs would be an irrecoverable cost if the housing association had borne them directly.

2. Increased VAT costs associated with the purchase of land

Notwithstanding the fact that housing associations can disapply the option to tax, many choose not to do so, and instead purchase opted sites via a wholly owned development company as this ensures that irrecoverable VAT is not trapped within the supply chain. If an option to tax is disappplied, vendors will ordinarily seek to increase the purchase price to reflect any VAT that they may have to repay as a result of the disapplication.

83% of the organisations that responded to our online questionnaire have a development company, and £56m input VAT is reclaimed by this sample of housing associations each year on average, on costs such as site acquisition, legal and professional fees etc. If we were to extrapolate this and apply this to the sector the adverse financial impact would be in the region of £81m per annum.

Using this £81m for the delivery of new housing, housing associations would have most likely accessed debt funding from the capital markets where the total average cost of housing association bonds is currently approximately 3%. This £81m cash flow therefore services £2,700bn of housing association debt. Assuming an average build cost per property of £145,000 (Regulator of Social Housing (RSH) quarterly survey) this debt funds the delivery of 18,621 affordable homes per annum.

Whilst we accept that the sector could revert to using the disapplication of the option this would not mitigate this cost in its entirety and a significant increase in costs is still likely to ensue for the reasons stated above.

3. Loss of the cost sharing exemption relief

The sector has sought to utilise the cost sharing VAT exemption relief where appropriate to do so. There are at least 47 housing associations participating in six cost sharing entities. However, in order to meet the three separate VAT entity requirement, the cost sharing entity is sometimes owned by two housing associations who are part of the same corporate group (but different VAT registrations) and an unconnected housing association. Compulsory VAT grouping could result in some of these cost sharing entities no longer meeting the eligibility criteria which would result in additional VAT costs of up to £4.6m per annum.

4. Increased compliance burden/costs

Accounting systems will need adjusting, and software may need to be updated with resultant additional system testing in order to ensure that a group registration/expanded group registration can meet all of the Making Tax Digital reporting obligations. This is further compounded if entities within the VAT group use different financial reporting systems.

It is likely that VAT guidance notes would need to be updated, and that additional training would need to be provided to the finance and development teams to ensure ongoing VAT compliance and that VAT risks are appropriately managed.

Any change in VAT number will result in stationery, letterheads etc. needing to be replaced, and digital templates, websites etc. that carry the original VAT numbers would also need to be amended to reflect the new VAT registration number.

Impact on financial covenants

A number of housing associations have advised that when they apply for third party funding, lenders often stipulate that the borrower cannot be part of a VAT group registration. Where this is the case, compulsory VAT grouping could result in financial covenants being breached.

Impact on investments

More recently, housing associations have begun to develop a market rental portfolio. To ensure that the primary purpose trade of the housing association and its associated corporation tax exemption status is maintained, these assets are owned by a subsidiary. Compulsory VAT grouping could not only give rise to these entities breaching their financial covenants but it could also impact the value of the subsidiary. Should the housing association wish to divest this entity, any prospective purchaser would have concerns vis a vis the joint and several liability provisions that come with group registration and would seek to price the value of the transaction to take into consideration this additional financial risk.

Regulatory impact

Many housing associations are charities and whilst they are allowed to have trading subsidiaries the charitable housing association cannot guarantee the VAT obligations of non-charitable organisations. Compulsory VAT grouping would be of concern to the Charity Commission.

The RSH regulates registered providers of social housing to promote a viable, efficient and well-governed social housing sector able to deliver homes that meet a range of needs. The regulator may have concerns if the assets of a regulated entity were jeopardised by a non-regulated entity due to the joint and several liability requirement associated with VAT group registrations.

17. How would compulsory VAT grouping impact the administrative processes for businesses?

Impact on housing association sector

The majority of respondents (83%) felt there would be a negative impact on their organisations administrative processes. The following reasons were cited:

- The flexibility of filing monthly VAT returns for some subsidiaries would be lost, impacting group cash flow.
- Those subsidiaries with single VAT registrations will have to deregister for VAT to join the VAT group and will have to change their VAT registration number on sales invoices etc. Similarly, websites etc. would have to be updated.
- Integrating other group members into the current VAT compliance process would be an onerous task.
- Single group VAT return would require data to be consolidated to prepare the VAT returns which in turn could double the time currently spent on this process.
- Making Tax Digital: filing one VAT return could be difficult due to the number of systems used and the size of data files, and there is further concern that organisations may not be able to fully comply with the digital links requirement. This requires the recording of the digital audit trail from the data entry point for the sales/purchase invoice through to the values reported on the VAT returns, and would be complicated if separate entities used different systems.
- 66% stated that they would need to agree a partial exemption special method (PESM) or amend an existing PESM.

18. How would compulsory VAT grouping interact with ‘establishment only’ VAT grouping provisions, if they were to be implemented?

Not applicable as the majority of the housing associations only have a fixed establishment in the UK.

19. How would compulsory VAT grouping impact businesses of different sizes, and would the minimised risk of errors be of benefit?

Based on the results of our online survey, 83% of respondents stated that compulsory VAT grouping would have a negative impact on their administrative processes. These ranged in size from groups comprised of two entities/48 units under management to 100+ entities and 209,000 homes under management.

98% of the organisations concerned had a development subsidiary, 36% felt they would need to agree a PESH or seek to amend an existing PESH to accommodate compulsory VAT grouping and 15% of respondents cited that financial covenants could be impacted.

17% stated that compulsory VAT grouping would have no impact or a positive impact on their administrative processes. This response was despite the fact that 53% of these organisations felt that they would need to agree a new partial exemption special method with HMRC.

How the impact of compulsory VAT grouping is perceived is very much dependent upon whether the corporate group has a development company and whether financial covenants could be breached. The size of the organisations themselves appears to have no bearing.

20. Are there any instances where businesses are not VAT grouped for specific commercial or regulatory reasons? Please provide examples.

Housing associations are currently able to freely choose whether to form a VAT group and which entities to include in it. VAT grouping decisions are predicated on the following:

Commercial

1. Mergers and acquisitions

There is often a preference to maintain newly acquired businesses outside of the VAT group until such a time that all appropriate group controls are in place to ensure that all business risks are effectively managed. In addition, introducing a new entity with a director/management earn out agreement into an existing VAT group would result in complexity when negotiating the performance of the earn out arrangement, especially if the VAT status, profit margins etc. of the entity being acquired are more favourable than the VAT group and vice versa etc.

2. Cash flow

Where a group has a large development programme, the development subsidiary will normally file VAT returns on a monthly basis in order to maximise cash flow, especially during the construction phase when it is likely to be in a repayment

position. The main VAT group registration will file VAT returns on a quarterly basis.

Whilst it would be possible for a VAT group registration to file monthly VAT returns due to the complexity of producing the consolidated return the administrative burden is likely to outweigh any cash flow benefits.

3. Utilisation of VAT reliefs

Separate VAT registrations allow housing associations to utilise zero rating reliefs when constructing housing for social/market rent, resulting in reduced VAT costs in relation to legal and professional fees. This is also to ensure that VAT does not become trapped within the supply, which would be the case should they have to rely on the disapplication of the option to tax when acquiring suitable sites.

As mentioned previously, housing associations within the same group may choose to separately register in order to be able to utilise the cost sharing exemption.

4. Reduced competitiveness

Vendors typically push back when a housing association seeks to utilise the option to tax disapplication relief and will often choose an alternative buyer. It is for this reason that many housing associations choose not to use the option to tax disapplication relief.

5. Joint and several liability

Where housing associations are investing in a market rental portfolio these assets are usually ring fenced and held by a subsidiary. Lenders will often insist on financial covenants that require the entity to be separately VAT registered. Separate VAT registration also makes any subsequent sale of the subsidiary to an investor such as a pension fund easier, as the tax risks/liabilities associated with the purchase will be limited to the subsidiary alone. The VAT grouping joint and several liability requirements are prohibitive and likely to result in an asset sale which may not be as financially advantageous.

Often when lending to a housing association, financial institutions, whilst securing the loan against the housing assets of the borrower, will insist that the borrowing entity cannot be in a VAT group with other group companies. This is to ensure that their creditor status is protected as much as possible.

6. Maintaining Corporate Tax Exemption

Charity primary purpose trade qualifies for tax exemption, and activities outside the primary purpose fall within the direct tax net unless within the de minimus limit (currently £85,000). It is for this reason that charitable entities ensure that all non-charitable activities are undertaken by a subsidiary. The subsidiary will then gift any profits to its charitable parent and in so doing claim gift aid relief. Inclusion of the subsidiary within the same VAT group can sometimes negatively impact on the housing associations partial exemption status and vice versa.

7. Treasury vehicle

A large number of housing associations have established a treasury subsidiary to raise finance via the bond markets. The inclusion of this entity within a VAT group registration would distort standard partial exemption calculations and require agreement of a PESM.

Regulatory

A charity cannot guarantee the VAT obligations of a trading subsidiary, and as stated above compulsory VAT grouping would be of concern to the Charity Commission. In addition, the RSH would also be concerned if the assets of a regulated provider could be jeopardised as a result of a failure of a non-regulated entity that was part of the same VAT group registration.

Chapter 3: Eligibility criteria: partnerships

There were a number of questions that related to establishment provision – see a summary of questions on the [consultation document from HM Treasury](#) (starting at page 13). However, the NHF and our advisors RSM agreed that these proposals would have minimal impact on housing associations and responded as such, as set out below.

Impact on housing association sector

Many housing associations have charitable status, and it is for this reason that the use of limited partnerships is a rare occurrence. Charitable housing associations will not take on the role of general partner as it is the general partner who is personally

liable for the partnership's debts and other obligations. As mentioned previously a charity cannot guarantee the liabilities of another entity.

Housing associations and their subsidiaries are sometimes limited partners, contributing monies or other assets such as land to the partnership. Although they maintain a right to a share of its profits, they do not have control over business decisions.

In return for surrendering management power, the housing association/subsidiary benefits from 'limited liability' – which is capped to the amount of their investment. However, due to the lack of management control and oversight most housing association boards prefer to utilise alternate legal forms that provide them with the opportunity to have a greater level of management oversight in order to protect the charity's investment.

Conclusion

Our response has set out that the establishment provisions (chapter one) would not have an impact on the housing association sector.

We have set out several key financial impacts that the compulsory VAT grouping will have on our sector, such as an increase in irrecoverable VAT costs associated with the development of homes for social/market rent, including the loss of 18,621 new affordable homes per year, increased difficulty in utilising the cost sharing exemption, and also VAT costs trapped within the supply chain due to increased use of the option to tax disapplication relief, not to mention the increased administrative burden.

In addition, the sector will be at a commercial disadvantage when seeking to acquire land if it is forced to use the option to tax disapplication relief more widely. There are also regulatory issues that need to be considered. Compulsory VAT grouping would place in-house property development activities (i.e. construction of new dwellings) at a significant disadvantage compared to third party developers, and this, in turn, would negatively impact on the ability of the sector to meet the aspirations of the government in respect of the supply of new homes. Lastly, the changes proposed in relation to eligibility would not have a major impact on the sector for the reasons stated.