

## Important ICAC ruling on the treatment of reductions and waivers of rental payments during COVID-19

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The Spanish Accounting and Audit Institute (“ICAC”) has published a ruling dated February 19, 2021, on the accounting treatment to be applied to **reductions and waivers of rental payments agreed as a consequence of the COVID-19 crisis in the case of operating leases**.

Since March 2020, due to the economic situation arising from COVID-19, rent waivers and reductions have been agreed for lessees affected by the restrictive economic measures of the state of emergency. The accounting and tax treatment of these measures has raised a number of doubts.

The treatment for **VAT purposes** was clarified by several rulings of the Spanish Directorate General of Taxes (“DGT”) (in this respect, we consider V2053-20 to be the most comprehensive), in which it is concluded that **if there is an agreement between the parties, VAT does not accrue on the amount of the agreed discount or waiver (and, therefore, the lessee should not be charged VAT on the discount portion)**. In the event that there is no agreement between the lessor and the lessee, the DGT takes the view that the waiver of the rent must be treated as self-consumption subject to VAT, except when the state of emergency has prevented the lessee from engaging in any business activity.

However, there was uncertainty as to the accounting treatment that should be applied to these discounts and waivers, a matter on which the ICAC had not ruled. Thus, the question could be raised as to whether the criterion in the ICAC rulings that had analyzed the treatment of grace periods and graduated rent payments could be extrapolated. In these rulings, the ICAC had chosen to record the rent reduction on an

accrual basis. Doubts arose because these situations were provided by contract and substantially different from those arising in 2020.

In its ruling of February 19, 2021, the ICAC offers a solution to this problem. The accounting regulator's reasoning **is based on the consideration that the reduction of payments requires the parties express agreement**, since the legislation on the subject (Royal Decree-law 15/2020, of April 21, adopting additional emergency measures to support the economy) only established a moratorium.

In light of the above, it considers that **contracts including the possibility of reducing payments in cases where activity is restricted or forced to stop by law or regulation, the reduction in the payment and the collection of the lessee and lessor, respectively, must clearly be treated as contingent rent** and, therefore, must be fully recorded in the income statement of the financial year affected by the reduction of payment and collection.

In all others cases, the most frequent in practice, the ICAC considers that in the exceptional situation caused by COVID-19 and where there is an agreement between the parties one could choose to consider that the economic event triggering the reduction of the price for the grant of the right of use is not related to subsequent financial years, but rather to the current economic situation, **which would lead to that agreement not being classified as an incentive for the lease, but rather as a temporary adjustment of the rent to the economic situation that arose** and, therefore, the treatment provided for contingent rents would apply.

In other words, it is permitted not to record on an accrual basis the waiver or reduction of agreed rents and, therefore, not to record the relevant income (or the expense, for the lessee) in view of the exceptional situation.

This means that the existence of an agreement and the capacity to prove its content will be key elements for direct taxation (based on accounting) and indirect taxation purposes.

A similar solution is reached by international accounting rules (incorporated into EU legislation by Commission Regulation (EU) 2020/1434 of October 9, 2020, amending Regulation (EC) No. 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 16).

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