Tolley® Exam Training

CTA ADVANCED TECHNICAL

DOMESTIC INDIRECT

PRE REVISION QUESTION BANK

FA 2019

May and November 2020 Sittings

PQ724
CTA

Tolley® Tax intelligence from LexisNexis®

INTRODUCTION

This Pre Revision Question Bank for the Advanced Technical Domestic Indirect paper contains 27 exam standard questions (all with answers updated to Finance Act 2019).

Using this question bank

All the CTA exams, with the exception of the Awareness paper, are **3¼ hours** in length. The initial 15 minutes are pre examination reading time and during this time you are permitted to read the question paper and the legislation and **annotate the question paper** but will not be allowed to write in the answer folder. Calculators may be used during this time. There will be an announcement at the end of the fifteen minutes reading time after which you may start writing in the answer folder.

During the 3 hour writing period we recommend you initially **allocate 1.7 minutes per mark** to allow time for a final review stage at the end of each question.

10 mark question = 17 minutes
15 mark question = 25 minutes
20 mark question = 34 minutes

You should attempt each question as if you were in the real exam. Try to **avoid just reading the answers** to questions - it is all too easy to nod as you read our answer saying “yes I know that point, yes I understand that advice given” - the test is would you have actually put those points in your answer? You won’t find this out unless you **write the answers out** yourself.

Writing “proper” answers also gives you a good idea of how long an exam standard answer will take you to write.

Reviewing your answers

It is essential to read through your answer when you have finished writing it. We thought it might be useful at this stage to pass on some tips about how to review your answers effectively – **before** you look at our model answer.

Remember the first thing the marker will do is read your answer through as a whole – what overall impression are you giving of your ability? Have you put the marker in a good mood as soon as they see your script or are they going to be dreading marking what you have handed in? You want those red ticks to be flowing freely onto your page!

Key **presentation considerations** include spacing your answer out, cross referencing your workings and using subheadings and short paragraphs in written answers.

You may be able to make some small corrections at this review stage – you may find you have missed out a vital word such as “not” or you may at this stage think of another point or two to add while reading your answer. This approach could increase your marks much more effectively than carrying on with the point you were making before you stopped to do this final review.

Perhaps consider giving your answer to somebody else (even a non-tax person) to read. If they can understand the points you are trying to make, your communication skills are fine. Remember that you are writing letters / memos etc for someone else to read, so look at your work from the viewpoint of the reader. Would the reader pay money for your advice?

Reviewing the model answer

In the Advanced Technical papers it is quite likely that there is no single right answer. The model answer is only one possible solution. You may well have included valid points which are not included in the model answer. Review critically both your answer and the model answer. Are there points in the model answer which you could have included in your answer to get extra marks? Are there points you have included which, with the benefit of hindsight, you should have left out?

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INCOME TAX - RATES AND THRESHOLDS

	2019/20	2018/19
Rates	%	%
Starting rate for savings income only	0	0
Basic rate for non-savings and savings income only	20	20
Higher rate for non-savings and savings income only	40	40
Additional and trust rate for non-savings and savings income	45	45
Dividend ordinary rate	7.5	7.5
Dividend upper rate	32.5	32.5
Dividend additional rate and trust rate for dividends	38.1	38.1
Thresholds	£	£
Savings income starting rate band	1 – 5,000	1 – 5,000
Basic rate band	1 – 37,500	1 – 34,500
Higher rate band	37,501 – 150,000	34,501– 150,000
Dividend allowance	2,000	2,000
Personal Savings Allowance		
- Taxpayer with basic rate income	1,000	1,000
- Taxpayer with higher rate income	500	500
- Taxpayer with additional rate income	Nil	Nil
Standard rate band for trusts	1,000	1,000
Scottish Tax Rates(1)	%	%
Starter rate	19	19
Scottish basic rate	20	20
Intermediate rate	21	21
Higher rate	41	41
Top rate	46	46
Scottish Tax Thresholds(1)	£	£
Starter rate	1 – 2,049	1 – 2,000
Scottish basic rate	2,050 – 12,444	2,001 – 12,150
Intermediate rate	12,445 – 30,930	12,151 – 31,580
Higher rate	30,931 – 150,000	31,581 – 150,000
Top rate	150,000 +	150,000 +

INCOME TAX - RELIEFS

	2019/20	2018/19
	£	£
Personal allowance(2)	12,500	11,850
Married couple's allowance(3)	8,915	8,695
- Maximum income before abatement of relief - £1 for £2	29,600	28,900
- Minimum allowance	3,450	3,360
Transferable Tax allowance for married couples and civil partners(4)	1,250	1,190
Blind person's allowance	2,450	2,390
Enterprise investment scheme relief limit(5)	1,000,000	1,000,000
Venture capital trust relief limit	200,000	200,000
Seed enterprise investment scheme relief limit	100,000	100,000
Social investment relief	1,000,000	1,000,000

Notes (1) Scottish taxpayers pay Scottish income tax on non-savings income.

(2) The personal allowance of any individual with adjusted net income above £100,000 is reduced by £1 for every £2 of adjusted net income above the £100,000 limit.

(3) Only available where at least one partner was born before 6 April 1935. Relief restricted to 10%.

(4) The recipient must not be liable to tax above the basic rate. The recipient is eligible for a tax reduction of 20% of the transferred amount.

(5) From 6.4.18, the limit is £2 million, where over £1 million is invested in knowledge intensive companies.

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ISA limits	**2019/20**	**2018/19**
Maximum subscription:	£	£
'Adult' ISAs	20,000	20,000
Junior ISAs	4,368	4,260

Pension contributions

	Annual allowance[(1)]	**Lifetime allowance**	**Minimum pension age**
	£	£	
2018/19	40,000	1,030,000	55
2019/20	40,000	1,055,000	55

Basic amount qualifying for tax relief £3,600

Notes (1) The annual allowance is tapered by £1 for every £2 of adjusted income above £150,000 for individuals with threshold income above £110,000. It cannot be reduced below £10,000.

Employer Supported Childcare

Exemption – basic rate taxpayer[(1)]	£55 per week	£55 per week

Notes (1) For schemes joined on or after 6 April 2011 the exempt childcare amounts for higher and additional rate taxpayers (based on the employer's earning assessment only) are £28 and £25 respectively.

ITEPA mileage rates

Car or van[(1)]	First 10,000 business miles	45p
	Additional business miles	25p
Motorcycles		24p
Bicycles		20p
Passenger payments		5p

Notes (1) For NIC purposes, a rate of 45p applies irrespective of mileage.

INCOME TAX - CHARGES

Child benefit charge	**Withdrawal rate**
Adjusted net income >£50,000	1% of benefit per £100 of income between £50,000 and £60,000
Adjusted net income >£60,000	Full child benefit amount assessable in that tax year

INCOME TAX - BENEFITS

Car benefits

Emissions	**2019/20**[(1)]	**2018/19**[(1)]
0 – 50 g/km	16%	13%
51 – 75 g/km	19%	16%
76 – 94 g/km	22%	19%
95 g/km or more	23% + 1% for every additional whole 5g/km above threshold	20% + 1% for every additional whole 5g/km above threshold
165 g/km or more	37%	
180g/km or more		37%

Fuel benefit base figure	**2019/20**	**2018/19**
	£24,100	£23,400

Notes (1) 4% supplement for diesel cars excluding those that meet the Real Driving Emissions Step 2 (RDE2) standard.

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Van benefits	**2019/20**	**2018/19**
	£	£
No CO_2 emissions	2,058	1,340
CO_2 emissions > 0g/km	3,430	3,350
Fuel benefit for vans	655	633

	2019/20	**2018/19**
Official rate of interest	2.5%	2.5%

INCOME TAX - SIMPLIFICATION MEASURES

Allowances

	2019/20	**2018/19**
	£	£
'Rent-a-room' limit	7,500	7,500
Property allowance/Trading allowance	1,000	1,000

Flat Rate Expenses for Unincorporated Businesses

Motoring expenses	First 10,000 business miles		45p per mile
	Additional business miles		25p per mile
Business use of home	25 – 50 hours use		£10 per month
	51 – 100 hours use		£18 per month
	101+ hours use		£26 per month
Private use of business premises	No of persons living there:	1	£350 per month
		2	£500 per month
		3+	£650 per month

Cash Basis for Unincorporated Businesses	£
Turnover threshold to join scheme	150,000
Turnover threshold to leave scheme	300,000

CAPITAL ALLOWANCES

Annual investment allowance for plant and machinery (AIA)(1)	100%
WDA on plant and machinery in main pool(2)	18%
WDA on plant and machinery in special rate pool(3)(4)	6%
WDA on patent rights and know-how	25%
WDA on structures and buildings (SBA) (5)	2%

Notes (1) On first £1,000,000 of investment in plant & machinery (not cars) from 1 January 2019 to 31 December 2020 (£200,000 before 31 December 2018 & from 1 January 2021).

(2) The main pool rate applies to cars with CO_2 emissions of not more than 110 g/km (130 g/km for expenditure incurred before 1 April 2018).

(3) The special pool rate applies to cars with CO_2 emissions greater than 110 g/km (130 g/km for expenditure incurred before 1 April 2018).

(4) The special pool rate was 8% prior to 6 April 2019 (1 April 2019 for companies).

(5) The 2% rate applies to expenditure from 29 October 2018 on new qualifying non-residential structures and buildings on a straight-line basis.

100% First year allowances available to all businesses

1) New energy saving plant and machinery, and water efficient plant and machinery (until April 2020).
2) Capital expenditure incurred by a person on research and development.
3) New zero-emission goods vehicles (until April 2021).
4) New cars registered before 31 March 2021 if the car either emits not more than 50 g/km of CO_2 (75g/km before 1 April 2018) or it is electrically propelled.
5) Electric vehicle charging points expenditure incurred from 23 November 2016 until April 2023.

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NATIONAL INSURANCE CONTRIBUTIONS

Class 1 limits	**2019/20**			**2018/19**		
	Annual	**Monthly**	**Weekly**	**Annual**	**Monthly**	**Weekly**
	£	£	£	£	£	£
Lower earnings limit (LEL)	6,136	512	118	6,032	503	116
Primary threshold (PT)/ Secondary threshold (ST)	8,632	719	166	8,424	702	162
Upper earnings limit (UEL)/ Upper secondary threshold for under 21 (UST)(1)/ Apprentice upper secondary threshold for under 25 (AUST)(2)	50,000	4,167	962	46,350	3,863	892

	2019/20	2018/19
Class 1 primary contribution rates		
Earnings between PT and UEL	12%	12%
Earnings above UEL	2%	2%
Class 1 secondary contribution rates		
Earnings above ST (1)(2)	13.8%	13.8%

Notes (1) Rate of secondary NICs for employees < age 21 on earnings between ST&UST is 0%.
(2) Rate of secondary NICs for apprentices < age 25 on earnings between ST&AUST is 0%.

	2019/20	**2018/19**
Employment allowance		
Per year, per employer	£3,000	£3,000
Class 1A contributions	13.8%	13.8%
Class 1B contributions	13.8%	13.8%
Class 2 contributions		
Normal rate	£3.00 pw	£2.95 pw
Small profits threshold	£6,365 pa	£6,205 pa
Class 3 contributions	£15.00 pw	£14.65 pw
Class 4 contributions		
Annual lower profits limit (LPL)	£8,632	£8,424
Annual upper profits limit (UPL)	£50,000	£46,350
Percentage rate between LPL and UPL	9%	9%
Percentage rate above UPL	2%	2%

OTHER PAYROLL INFORMATION

Statutory maternity/adoption pay First 6 weeks @ 90% of AWE
Next 33 weeks @ the lower of £148.68 and 90% of AWE

Statutory shared parental pay /paternity pay For each qualifying week, the lower of 90% of AWE and £148.68

Student Loan	Plan 1:	9% of earnings exceeding £1,577 per month
	Plan 2:	9% of earnings exceeding £2,143 per month
Postgraduate Loan		6% of earnings exceeding £1,750 per month

National living/minimum wage (April 2019 onwards)

Category of Worker	**Rate per hour**	**Category of Worker**	**Rate per hour**
Workers aged 25 and over	£8.21	18–20 year olds	£6.15
21–24 year olds	£7.70	16–17 year olds	£4.35
		Apprentices	£3.90

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CAPITAL GAINS TAX

	2019/20	2018/19
Annual exempt amount for individuals	£12,000	£11,700

CGT rates for individuals, trusts and estates

Gains qualifying for entrepreneurs' relief/investors' relief	10%	10%
Gains for individuals falling within remaining basic rate band(1)	10%	10%
Gains for individuals exceeding basic rate band and gains for trusts and estates(2)	20%	20%

Notes (1) The rate is 18% if the gain is in respect of a residential property
(2) The rate is 28% if the gain is in respect of a residential property

Entrepreneurs' relief and Investors' relief(1)	**2019/20**	**2018/19**
Relevant gains (lifetime maximum)	£10 million	£10 million

Notes (1) The first claims for investors' relief can be made in 2019/20.

Retail Prices Index

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1982	–	–	79.44	81.04	81.62	81.85	81.88	81.90	81.85	82.26	82.66	82.51
1983	82.61	82.97	83.12	84.28	84.64	84.84	85.30	85.68	86.06	86.36	86.67	86.89
1984	86.84	87.20	87.48	88.64	88.97	89.20	89.10	89.94	90.11	90.67	90.95	90.87
1985	91.20	91.94	92.80	94.78	95.21	95.41	95.23	95.49	95.44	95.59	95.92	96.05
1986	96.25	96.60	96.73	97.67	97.85	97.79	97.52	97.82	98.30	98.45	99.29	99.62
1987	100.0	100.4	100.6	101.8	101.9	101.9	101.8	102.1	102.4	102.9	103.4	103.3
1988	103.3	103.7	104.1	105.8	106.2	106.6	106.7	107.9	108.4	109.5	110.0	110.3
1989	111.0	111.8	112.3	114.3	115.0	115.4	115.5	115.8	116.6	117.5	118.5	118.8
1990	119.5	120.2	121.4	125.1	126.2	126.7	126.8	128.1	129.3	130.3	130.0	129.9
1991	130.2	130.9	131.4	133.1	133.5	134.1	133.8	134.1	134.6	135.1	135.6	135.7
1992	135.6	136.3	136.7	138.8	139.3	139.3	138.8	138.9	139.4	139.9	139.7	139.2
1993	137.9	138.8	139.3	140.6	141.1	141.0	140.7	141.3	141.9	141.8	141.6	141.9
1994	141.3	142.1	142.5	144.2	144.7	144.7	144.0	144.7	145.0	145.2	145.3	146.0
1995	146.0	146.9	147.5	149.0	149.6	149.8	149.1	149.9	150.6	149.8	149.8	150.7
1996	150.2	150.9	151.5	152.6	152.9	153.0	152.4	153.1	153.8	153.8	153.9	154.4
1997	154.4	155.0	155.4	156.3	156.9	157.5	157.5	158.5	159.3	159.5	159.6	160.0
1998	159.5	160.3	160.8	162.6	163.5	163.4	163.0	163.7	164.4	164.5	164.4	164.4
1999	163.4	163.7	164.1	165.2	165.6	165.6	165.1	165.5	166.2	166.5	166.7	167.3
2000	166.6	167.5	168.4	170.1	170.7	171.1	170.5	170.5	171.7	171.6	172.1	172.2
2001	171.1	172.0	172.2	173.1	174.2	174.4	173.3	174.0	174.6	174.3	173.6	173.4
2002	173.3	173.8	174.5	175.7	176.2	176.2	175.9	176.4	177.6	177.9	178.2	178.5
2003	178.4	179.3	179.9	181.2	181.5	181.3	181.3	181.6	182.5	182.6	182.7	183.5
2004	183.1	183.8	184.6	185.7	186.5	186.8	186.8	187.4	188.1	188.6	189.0	189.9
2005	188.9	189.6	190.5	191.6	192.0	192.2	192.2	192.6	193.1	193.3	193.6	194.1
2006	193.4	194.2	195.0	196.5	197.7	198.5	198.5	199.2	200.1	200.4	201.1	202.7
2007	201.6	203.1	204.4	205.4	206.2	207.3	206.1	207.3	208.0	208.9	209.7	210.9
2008	209.8	211.4	212.1	214.0	215.1	216.8	216.5	217.2	218.4	217.7	216.0	212.9
2009	210.1	211.4	211.3	211.5	212.8	213.4	213.4	214.4	215.3	216.0	216.6	218.0
2010	217.9	219.2	220.7	222.8	223.6	224.1	223.6	224.5	225.3	225.8	226.8	228.4
2011	229.0	231.3	232.5	234.4	235.2	235.2	234.7	236.1	237.9	238.0	238.5	239.4
2012	238.0	239.9	240.8	242.5	242.4	241.8	242.1	243.0	244.2	245.6	245.6	246.8
2013	245.8	247.6	248.7	249.5	250.0	249.7	249.7	251.0	251.9	251.9	252.1	253.4
2014	252.6	254.2	254.8	255.7	255.9	256.3	256.0	257.0	257.6	257.7	257.1	257.5
2015	255.4	256.7	257.1	258.0	258.5	258.9	258.6	259.8	259.6	259.5	259.8	260.6
2016	258.8	260.0	261.1	261.4	262.1	263.1	263.4	264.4	264.9	264.8	265.5	267.1
2017	265.5	268.4	269.3	270.6	271.7	272.3	272.9	274.7	275.1	275.3	275.8	278.1

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Lease percentage table

Years	Percentage	Years	Percentage	Years	Percentage	Years	Percentage
50+	100.000	37	93.497	24	79.622	11	50.038
49	99.657	36	92.761	23	78.055	10	46.695
48	99.289	35	91.981	22	76.399	9	43.154
47	98.902	34	91.156	21	74.635	8	39.399
46	98.490	33	90.280	20	72.770	7	35.414
45	98.059	32	89.354	19	70.791	6	31.195
44	97.595	31	88.371	18	68.697	5	26.722
43	97.107	30	87.330	17	66.470	4	21.983
42	96.593	29	86.226	16	64.116	3	16.959
41	96.041	28	85.053	15	61.617	2	11.629
40	95.457	27	83.816	14	58.971	1	5.983
39	94.842	26	82.496	13	56.167	0	0.000
38	94.189	25	81.100	12	53.191		

CORPORATION TAX

Financial year	**2019**	**2018**	**2017**
Main rate	19%	19%	19%

EU definition of small and medium sized enterprises	Small [2]	Medium [2]	Extended definition for R&D expenditure
Employees[1]	< 50	< 250	<500
Turnover[1]	≤ €10m	≤ €50m	≤ €100m
Balance sheet assets[1]	≤ €10m	≤ €43m	≤ €86m

Notes (1) Must meet employees criteria and either turnover or balance sheet assets criteria.
(2) Thresholds apply for transfer pricing and distributions received by small companies.

VALUE ADDED TAX

	Standard rate	**VAT fraction**
From 4.1.11	20%	1/6

Limits	**From 1.4.19**	**From 1.4.18**
Annual registration limit	£85,000	£85,000
De-registration limit	£83,000	£83,000

Thresholds	**Cash accounting**	**Annual accounting**
Turnover threshold to join scheme	£1,350,000	£1,350,000
Turnover threshold to leave scheme	£1,600,000	£1,600,000

OTHER INDIRECT TAXES

	2019/20	**2018/19**
Insurance premium tax[1]		
Standard rate	12%	12%
Higher rate	20%	20%

Tobacco products duty	**From 29.10.18**	**Until 28.10.18**
Cigarettes	16.5% x retail price + £228.29 (or £293.95 [2]) per thousand cigarettes	16.5% x retail price + £217.23 (or £280.15 [2]) per thousand cigarettes
Cigars	£284.76 per kg	£270.96 per kg
Hand-rolling tobacco	£234.65 per kg	£221.18 per kg
Other smoking/chewing tobacco	£125.20 per kg	£119.13 per kg
Tobacco for heating from 1 July 2019	£234.65 per kg	N/A

Notes (1) Premium is tax inclusive (3/28 for 12% rate and 1/6 for 20% rate).
(2) The £293.95/£280.15 per thousand cigarettes is a minimum excise duty (if higher than the first calculation).

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INHERITANCE TAX

Death rate	40%[1]	**Lifetime rate**	20%

Notes (1) 36% rate applies where 10% or more of the deceased person's net chargeable estate is left to charity.

Nil rate bands

6 April 1996 – 5 April 1997	£200,000	6 April 2003 – 5 April 2004	£255,000
6 April 1997 – 5 April 1998	£215,000	6 April 2004 – 5 April 2005	£263,000
6 April 1998 – 5 April 1999	£223,000	6 April 2005 – 5 April 2006	£275,000
6 April 1999 – 5 April 2000	£231,000	6 April 2006 – 5 April 2007	£285,000
6 April 2000 – 5 April 2001	£234,000	6 April 2007 – 5 April 2008	£300,000
6 April 2001 – 5 April 2002	£242,000	6 April 2008 – 5 April 2009	£312,000
6 April 2002 – 5 April 2003	£250,000	6 April 2009 – 5 April 2021	£325,000

Residence nil rate bands[2]

6 April 2017 – 5 April 2018	£100,000	6 April 2019 – 5 April 2020	£150,000
6 April 2018 – 5 April 2019	£125,000	6 April 2020 – 5 April 2021	£175,000

Notes (2) An additional nil rate band is available where a main residence is passed on death to a direct descendant. Tapered withdrawal for estates > £2million.

Taper relief		
Death within 3 years of gift		Nil%
Between 3 and 4 years		20%
Between 4 and 5 years		40%
Between 5 and 6 years		60%
Between 6 and 7 years		80%
Quick Succession relief		
Period between transfers less than one year		100%
Between 1 and 2 years		80%
Between 2 and 3 years		60%
Between 3 and 4 years		40%
Between 4 and 5 years		20%
Lifetime exemptions		
Annual exemption		£3,000
Small gifts		£250
Wedding gifts	Child	£5,000
	Grandchild or remoter issue or other party to marriage	£2,500
	Other	£1,000

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

Residential property value	From 1.4.19	From 1.4.18
>£0.5m - ≤ 1m	£3,650	£3,600
> £1m - ≤ 2m	£7,400	£7,250
> £2m – ≤ 5m	£24,800	£24,250
> £5m – ≤ 10m	£57,900	£56,550
> £10m – ≤ 20m	£116,100	£113,400
> £20m	£232,350	£226,950

STAMP DUTY/SDRT

Stamp duty[1]	- On shares transferred by physical stock transfer form	0.5%
Stamp duty reserve tax[1]	- On agreements to transfer shares[2]	0.5%
	- On shares transferred to depositary receipt schemes	1.5%

Notes (1) Does not apply to UK securities traded on a recognised growth market (eg AIM).
(2) Does not apply to units in UK unit trust schemes or shares in UK OEICS bought from fund managers.

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STAMP DUTY LAND TAX

Stamp Duty Land Tax on purchase price / lease premium / transfer value – England & NI

Basic Rate %(1)(2)(3)	Higher Rate %(1)(2)	Residential(1)(2)(3)	Non-Residential
0	3	£0 - £125,000	£0 - £150,000
2	5	£125,001 - £250,000	£150,001 - £250,000
5	8	£250,001 - £925,000	£250,001 +
10	13	£925,001 - £1,500,000	N/A
12	15	£1,500,001 +	N/A

Notes (1) The basic rates are increased by 3% where the purchase is of an additional residential property for individuals (see column 2 for the rates that apply). Companies and trusts pay the additional 3% on all purchases of residential properties, subject to note 2 below.

(2) Companies pay 15% on purchases of residential property valued > £500,000.

(3) First-time buyers purchasing a single dwelling as their only or main residence on or after 22.11.17 may benefit from a reduced rate. (This includes qualifying shared ownership properties.) SDLT will not be due on properties up to £300,000. For homes up to £500,000, SDLT will be payable on £200,000 at 5%. Homes bought for more than £500,000 will incur the rates as per column 1 of the table above.

New leases – Stamp Duty Land Tax on lease rentals – England & NI

Rate (%)	Net present value of rent	
	Residential	**Non-residential**
Zero	Up to £125,000	Up to £150,000
1%	Excess over £125,000	£150,001-£5m
2%		Over £5m

Land and Buildings Transaction Tax (LBTT) on purchase price – Scotland

Basic Rate %(1)(2)(3)	Residential	Rate %(1)(4)	Non-Residential
0	up to £145,000	0	£0 - £150,000
2	£145,001 - £250,000	1	£150,001 - £250,000
5	£250,001 - £325,000	5	£250,001 +
10	£325,001 - £750,000		
12	£750,001 +		

Notes (1) Rates are charged on the portion of consideration that falls in each band. The same tax is payable for a premium granted for a land transaction, except for residential leases which are generally exempt. Special rules apply to a premium for non-residential property where the rent exceeds £1,000 a year.

(2) An additional amount of tax equal to 4% (for effective dates on or after 25 January 2019) of the relevant consideration applies broadly to purchases of an additional dwelling by individuals and trusts (over which the beneficiary has substantial rights) and to purchases of a dwelling by certain businesses, companies and other trusts. Where the effective date is on or after 25 January 2019 but the contract was entered into prior to 12 December 2018, the 3% (prior) rate will apply.

(3) For contracts entered into after 8 February 2018, where the effective date of the transaction is on or after 30 June 2018, there is a relief for first-time buyers where a 0% rate is applied to the first £175,000 of the purchase consideration.

(4) These rates apply where the effective date is on or after 25 January 2019. Prior to this date the 0% band was the same, £150,001-£350,000 was 3%, £350,001+ was 4.5%.

New leases – Land and Buildings Transaction Tax (LBTT) on lease rentals - Scotland

Rate (%)	Net present value of rent(1)
	Non-residential
Zero	Up to £150,000
1%	£150,001+

Note (1) Residential leases are generally exempt

VAT QUESTIONS

1. Jacob Ltd is a new company registered from 1 April 2019 for VAT, which manufactures car batteries and radiators for the UK market. It also earns insurance commission on extended warranties sold on its products. It receives insurance commission in arrears.

It has recovered VAT each quarter using the standard values-based method.

The sales and purchase information for each quarter in its first VAT year is as follows:

	April-June 2019	July-September 2019	October-December 2019	January-March 2020
	£	£	£	£
Product Sales (exc. VAT)	175,000	180,000	184,000	193,000
Insurance Commissions	0	0	125,000	130,000
Input VAT on Raw Materials	20,000	20,000	19,000	20,000
Other Input VAT	40,000	4,250	2,350	14,000

Included in "Other VAT" is £2,000 VAT incurred at the beginning of April 2019 for advice on the regulatory aspects of acting as an insurance broker.

Requirement:

1) **Calculate Jacob Ltd's annual adjustment and state when and how it should be made.** (7)

2) **Comment on any alternative methods of partial exemption calculation available to Jacob Ltd in respect of this period, assuming that no application to use a special method within reg.102 SI 1995/2518 has been made.** (3)

Total (10)

2. Your client, Caring Charity Ltd, has received the following letter from HMRC following a control visit.

Dear Mr Woods

Following our control visit at Caring Charity Ltd premises last month I set out below my comments on particular items which we discussed.

1) Health club membership fees for employees; golf club membership for the chief executive.

Input tax may not be claimed on items which are for the personal use of employees. It is not relevant for VAT that this benefit is available to all employees or taxable to PAYE.

2) Tax advice on the charity's VAT position and Inheritance Tax liability of chief executive.

Tax advice is not allowable as only legitimate business expenses qualify for recovery.

3) Fees for consultancy report on (aborted) retail business.

In order to reclaim input tax in full one needs to be able to directly attribute costs to an actual taxable supply. As in this case the planned business to which the report pertains never materialised, the VAT charged by the consultants is not recoverable.

4) Legal advice regarding future business activity received pre-registration (incurred 20 May 2017).

Although you are within the time limit or "cap" for late input tax claims, to claim input tax one needs to be registered for VAT or at least making supplies at the time the cost is incurred. Therefore this VAT incurred in the month before your effective registration date (1 June 2017) is not recoverable.

5) Changes of intention.

You incurred £2,500 VAT on legal advice in relation to a market-rate loan to a foreign charity with similar aims. The originally intended recipient was a French charity so you correctly did not recover the VAT. However you ultimately made the loan to a US-based charity and now wish to claim back the VAT in full per SI 1999/3121. Similarly you incurred £5,000 VAT on software development fees to be used in your non-business charitable activities. However six months after you started using the software you identified a business opportunity to sell on the software to third parties at a profit. Loans are VAT exempt supplies which do not allow VAT recovery.

Furthermore, a taxpayer's original attribution on input tax must stand (subject only to the annual and capital goods adjustments) so I must deny your claim to adjust recovery.

Please let me know if you have any questions on the above.

A N Officer

Requirement:

Write a letter to your client to explain whether HMRC are right. (20)

3. A client of your firm, Mr Day, owns a portfolio of commercial properties and is in the process of selling two of these properties. He has been VAT registered since 1985.

Property A was let to tenants until 2017 but has stood empty since that date. Mr Day opted to tax the property when he acquired it on 1 November 1997 in order to reclaim VAT charged on the purchase. No work has been carried out to the property other than minor repairs.

Property B is also empty. Mr Day opted to tax the property on acquisition in January 2008 and again no work has been carried out on the property. The prospective purchaser intends to convert the property into a house for his own occupation.

Neither prospective buyer is VAT registered and both have indicated they will not go ahead with the purchase if Mr Day is required to add VAT onto the purchase price. Mr Day has asked you whether there is any way in which he can sell the properties without charging VAT.

Last year Mr Day constructed a small building which was used in his business for storage purposes on a piece of land he owns at a cost of £25,000. He now intends to give the freehold of this building to a local charity which will also use it for storage purposes. Mr Day is not connected with the charity.

Requirement:

Write to Mr Day advising him:

1)	**Whether it is possible to sell properties A and B without charging VAT.**	(10)
2)	**On any VAT implications of the proposed gift to the charity.**	(5)
	Total	(15)

4. You have been contacted by a small firm of accountants, Small & Co. They have a client, an engineering company, which has recently had an assurance visit from HMRC. An assessment has been issued by HMRC in respect of an alleged under-recording of sales in the last two financial years. Small & Co believes this can be explained by timing differences and other accounting adjustments and has asked for advice on how to contest this matter as far as the First Tier Tribunal.

   Requirement:

   Write a letter to Mr Small, the senior partner, advising him on the relevant appeal procedures. (10)

5. A Ltd, a client of your firm sells computer equipment and software. It is in the process of negotiating the sale of a number of computers and some standard software to B Ltd, a company which provides advertising services to A Ltd. A Ltd and B Ltd are both VAT registered.

The terms of the sale of equipment and software are as follows.

1) Cash payments totalling £100,000. The first £50,000 will be paid on delivery followed by a further £25,000 on each of the next two anniversaries of the sale.

2) In order to assist B Ltd's cash flow, its parent company, C Ltd, will make the first payment of £50,000.

3) In addition, B Ltd will continue to provide advertising services to A Ltd for a period of two years for no payment.

Mr Brown, the finance director of A Ltd has asked you to write to him explaining the VAT treatment of the transaction as detailed above. Since he intends to copy the advice to A Ltd's company solicitors who are dealing with the contract, he has asked you to provide any relevant legal references.

Requirement:

Write to the finance director in response to his request. (10)

6. AB Housebuilders Ltd is a company engaged in the construction and sale of new houses. It has only one site under construction at present and has completed Phases 1 and 2 of the site.

Phase 1 comprised 25 houses, of which 24 have been sold for a total sales price of £7.2 million. They are just about to exchange on the sale of the final property for £310,000. The final property was taking quite a while to sell so AB Housebuilders offered to buy the existing house of any individual that wanted to buy the final property. The house they are taking in part-exchange was valued at £260,000 which they intend to let. When the market improves they will sell the part-exchange property.

Phase 2 was completed in the year to 31 March 2020 and in view of the current surplus of new houses in the area, AB Housebuilders Ltd is now considering an arrangement to let the 25 houses in Phase 2 to an investment company on two year leases at a monthly rent of £1,500 per house. At the end of the two year period, the houses will revert to AB Housebuilders Ltd who will put them back on the market for sale at £350,000 each.

Development costs (exclusive of VAT) of Phase 2 were:

	£000
Direct costs of materials	3,750
Own labour	2,000
Sub-contract builders	500
Carpets and white goods	375
Professional costs (architect, surveyor)	200
Site overheads	150

These costs were all incurred between April and December 2019 and VAT has been reclaimed as input tax where deductible. The material suppliers, sub-contractors and professional services providers are all registered for VAT. The overhead costs were all subject to VAT.

Requirement:

Prepare notes for a meeting with the client explaining the VAT and SDLT consequences for AB Housebuilders of the proposed arrangements and noting any steps the client can take to mitigate any loss of input tax. Include any relevant statutory and other references in your answer. (20)

7. You have received a letter from the managing director of Sunnyview Homes Ltd, a property development company. The following is an extract:

"We have three companies in the group, Sunnyview Homes Ltd (SH), Sunnyview Builders Ltd (SB) and Sunnyview Rentals Ltd (SR). When we have developed previous holiday sites, SH has bought the land, SB has built properties for SH, and SH has then sold them either to private customers or to SR for renting out. SR also manages properties for private customers who want to rent them out while they aren't using them. The companies are all separately registered for VAT.

We are considering a different format for the development at Barrington View Lake. Although the specification of the properties is almost exactly the same as it would be for a family house, the local authority has issued the usual planning consent for a holiday home development, prohibiting occupation of the properties during February in each year. I sometimes wonder whether that really makes any difference because the local authority never checks on it, and in some of our sites we do have people who live in the properties year-round as their main residence. They go somewhere else for their holidays!

SH has bought the site, as usual, but we are thinking of selling off individual plots to purchasers rather than building the house first. The purchasers will have the benefit of the same planning permission, so they will be able to build a house that they aren't allowed to live in year-round (although they also might find that no-one checks). We didn't pay VAT on the purchase of the land and we haven't opted to tax the site.

Once we've sold 60% of the plots, we'll take a view on whether it's then better to build on the remainder ourselves in accordance with our normal format, or whether to carry on selling the land separately.

Purchasers of a plot will be able to use SB to build their holiday home, or use a different builder if they want to. SB will be able to give people a good deal, because we are on site and benefiting from economies of scale here, but I expect a few people will use their own preferred firms. We offer design-and-build. They will also be able to use SR or a different management company to manage the property later – although SR will be best placed to provide the service.

Typically a customer will pay about £300,000 all in for an 80-year lease of one of our newly-built holiday homes, including the land (with a small ground rent each year after that, as well as a service charge). We expect that the plots will go for about £100,000 each (similar 80-year lease); SB will charge something like £170,000 excluding VAT for designing, building and fitting the property out to the same specification. What people pay their own builders is up to them.

I'd like to have some understanding of the different VAT treatments of the different ways in which our customers can end up with a holiday home – or home they can live in for 11 months in a year – depending on which format for the project they adopt. I understand that if they buy the plot and get it built themselves, they may even be able to claim back VAT on any fittings they buy to put in the building. Is that true?

Also, how does Stamp Duty Land Tax apply to the different formats?"

Requirement:

Explain the VAT and SDLT issues arising from the different arrangements set out in the client's letter. (15)

8. Mr Jay is a professional trustee, working mainly for defined benefit pension funds. His appointments are on a continuing basis and he issues VAT invoices to the pension fund trustees at the end of each month. He sub-lets a part of his office to an insurance broker and has not opted to tax the property. His annual VAT exclusive turnover for his trusteeship business is £90,000 and he receives annual rents of £16,000. He has been registered for VAT for a number of years and has a good compliance record. He does not have any special partial exemption method but has however recently heard that HMRC allow small businesses to operate special VAT accounting schemes and has asked you if any of these schemes would be suitable for his business.

Details for his VAT account for the quarter ended 30 September 2020 are set out below:

	£		£
Invoiced sales	22,000	Plus	4,400 VAT
Debtors at 30 September in respect of above sales	11,000	Plus	2,200 VAT
Payments received in respect of invoices issued in previous VAT quarter	9,000	Plus	1,800 VAT
Rent received 23 September	4,000		
Overhead expenses used in both businesses	5,500	Plus	1,100 VAT
Creditors in respect of above overhead expenses	1,200	Plus	240.00 VAT
Heat, light etc for office, including sub-let area	750	Plus	37.50 VAT

These invoices have been paid.

In August he bought new computer equipment on hire-purchase for use in both parts of his business at a cost of £1,600 plus £320 VAT.

One of Mr Jay's clients is the Trustees of A plc Pension Plan. The employer that set up the Plan, A plc has recently gone into liquidation and Mr Jay is now the sole independent trustee. Mr Jay has also asked if there is now any way to reclaim VAT on actuarial and audit costs relating to the Plan.

Requirement:

Write a letter to Mr Jay advising him:

1) **Whether it would be beneficial to use a special VAT accounting scheme and illustrating your comments by appropriate calculations of the liability for the quarter ended 30 September 2020 on the assumption that any scheme was already being used;**

2) **Of any other ways in which he could operate his VAT accounting more efficiently, and;**

3) **Whether VAT incurred on actuarial and audit costs relating to the A plc Pension Plan may be reclaimed.**

Total (20)

9. Mr Cream left his employment in December 2019 to set up his own business as a computer and IT consultant. He commenced trading in January 2020 through a limited company, Cream Computers Ltd, of which he is the sole director. Mr Cream has provided you with the following financial information about the company:

The company's turnover in the period January to November 2020 was as follows:

	£		£
January	9,824	July	20,025
February	9,971	August	8,556
March	10,013	September	14,920
April	11,675	October	15,462
May	12,279	November (estimated)	15,025
June	13,967		

In the period January to November 2020, the company incurred VAT on computer consumables as follows:

	£		£
January	242	July	348
February	253	August	137
March	248	September	361
April	349	October	359
May	356	November (estimated)	360
June	358		

The company purchases computer consumables as required and carries no stock of these. Mr Cream instructed an accountancy practice to prepare a business plan for the company and the invoice for this was issued in December 2019 in the sum of £200 plus £40 VAT. Mr Cream was subsequently reimbursed by the company. The company purchased a computer in January 2020 for £2,000 plus £400 VAT for use in the consultancy business.

The company has proper tax invoices for the computer consumables, business plan (although this invoice is addressed to Mr Cream) and the computer purchase.

Mr Cream advised HMRC in January 2020 that the company had commenced trading but has not registered for VAT, believing that this will be dealt with at the end of the first year's trading.

The company works mainly for private individuals and small businesses, which pay on completion of the work. A couple of larger clients have requested VAT invoices. The company has therefore issued two invoices in August showing VAT amounts of £200 and £300, although these do not show any VAT number. The company intends to pay this VAT to HMRC once the company's VAT position is settled.

One of these customers has advised Mr Cream that the company's procedures in relation to VAT are incorrect and Mr Cream has asked for a meeting with you to discuss the company's VAT position.

Requirement:

In advance of the meeting with Mr Cream:

1) **State the company's effective date of VAT registration and calculate the estimated net VAT due to 30 November 2020.** (5)

2) **Prepare notes on and calculate the estimated amount of any potential penalties in relation to the failure to register for VAT and the issue of the invoices on the assumption that the company notifies HMRC of its liability to register at the end of November 2020.** (10)

Total (15)

10. Messrs Blue, Black and Brown are individual investors who are tax clients of your firm. In January 2020 they decided to bid for a company, Green Holdings Ltd and its three subsidiary companies which operate in the renewable energy sector. They engaged a private equity firm, PEH LLP to assist with the acquisition and instructed solicitors and accountants to advise them jointly.

The acquisition was structured by the formation of a new company, BBB Holdings Ltd to acquire the share capital of Green Holdings Ltd, which in turn holds the entire share capital of the subsidiary companies. Green Holdings Ltd and its subsidiaries are all members of a fully taxable VAT group registration with Green Holdings Ltd as the representative member. The engagement letters with the solicitors and accountants were issued jointly to the three investors in their role as directors of BBB Holdings Ltd and the private equity house. Some bank funding was also obtained and BBB Holdings Ltd agreed to pay the legal costs of the bank which had independently instructed its own solicitors.

The acquisition was completed in May 2020. Immediately on completion, BBB Holdings became a member of the existing Green Holdings Ltd VAT group. Tax invoices from the professional advisers were issued shortly after BBB Holdings Ltd had joined the Green Holdings VAT group. The bank's solicitors addressed their invoices to the bank.

Initially no claim to deduction of input tax was made on these invoices and the amounts were included as a gross cost in the share premium account. Mr Blue, who is a solicitor, has suggested VAT may be recoverable on the invoices and has asked you for an opinion on the VAT position.

Requirement:

Write a letter to Mr Blue discussing the matter of VAT recovery and advising him how to proceed. You should make reference to relevant case law. (20)

11. Your client, Walrus Ltd, a VAT-registered business preparing calendar quarterly returns, has forwarded you an extract from a letter from HMRC following a recent visit.

> "Following my recent visit to inspect your business records, I write to set out my views on certain matters where I believe the VAT treatment applied may require correction.
>
> Ming Ltd
>
> The first is the purchase of the insurance business from Ming Ltd in 2016 on which you were charged £150,000 VAT. You explained that you purchased the staff, brand name and client book and continued the business identically as it had run previously under Ming Ltd, charging insurance companies for referring new retail clients to them via website click-through advertising. Because you are charging VAT on your introductory fees you have claimed all of the VAT back on the acquisition.
>
> I am unable to agree with this. Firstly, and fundamentally, the VAT should not have been charged as this was a transfer of a business between two VAT-registered entities. In this circumstance it cannot be claimed back.
>
> Even if this were properly charged VAT, the services you supply in introducing insurance business are VAT exempt and any input VAT would therefore not be recoverable under partial exemption principles.
>
> Gordon Ltd
>
> The second item I think is incorrect is your claim for £400,000 input tax on the purchase of a tenanted commercial property, the Mercury Building, which you purchased from Gordon Ltd in April 2018. The property was six years old when you purchased it and had undergone a £300,000 plus VAT refurbishment three years prior to your purchase. The tenants have always been charged VAT and you opted to tax the property before the purchase went through. Since April 2018, due to a tenant leaving, you have occupied one of the four floors yourself, running the insurance introduction business from there.
>
> Again, this should not have been subject to VAT as it constituted the transfer of a property rental business. You have also failed to make capital goods scheme adjustments to reflect your exempt use of the property and were not able to provide me with the relevant records which you are required to maintain.
>
> Please consider my points above and let me have your response (in case I have misunderstood any of the circumstances) and your capital goods scheme calculations in relation to the Mercury Building so that I can raise an assessment."

Mr Lennon, the managing director of Walrus Ltd, is aware of the penalty and interest implications but wants to know whether the officer is correct, what the capital goods scheme is and how it affects Walrus Ltd. He is confused as to how the officer can argue that no VAT was due on the Mercury Building purchase yet adjustments need to be made. He also strongly suspects that the refurbishment may have been stripped out before he bought the building.

Requirement:

Write a letter to Mr Lennon, responding to his concerns. (20)

You are not required to discuss interest or penalty issues.

12. You are an independent tax adviser providing VAT advice to small accountancy firms. Below is an extract from a letter you have recently received from one of your clients, Smallchange Accounts Ltd:

> "Two of our clients (the first a charity and the second a sole-trader) have recently challenged our calculation of their VAT recovery.
>
> In each case their purchases were not used solely for business purposes and therefore, as we understood from previous discussions with you in relation to other clients, we have not treated all the related input tax as recoverable since it is not “input tax”. The charity purchased a computer for £60,000 in May 2019 which they use for their fully taxable retail shop business as well as for non-business purposes. In the other case, the client (a fully taxable trader) paid £100,000 plus VAT for construction work in November 2019 on an extension to the property where she resides and has her office. The extension is used partly as an office and partly for residential purposes and is almost the same size again as the original property.
>
> Our clients claim to have received advice that they can recover all of this VAT back under EU case-law principles and they are asking us to amend the returns accordingly. With that in mind, I would greatly appreciate a note from you explaining whether my clients are correct and what the position is. Can we amend the returns and are there any calculations or evidence we need to provide?"

Requirement:

Prepare a memo responding to the note. (10)

13. You are the VAT manager in an accountancy firm. The chief accountant of a client company, Xessus Ltd, has provided the following details of sales ledger issues to obtain your advice about the correct VAT treatment in the VAT return for the quarter to 30 April 2020.

1) An invoice was raised to Durdum Ltd on 30 April 2012 for £100,000 plus 17.5% VAT. This represented a fee in respect of work done on the design of a new component for one of Durdum's manufactured products. The customer disputed the quality of the work done and refused to pay. Xessus Ltd maintained that the debt was due and has never claimed bad debt relief in respect of it. On 16 March 2020 an agreement was reached to settle the dispute by Xessus Ltd issuing a credit note for £50,000 plus VAT and Durdum Ltd paying the balance. The chief accountant is not sure how the change of VAT rate affects this.

2) An invoice was raised to Nampech Ltd on 6 July 2015 for £200,000 plus 20% VAT in respect of consultancy work. The customer was an associated business (although not a member of a VAT group). Nampech Ltd was in financial difficulties, and Xessus Ltd did not pursue the debt because of the connection between the companies. On 25 April 2020 the directors of Xessus Ltd decided finally to write the debt off as it has become apparent that it will not be paid. No bad debt relief has ever been claimed in respect of this debt.

3) An invoice was raised to Madstop Ltd on 10 December 2016 for £60,000 plus 20% VAT in respect of a supply of staff. Madstop Ltd was also in financial difficulties and failed to pay, so Xessus Ltd claimed bad debt relief in the quarter to 31 July 2017. On 15 February 2020, Madstop Ltd paid £40,000, and the company's chief accountant has promised that the balance will be paid in the near future.

4) Anessam Ltd has informed Xessus Ltd that it has gone into administration and is unlikely to make any further payment of debts. The following invoices have been issued to the company in 2019:

Date	VAT rate	Net	VAT
		£	£
10 July 2019	Standard	40,000	8,000
16 August 2019	Zero	60,000	Nil
18 September 2019	Standard	50,000	10,000
31 December 2019	Standard	100,000	20,000

Anessam Ltd sent a cheque for £40,000 on 10 October 2019, stating that this was intended to be put towards the August 2019 invoice. No other payments have been received, and it has been decided to write off the whole outstanding balance.

The normal terms of trade state that invoices are payable within 30 days.

The company has an annual turnover of £15 million.

Requirement:

Explain the correct VAT treatment of each of the above matters, assuming that Xessus Ltd wishes to claim any available relief as early as possible, setting out how any relief is claimed. (15)

14. Bill Smith has recently been appointed as the tax manager of the Blue group of companies. The group comprises a holding company, Blue Holdings plc, a distribution company and two retail companies. The distribution company and retail companies are all separately registered for VAT and are fully taxable. The holding company is not VAT registered.

The group is now in the process of setting up a financial services operation to provide finance to customers of the retail companies. The financial services will be provided by a joint venture company, which will be 51% controlled by Blue Holdings plc with the other 49% held by a company with expertise in the financial services industry.

Since 2018 the group's strategy has been to employ all staff through Blue Holdings plc with a term in their contract requiring them to work for other group companies as required and the group wishes to maintain this policy. The payroll, tax, insurance and other employment issues are dealt with centrally by Blue Holdings plc with reimbursement of exact employment costs made by the other group companies. No administration charge is made. The total annual payroll is around £1,500,000.

Requirement:

Provide Bill Smith with a briefing paper advising him of:

1) **Any VAT exposure which Blue Holdings has in relation to these past arrangements; and**

2) **Alternative VAT efficient arrangements which the group could consider in future in relation to provision of staff to the group companies, including the new financial services company.**

(20)

15. You are a Chartered Tax Adviser with a firm of accountants and one of your firm's clients, BTSKY Ltd, operates in the telecoms sector. The client partner has a meeting arranged with the company's chief executive and one of the items on the agenda is the VAT treatment of trading in wholesale SMS services. The company is negotiating with another UK company in the sector to buy wholesale SMS services with the intention of selling these SMS services wholesale to other telecoms companies. Whilst the majority of SMS services being acquired by BTSKY are for wholesale onward supply, BTSKY does have one customer that uses the SMS services within their corporate group.

The vendor has advised the company that under new rules, the purchaser must deal with the VAT formalities. The company has not dealt in wholesale telecommunications since January 2018 but the chief executive recalls that at that time there were no VAT implications of these trades. He has asked for confirmation of the correct VAT treatment. BTSKY Ltd, the vendor and the prospective purchasers are all registered for VAT.

Requirement:

Prepare a briefing note for the client partner, who is not a tax specialist, explaining the background to the VAT rules in the industry and confirming details of the correct VAT treatment. (10)

16. Red and Yellow Bricks Ltd is a property development company. It is registered for VAT and is partially exempt. It uses the partial exemption standard method and its taxable percentage for the year ended 31 March 2021 is expected to be around 70%.

The company has recently completed a development of 20 retail units. Three have been let. Lease agreements have been signed in relation to another 12 of the retail units but the tenants are not yet in occupation. The rest of the retail units are still available to let. An option to tax has been exercised over the properties. A sale of the entire development to an investment company in which Red and Yellow Bricks Ltd holds 51% of the shares has been agreed on terms which provide that Red and Yellow Bricks Ltd will guarantee the rents in relation to the vacant properties for a period of six months. Since the purchaser is connected with Red and Yellow Bricks Ltd, the development will be sold at a 10% discount to its market value and the sale price will be reduced to take account of rents paid in advance.

In 2019 the company purchased a piece of land with some disused buildings on it. The company incurred a substantial amount of professional fees on examining various environmental issues and opted to tax the site in order to recover these. It has also constructed a road through the site at a cost of £200,000 plus VAT. A housing association has made an offer to purchase the land with a view to building flats with a small shopping complex at the side.

Also in 2019 the company purchased a commercial building for £1,500,000 plus VAT which it intended to develop. It opted to tax the property on acquisition in order to reclaim VAT on the purchase. However a charity which provides food and clothing free of charge to homeless persons has now made an offer to buy the property. The charity intends to use the building for storage of the food and clothing prior to distribution. It will have a small office which will be used to administer the distribution process which will occupy about 5% of the property. The charity also intends to utilise an area at the rear of the property, which amounts to about 10% of the floor space, for fund-raising purposes by operating a cafeteria which will sell food and drink to the public at a commercial price.

The company is also building a new head office for its own occupation. It will purchase building materials but use in-house labour to carry out the work. A third party labour only quote was received for £140,000 plus VAT but this was regarded as too expensive.

Requirement:

Write a letter to the finance director at Red and Yellow Bricks Ltd advising him of the VAT implications of these projects. He would also like to understand any Stamp Duty Land Tax implications for the purchaser. (20)

17. You are a VAT adviser in a firm of Chartered Tax Advisers. One of the partners has passed you the following details of the business interests of one of the firm's clients.

Albert Ross runs a consultancy practice as a sole trader, turning over £100,000 a year in fees from UK commercial clients.

He is also a partner in his wife's business, although he does not have an active role. The firm makes and sells sweets, and turns over £300,000 a year.

He is a partner in a Limited Liability Partnership in which he has a 60% share and his friend Chris Teddit holds the other 40%. The LLP is involved in property development and turns over a variable amount each year, usually at least £100,000.

He owns 100% of two companies, both UK incorporated and established:

1) Albatross Ltd, which is a pure holding company only, receiving dividends from its subsidiary;

2) Birdy Ltd, which is a manufacturing company as well as holding shares in other companies.

Albatross Ltd owns 100% of Speckleden Inc, an American incorporated trading company which has no presence in the UK.

Speckleden Inc owns 50% of Fishawk Inc, another American incorporated trading company which has a UK office.

Birdy Ltd owns:

1) 80% of the share capital of Eagle Ltd, a UK company whose only trading activities are exempt for VAT purposes. (The other 20% of the shares are held by an unconnected company.)

2) 50% of the share capital of Woodpecker Ltd, a UK company with taxable trading activities. (The other 50% are held by five unconnected individuals who own 10% each.)

Finally, Eagle Ltd owns the 50% of Fishawk Inc that Speckleden Inc does not own.

At present, the nine business interests of Albert Ross have six separate UK VAT registrations. Mr Ross would like to bring as many as possible of his business interests within a single VAT registration.

Requirement:

Explain which of these businesses can be brought within a single VAT registration, with explanations of any conditions which may apply or any reasons why it may not be possible. (10)

18. Strongwinds Ltd is an energy company which was incorporated by its holding company, Eastwinds plc in June 2018 to develop alternative energy sources (wind farms) at various sites around the United Kingdom. The company instructed an environmental consultancy to undertake a feasibility study in 2018 and since then has taken professional advice on the financial and legal aspects of the project. It has also instructed a PR agency to help it to develop and to present the project. These professional costs are as follows:

Date	Services	£
September 2018	Feasibility study	75,000 plus 15,000 VAT
December 2019	Financial advice	20,000 plus 4,000 VAT
June 2020	Legal advice	35,000 plus 7,000 VAT
October 2020	PR consultancy	30,000 plus 6,000 VAT

Eastwinds plc sub-lets two rooms in its headquarters office to Strongwinds Ltd. Under the terms of the lease it also charges Strongwinds Ltd a proportion of all office overheads based on the proportion of office space occupied and makes a separate charge of £20,000 per annum for telephone and computer usage. These amounts have been invoiced to Strongwinds Ltd but it has been agreed that payment will be deferred until Strongwinds Ltd starts to generate some income.

Strongwinds Ltd is funded by equity investment from its parent company, Eastwinds plc and bank loans. In 2020 it was awarded some EU grant funding to develop the project, payable in two instalments of £500,000 each on 1 January 2020 and 1 January 2021. The funding has been made on the condition that it is used to purchase assets in connection with the development of green energy and is repayable out of the proceeds of any subsequent sale of the assets. Strongwinds must provide regular reports and accounts to the EU evidencing the use of the funding. The company has received no other income to date.

Strongwinds Ltd is now negotiating the freehold purchase of two sites and once planning permission is obtained, it will invite contractors to tender for carrying out the construction work. The company believes VAT will be payable on the purchase of the land and the contractors' services. The total development cost of each site is likely to exceed £1 million. The entire project is subject to planning permission and other regulatory approvals.

The earliest date any sales of power from the project will be made is February 2022. Neither company is presently registered for VAT. Eastwinds plc does not wish to register unless it has a legal requirement to do so and Strongwinds Ltd will register when it either has a legal requirement to do so or it is otherwise beneficial to do so.

If planning and related consents are obtained it is intended that the wind farm project will be sold once energy production has started, either by a disposal of Strongwinds Ltd or an asset sale. If planning permission is not obtained, the project will be abandoned and the sites sold.

The company solicitor, who works for both Eastwinds plc and Strongwinds Ltd, has asked for some advice on the VAT implications of the development for both companies.

Requirement:

Write a letter to the company solicitor advising on:

1) **The liability to VAT registration of both Strongwinds Ltd and Eastwinds plc and the possibility of recovery of VAT on previous and future costs; and** (10)

2) **The VAT implications of the project being abandoned or the sale of Strongwinds Ltd or its assets.** (5)

Total (15)

19. You have received the following letter from a client.

1 November 2020

"Dear Chris,

Thanks for meeting me yesterday and listening to my list of complaints about VAT. I'm writing to set out my problems in more detail.

You will recall that we had a long-running argument with HMRC and were encouraged to keep it going by our previous advisers. Our eventual defeat was the main reason we changed to your firm – it soured our relationship with Optimist & Co, even though they probably did a good job in general.

With their encouragement, we changed the treatment of some of our supplies from standard to zero-rated in January 2016. We put in a claim for repayment going back four years. HMRC of course refused it, and told us they would raise assessments for later periods as we went along. When we went to the Tribunal in March 2018 we won: HMRC had to pay us all the money in our reclaim. By that time they hadn't got around to raising any assessments for periods after January 2016 – presumably they thought they would do that once they'd proved their point in court.

As you know, the Court of Appeal didn't see it our way, and we lost in March 2020. So we ended up paying the January 2016 reclaim back to HMRC with interest. But HMRC still hadn't raised any assessments for periods after January 2016, or even asked us for any more information since the Tribunal case.

They seem finally to have woken up to that fact. On 28 September this year they sent us assessments for the quarters to March, June and September 2016. These were all based on extrapolation of the numbers we were using for our reclaim in respect of periods up to January 2016 – are they allowed to do that? The balance of standard and what we thought was zero-rated varied from period to period, and their extrapolation wouldn't produce the right figure. We haven't paid these assessments – we've written to query them (within 30 days) but we haven't heard back.

They seem to have recognised that as well, because they have at long last – last week – asked for more detail about the December 2016 quarter. That seems a bit steep to me, so long after the event. I know from my Income Tax return that they only get a year to ask questions.

Can you tell me what the rights and wrongs of these assessments are, and whether we have to provide this information? What happens if we don't? Coming up to Christmas and New Year is really busy in our accounts department, so it's going to be a pain going back to look through old files. And if we have to pay some VAT, will there be penalties or interest on top?

I look forward to hearing from you.

Will Jackson"

Requirement:

Draft a letter responding to Will Jackson. (15)

20. You are the VAT manager in a firm of Chartered Tax Advisers. One of your direct tax colleagues has referred the following situations to you for comment:

<u>Farmer Giles</u>

1) Farmer Giles runs a farming business through a company which is registered for VAT. Your colleague has discovered that he has also been organising shooting parties (which hunt game birds such as pheasant and partridge) for some friends on an adjoining farm and has not reported this activity to HMRC.

2) 20 people are members of the Little Farmead Shooting Society (LFSS), including Farmer Giles.

3) LFSS has been in existence for four years. It is unincorporated and has no written constitution, but it has a bank account and a second-hand Land Rover which is used for the shooting parties. Farmer Giles himself prepares informal accounts which he circulates to the other members.

4) The members (including Giles himself) have paid a variable amount each year which covers the costs and usually leaves a small float in the bank account at the end of the year to be carried forward. The contributions are adjusted to reflect different numbers of days on which each member has taken part. The contribution in the first year was considerably higher in order to cover the cost of the Land Rover. In the last accounting year (to 31 December 2019) the average contribution per member was £4,000.

5) Currently the main annual expense is the shooting licence, which is made out to Farmer Giles himself and costs £30,000 plus VAT (charged by the owner of the adjoining farm).

Your colleague is concerned that this activity should possibly be reflected in the VAT returns of Farmer Giles' company, or else should be subject to a VAT registration in the name of Farmer Giles as a sole trader. He is satisfied that he can deal with any direct tax aspects himself.

<u>Sir Archie Fettrich</u>

1) Sir Archie Fettrich owns a Scottish estate which is registered for VAT in his name as a sole trade. For some years Sir Archie has hunted deer on the estate as a hobby, but in 2019he decided that the herds were getting too numerous and it would make sense to cull them and sell the meat to butchers.

2) Because parts of the estate are remote, he bought a second-hand helicopter for £300,000 plus VAT in January 2019. He says that he has some private use of this, but according to the log 80% of the flying hours are related to hunting (mainly the recovery of carcases from inaccessible places). The VAT on the purchase was claimed in full as Input Tax in the VAT return for the period to March 2019. All running expenses incurred since then have also been claimed.

3) Sir Archie invites friends to take part in the hunting. They do not pay to do so, but they bring their own equipment: the only costs incurred by Sir Archie for the hunters are refreshments, which he does not charge through the business. In 2019 the estate sold 30 carcases to the local butcher for a total of £6,000. This has been treated in the records as a zero-rated sale, and all costs associated with the hunting activity (apart from refreshments) have been claimed as business costs. Sir Archie hopes to increase the sales in future years.

Your colleague is concerned that HMRC may regard the hunting as merely an expansion of Sir Archie's former hobby, with the result that the expenditure on the helicopter should not have been claimed. Again, he is satisfied that he can deal with any direct tax issues.

Requirement:

Draft an e-mail to your colleague responding to his concerns. (15)

21. You are the VAT manager for Fresco plc, a medium-sized manufacturing business. The company prepares VAT returns for calendar quarters, and its recent record of payments has been:

	£
September 2018	1,500,000
December 2018	1,300,000
March 2019	1,200,000
June 2019	1,000,000
September 2019	900,000
December 2019	800,000
March 2020	700,000

During the year to 31 March 25020, the company has been subject to the payments on account (POA) regime, with POA set at £200,000 based on the year to 30 September 2018.

The September 2019 return was filed late because the staff member concerned was on holiday. You have accepted that there was no reasonable excuse for this failure. You have now discovered that the POA due on 31 March 2020 was not paid because your instruction to revise the payments going forward was misunderstood by the accounts department. They cancelled the existing bank instruction for £200,000 per month with immediate effect and failed to replace it with a new instruction. This was only noticed six days later, and the money was transferred to HMRC two days after that. You have now received notification of a surcharge of £4,000.

Requirement:

1) Calculate the payments on account for the year to 31 March 2021, if no action is taken; and

2) Comment on the possibility of reducing the payment due on 31 May 2020; and

3) Comment on the likelihood of a successful defence against the imposition of the surcharge.

Total (10)

22. You have received the following letter from a client:

1 May 2020

Dear Sara

Jane and I are in partnership farming 200 acres of land in the Cotswolds. The partnership owns three derelict stone barns which are no longer suitable for farming purposes and therefore we propose to convert them. Fortunately, they are not listed.

Haycroft Barn will be converted into a home for our daughter Lizzie; Windrush Barn will be converted to small workshops/offices for rental by the company to local small enterprises; and finally, Burford Barn will be converted to provide accommodation rent free for a farm worker.

Work will commence in November 2020 and is scheduled for completion in September 2022. We will use the same builder who is flexible as to when the scheduled works are invoiced and paid. I have set out below an analysis of the builder's agreed costs and a schedule of his proposed invoices for the work done – the builder has advised all sums due will be subject to VAT at the standard rate:

Payment periods	Total payments	Haycroft Barn	Windrush Barn	Burford Barn
	£	£	£	£
November/ December 2020	25,000	20,000	5,000	
three months to March 2021	40,000	30,000	10,000	
three months to June 2021	68,000	60,000	8,000	
three months to September 2021	72,000	60,000	12,000	
three months to December 2021	50,000	30,000	10,000	10,000
three months to March 2022	20,000		20,000	
three months to June 2022	15,000		15,000	
three months to September 2022	22,000			22,000
	312,000	200,000	80,000	32,000
Projected VAT (at 20%)	62,400	40,000	16,000	6,400

Lizzie is not employed by the farming partnership, nor is there any intention that she will be. Jane and I are anxious that she should have her own home, so we are proposing that the partnership convert Haycroft Barn and, on completion of the works, we give it to Lizzie. In case it is relevant, in its state the barn is valued at £40,000 and, as I say, we will be spending £200,000, plus VAT in converting it. A charge to Jane and my partnership capital accounts will be made to reflect the transfer of the asset out of the partnership.

Insofar as Windrush Barn is concerned, on completion of the works, the partnership will let out the units to local small enterprises. We envisage that the term of the leases will not exceed five years and the annual rents will vary between £8 – £12,000 per annum. As the expected tenants are very unlikely to be VAT registered, we do not wish to charge VAT on the rents. I expect the first tenants will occupy the units in September 2022, with the rents receivable in the period to 31 March 2023 to be £30,000. If there is any way in which we may reclaim VAT incurred on these works, I will be delighted to meet your reasonable fee.

In case it should be relevant, the partnership's VAT returns to the four quarters to March 2020 showed:

VAT Quarter to:	Taxable supplies	Input tax claimed
	£	£
30 June 2019	200,000	30,000
30 September 2019	600,000	15,000
31 December 2019	800,000	45,000
31 March 2020	400,000	10,000
	2,000,000	100,000

It is unlikely that these figures will be materially different in 2020/21 to 2022/23. As the partnership has never made VAT exempt supplies, it has reclaimed in full all VAT incurred by it. Input tax claimed includes VAT charged on general overhead expenses – these have been of the order of £60,000 per annum (VAT £12,000) and again, I don't envisage any increase in these costs in the next two to three years.

In case it is relevant, the planning consent in relation to Burford Barn restricts its use to the provision of accommodation for a farm worker.

Until now, completion of the partnership's VAT returns has been straightforward. Since the partnership makes mainly zero rated supplies of food, it has reclaimed VAT in full on its costs. As we are moving into new areas, I would appreciate your observations on the VAT and SDLT implications of what is being proposed. As your colleague Derek is looking at the direct tax implications, there is no need for you to address such matters.

Kind regards

Horace Baggins

Requirement:

Write a letter to the client in response to his enquiry. (20)

23. You have received the following memorandum from your tax partner:

1 May 2020

Dear Doug

<u>AXcess</u>

The firm has recently taken on the audit and tax affairs of AXcess which is a registered charity whose principal objective is the provision of support services to young persons with learning difficulties and their carers.

I am due to meet with AXcess's finance director next week to discuss the following matters:

1) AXcess has been asked by a Local Authority ("LA") to quote for the provision of a holiday scheme for children with learning difficulties. Under the scheme, every child aged five – 12 years with learning difficulties nominated by the LA will be offered during the Easter and summer holidays a three day non-residential break comprising two days' participation in activities such as arts and crafts, computer skills, sport, cooking and a day's excursion. The central objectives of the scheme are to help participating children to engage with others, and to give their carers a break.

2) AXcess has been asked by another charity to provide a series of "sibling days" which are aimed at providing an environment in which the siblings of children with learning difficulties and other disabilities meet with other siblings through participation in sport and other recreational activities. The objective is to provide support for siblings and to enable them to learn from the experience of others. Participating siblings will usually – but not always – be young persons. AXcess's client is not registered for VAT, so the draft contract provides for a VAT inclusive price.

3) In return for funding of £30,000, AXcess has agreed to assist a LA to develop a database which identifies within the county voluntary sector bodies dedicated to supplying support services to young persons with learning difficulties and their carers. Local residents will have free access to the database which will be operated under the auspices of the LA.

4) A LA which has a statutory obligation to provide dedicated teaching to children with special needs is anxious to outsource the delivery of these educational services. It is envisaged that LA staff, buildings and other assets will be transferred to the successful bidder, with it supplying then supplying the services to the LA. AXcess is keen to bid for the contract, but the buildings need to be refurbished at a projected cost of £2 million, plus VAT. Unless some mechanism can be found which allows AXcess to reclaim VAT on the works, it cannot proceed with its bid.

Please could you provide me with a note setting out firstly, the likely VAT status of AXcess's services set out in paragraphs 1 – 3 and briefly, secondly whether there are any options open to AXcess to reclaim VAT in the necessary building works. You should restrict your observations solely to VAT and, in the light of your excellent presentation at last year's tax conference, there is no need to supply me with a detailed analysis of the abuse of law principle, save for highlighting whether it may be an issue.

Regards
Dermot

Requirement:

Draft a memorandum in response to the issues raised by Dermot. (15)

IPT QUESTIONS

24. Home Repairs Ltd is a company that specialises in repairing domestic appliances. It is offering an insurance policy to householders to insure their domestic appliances. The following details their activity in 2020.

The number of policies taken out in the following locations were:

20,000	Great Britain
10,000	Republic of Ireland
1,000	Isle of Man
1,000	Channel Islands
500	Scilly Isles

A fee of £100 was charged for each policy taken by a householder. A similar policy was sold to a hotel group with hotels in Great Britain and Republic of Ireland. There are 80 hotels in Great Britain and 20 in Republic of Ireland, though the cost of insurance in Republic of Ireland is 10% higher. A fee has been calculated of £20,000. In addition to this fee, Home Repairs Ltd charged the hotel group 8% interest per annum for accepting payments in instalments and this was charged separately at the year-end. Over the past year this interest was £730.

Home Repairs Ltd has an arrangement with a well-known kettle manufacturer, Black Pots Ltd, which offers its customers a free warranty for the first year of ownership. The customer is to return a card that is contained in the kettle's packaging to Home Repairs Ltd, which administers this warranty service for Black Pots Ltd for a fee of £10,000 a year. Black Pots Ltd tries to persuade its customers to purchase an extended warranty. Each purchaser is charged £10 for the extended warranty. Black Pots Ltd retains £1 of this for its administrative costs and pays the remaining £9 to Home Repairs Ltd. 750 policies have been sold. Any customer that has not taken up the extended warranty is sent a reminder by Home Repairs Ltd when the free warranty is about to expire to sell a similar extended policy for the kettle. The cost of this is £10, and Home Repairs Ltd keeps the whole fee. 1,200 of these policies have been sold.

Home Repairs Ltd is an authorised insurer and registered for IPT.

Requirement:

Calculate with full explanations the amount of IPT arising in respect of the above transactions.

You are NOT required to comment on VAT or any other taxes. (10)

25. Your firm's direct tax specialists have referred the following client scenario to you for comment. Although aware of the existence of case law and legislation on Insurance Premium Tax (IPT) they are not up-to-date on the details.

MLU is a Belgian insurance company which has been providing insurance cover for plumbing and heating system emergencies to households across Europe for the last five years. The policies in the UK are arranged, sold and administered by an unconnected UK company, Thompson Ltd, a licensed insurance broker. Thompson Ltd sends out the marketing materials, deals with initial queries and collects and processes the applications from customers.

Claims handling is outsourced by MLU to another unconnected UK company, Wagg Ltd, which operates a hotline service, receiving calls from policy holders, arranging for engineers to attend the properties and settling complaints.

The marketing material points out to customers that customers will have a contract of insurance with MLU for which an insurance premium is payable as well as a separate contract for arranging and administering the insurance contract with Thompson Ltd for which a £15 administration fee is charged. It is emphasised that the overall price for the cover is not affected by this arrangement. No IPT is accounted for on the amounts retained by Thompson Ltd.

Thompson Ltd has recently begun to offer extended insurance warranties to customers who choose to pay for upgraded boilers when their old ones break down. They charge a £10 documentation fee for arranging the policy, pay 10% of the premium to the boiler supplier and the rest to MLU.

MLU accounts for standard rated IPT on all premium amounts it physically receives.

Requirement:

Prepare a memo to your colleagues explaining the relevant issues for Insurance Premium Tax purposes. You should quote statutory references and case law where appropriate. (10)

26. You are the indirect tax specialist in an accountancy firm. An audit partner has sent you the following note:

As you know the firm has recently expanded into the insurance sector and consequently several points have arisen where I am in need of your guidance as regards the rules on Insurance Premium Tax.

1) Some of my clients account for Insurance Premium Tax when they receive the money from their customers whereas other clients go by the date they enter the premium details as due into their statutory records. What are the rules around this and, if it is right to use the date of entry into the records, what happens with bad debts and overpayments etc?

2) We have a client that supplies double glazing to individuals and they have been charging their customers a 'guarantee premium' of 10% of the value of the goods. This means that if the double glazing needs repairing or replacing in a 20-year period then our client will make good the repair/replacement. The contractor separately takes out an insurance policy on behalf of the individual customer which allows that customer to claim for any repairs that are needed under the guarantee should the contractor go out of business prior to the end of the 20-year period. Someone suggested that this 'guarantee premium' might be liable to IPT. Can you clarify this please?

3) As regards errors I was under the impression that they had to disclose these to HMRC (HMRC) unless the net error was less than £10,000 but one client, FYO Ltd, assures me I am wrong and that only errors above £50,000 need be notified to HMRC. Is this right? I have another client, DOR Ltd, who is asking me to review his calculations in a disclosure for £18,000 and I would like to advise him as to whether he can simply adjust his next return.

4) One client, Karam Ltd, is a UK insurer registered for Insurance Premium Tax. As a new business venture the company has started providing credit guarantees, essentially charging manufacturers a premium against their risk that a customer will not pay their credit instalments on purchases. Should this be subject to Insurance Premium Tax? Also, Karam Ltd employs a third party, Azov Ltd, to administer their household emergencies insurance contracts for which the insured pays a set fee directly to Azov Ltd. I saw something in the firm's technical updates about these arrangements from an Insurance Premium Tax perspective. Can you clarify this please?

5) Another client, Gogol Ltd, has had to dismiss an employee for alleged fraud and is now concerned about an Insurance Premium Tax return for the second half of 2019 as they seem to have understated the liability deliberately. I know about the new civil penalty regime from your previous note to the practice and, of course, the client should seek specialist legal advice but, for my information, what criminal sanctions could apply?

I would greatly appreciate some legislative references so that I can verify the wording of the law myself and not have to keep coming back to you with subsequent "basic" questions.

TK Bashem

Partner

Requirement:

Write a memo in response to your colleague's note, providing statutory references where appropriate. (20)

27. An American based company, “Coversure Inc” is intending to sell travel insurance (amongst other things) via the internet to individuals around the world, including the UK. The company has not thought about becoming registered for IPT in the UK and believes it is not necessary to do so, as it is based in America.

It has come to you for advice as to whether this is necessary and if so how it will go about becoming registered. The CEO doesn’t know much about the UK’s IPT regime as Coversure doesn’t have a place of business in the UK. The company is concerned as to how it will manage any UK IPT affairs, as well as what the company will be required to do if it is liable to register.

Requirement:

Write a letter to the CEO answering his queries. (15)

VAT ANSWERS

1. JACOB LTD

1) ANNUAL ADJUSTMENT

Amount Originally Recovered

	£	
Q1	58,000	[100% TAXABLE SUPPLIES – £2,000 directly attributable to exempt]
Q2	24,250	[100% TAXABLE SUPPLIES]
Q3	21,350	[£19,000 FULLY RECOVERABLE +£2,350 RESIDUAL (184,000/(184,000+125,000)) = 59.5% ROUND UP 60% x £2,350 = £1,410 RESIDUAL Balance of residual input tax (£940) is below de minimis threshold so all recoverable: recover £2,350
Q4	28,400	[£20,000 FULLY RECOVERABLE + £8,400 RESIDUAL (193,000/(193,000+130,000)) = 59.8% ROUND UP 60% x £14,000 = £8,400
	132,000	RECOVERED IN THE QUARTERS

Annual Adjustment

	£	
Directly Attributable Exempt	2,000	
Directly Attributable Taxable	79,000	[20,000+20,000+19,000+20,000]
Residual Input Tax	58,600	[40,000+4,250+2,350+14,000–2,000]
Total Input Tax	139,600	[2,000 + 79,000 + 58,600]
Annual recovery percentage	75%	[732,000/(732,000+255,000) ROUND UP]
Recoverable input tax	122,950	[(£58,600 x 75%)+£79,000]
Recovered in quarters	132,000	[see above]
ANNUAL ADJUSTMENT	9,050	[£132,000 – £122,950]
De Minimis	NO	[(£14,650+£2,000)/12 > £625 per month]

The simplified de minimis tests cannot be used in this case because the input tax figures are too large. The adjustment is due to HMRC and should be entered as a negative figure in the VAT recoverable account for the quarter to June 2019 (reducing Box 4 on the VAT return).

2) ALTERNATIVE CALCULATION

HMRC have recognised that the standard outputs-based method of partial exemption can be unrepresentative in the early years of a business, or when there is a change in activity so that exempt input tax is incurred for the first time. Businesses using the standard method will therefore be allowed to calculate input tax recovery according to the “use of the inputs” (in effect, using a “fair and reasonable” calculation rather than one based on turnover) in the following three situations:

- During its registration period. This is the period running from the date a business is first registered for VAT to the day before the start of its first tax year.
- During its first tax year (normally the first period of 12 months commencing on 1 April, 1 May or 1 June following the end of the registration period), provided it did not incur input tax relating to exempt supplies during its registration period.

- During any tax year, provided it did not incur input tax relating to exempt supplies in its previous tax year.

Jacob Ltd can therefore consider whether a use-based calculation should be used instead of the standard method to give a fairer result. The standard method has disallowed 25% of the residual input tax from the first quarter because of the insurance commission income later in the year; if there is a stronger link between that residual tax and the taxable business (supported by reasoning and calculations), the company could claim more of it. Information Sheet 04/2009 sets out the principles to take into account.

Tutorial Note:

Note that this model answer does not have a marking guide as the question was set before the CIOT started publishing their marking guides. You will also find this is the case for a few of the other model answers in this bank.

2. CARING CHARITY LTD

Our address

Your address

1 May 2020

Dear Mr Woods

HMRC LETTER - VAT

Thank you for your inquiry in relation to matters arising from HMRCs recent assurance visit to Caring Charity Ltd. For the reasons set out below we do not fully agree with the views set out by the officer and would recommend drafting a response setting out the reasons we disagree with his analysis.

Health club membership fees for employees; golf club membership – chief executive

Whilst recovery of input tax can be subject to restriction in relation to private use, this applies differently in the case of a company as compared to, say, a sole trader. Input tax is allowed on staff entertainment and similar benefits where such costs are incurred to reward, motivate and retain staff – i.e. they are for the purposes of the company's business. The VAT on the health club costs should therefore be allowable.

The position is no different with the golf club membership which is also a means of rewarding the staff member concerned.

However, where a business cost is provided without charge to staff for personal use, there may be a deemed output tax charge which the company must account for under the Supply of Services Order 1993. The value of the supply will be the full cost of providing the services i.e. the cost of membership, effectively cancelling out the initial VAT deduction.

HMRC do not seek to apply this treatment where a benefit is available to all staff but perks provided for individual employees will be subject to this charge. Therefore you should be able to get the VAT back on the health club fees without an output tax charge but not in relation to the golf club membership.

Tax advice on the charity's VAT position and inheritance tax liability of chief executive

Tax advice enabling the charity to comply with its tax obligations is a legitimate business expense and there is no specific disallowance for such costs. This extends to advice on employment tax and PAYE matters for the company and its employees.

However where a company pays for tax advice with no connection to the individual's employment, this is not seen as a cost incurred for business purposes by HMRC. It is therefore not recoverable as input tax and this applies to the inheritance tax advice for the chief executive.

Fees for consultancy report on aborted retail business

The officer is incorrect when he suggests there must eventually be an actual supply to which VAT on costs can be attributed before recovery is possible. Where there is a genuine intention to pursue an economic activity and make supplies, there is a line of EU case-law which states that preparatory acts must be treated as part of the commercial activity. INZO (1996) confirmed that where the intention to make a taxable supply was genuine, the business was entitled to recover input tax on an aborted project.

In this case, one would look through to the intended supplies of the planned retail business. These would probably have been 100% taxable and therefore the VAT on the report should be recoverable in full. This has also been confirmed in a later CJEU case, Ryanair (C-249/17).

If there were no evidence of a genuine intention to make supplies, the cost could still potentially be treated as a residual overhead and VAT recovery allowed provided Caring Charity Ltd was already making other supplies at the time. A report examining further commercial opportunities should clearly be a business-related cost. However, the CJEU recently held in C&D Foods Acquisition that VAT is not deductible on costs directly related to a share sale where the funds raised are intended to repay a debt. The Court did not consider that there was a direct link between the costs and taxable supplies made by the business.

Legal advice received pre-registration – incurred 20 May 2017

Usually the right to deduct input tax can be exercised only by someone who is a 'taxable person' (i.e. VAT registered) at the time the relevant supplies were received. There are, however, instances when VAT has been incurred by someone in connection with their business activities at a time when they were not registered for VAT. In these circumstances VAT recovery is permitted under reg. 111 SI 1995/2518 (the VAT Regulations).

Where goods or services are purchased in respect of taxable business activities by a person prior to the date of registration for VAT, relief from the VAT incurred is permitted provided the following criteria are met:

The amount of tax that can be recovered is the amount that would have been recoverable had the trader been registered at the time the tax was incurred – i.e. partial exemption and non-business aspects need to be considered.

In the case of services, these were supplied not more than 6 months prior to the effective date of registration.

A person may not use reg. 111 to recover tax on supplies that were purchased for non-business or private purposes. You would need to be sure that the legal advice related to the business activity of Caring Charity Ltd.

Changes of intention

Legal advice re: loan

Where you incur input VAT attributable to an intention to make an exempt supply and, before that intention is fulfilled, you use the costs in making a taxable supply, reg. 109 SI 1995/2518 allows for adjustment of the original attribution and recovery of the VAT previously disallowed. The time limit for making the adjustment is 6 years from the first day of the accounting period in which the original attribution occurred.

The provision of credit is usually an exempt supply, as the officer states. However certain exempt supplies when provided to non-EU counterparties are specified as allowing recovery of related costs [SI 1995/2518 Reg 103 and SI 1999/3121 refers]. Therefore the officer is incorrect and you can recover the VAT incurred in what turned out to be a loan to a non-EU counterparty. It may be the case that the loan was granted to further the charitable objects of Caring Charity Ltd and, if this is the case, one would need to consider carefully whether the loan constituted a non-business activity which would not allow recovery of associated VAT on costs.

<u>Software</u>

VAT you incur on goods and services that are used exclusively for non-business purposes is not input tax and you cannot recover it. VAT on goods and services that you use partly for business purposes and partly for non-business purposes must be apportioned between business and non-business use before dealing with partial exemption. This applies potentially to all the costs previously discussed above – they must be attributable to business activities in order to qualify as input tax.
Here, although your original intention changed and you used the costs in making a taxable supply, you were already using the software for non-business purposes. You cannot therefore benefit from the change of intention payback provisions in reg. 109 as these only apply to a switch from the intention to use costs for exempt (or both taxable and exempt) supplies to making taxable supplies.

The Greenpeace Tribunal case [VTD 16,681] confirmed that the standard error correction provisions may apply in such circumstances so that, provided the correction relates to a period not more than 4 years prior to your claim, an adjustment should still be able to be made.

However, HMRC may argue that this is not an error but simply a change of intention from making non-business to making business supplies. If that is the case, no adjustment would be possible.

A further consideration is the possibility that Caring Charity Ltd has agreed, as part of its partial exemption method or separately with HMRC, a methodology for apportioning VAT between business and non-business use. If so, this may be relied upon by the officer to deny adjustments to previous apportionments (or by the charity to make them).

I trust this letter addresses your query clearly but please do not hesitate to contact me should you require further clarification.

Yours sincerely

T Adviser

3. MR DAY

Our address

Your address

May 2020

Dear Mr Day

VALUE ADDED TAX TREATMENT OF PROPOSED PROPERTY TRANSACTIONS

Following our telephone conversation, I am writing concerning the VAT treatment of the proposed sale and gift of your properties.

Property A

Once you have exercised an option to tax over a property, normally you need to charge VAT on any income from the property, including on the proceeds of a disposal. However, when an option to tax has been in place for 20 years, in certain circumstances, it is possible to revoke the option to tax. This would allow you to sell the property free of VAT and achieve a higher sales price.

You can revoke the option without permission from HMRC, provided you satisfy the following conditions.

1) You held an interest in the property after the option to tax had effect and also more than twenty years before the option is revoked. You satisfy these conditions.

2) The building is no longer a capital item for VAT purposes. A capital item adjustment period for property lasts for 10 years and since you acquired the property more than ten years ago and have made no alteration to the building, you also satisfy this condition.

3) You have not granted any interest in the property in the last 10 years for an amount less than open market value nor will you receive any payment after revocation arising from a grant of an interest in the property made before revocation that is significantly greater than payments received prior to revocation, for example a ‘balloon’ rent. Since the property has been vacant for two years this seems unlikely but perhaps you could confirm the point.

4) You will not receive any goods or services prior to revocation that will be used in connection with the property more than 12 months after the option is revoked. Again, since the property is shortly to be sold, this seems unlikely.

If you satisfy these conditions, you can revoke the option to tax by notifying HMRC on form VAT 1614J. It is a legal requirement that you use this form.

You must:

- State the date of revocation (which cannot be before the date of notification)
- Certify that you satisfy the above conditions for revocation
- Provide the other information required on the form

If you cannot satisfy all the above conditions, it may still be possible to revoke the option but you will need to apply to HMRC for permission.

Property B

The option to tax will not apply to the sale of a property if the buyer intends to convert the property to a dwelling. The buyer must provide you with a certificate on form VAT 1614D confirming that the property will be converted to a dwelling. If this certificate is given before exchange of contracts for the sale, which is the time when the price is legally fixed, you must treat the sale as VAT exempt. At your discretion, you can still accept a certificate issued between exchange and completion and treat the sale as exempt. Otherwise the option to tax will remain effective and VAT must be charged on the sale.

It should be possible therefore to sell both properties without charging VAT.

However, you should be aware that if you do not charge VAT on the sale of the properties, it may not be possible to reclaim VAT on costs related to the sales. This depends on the level of costs involved and the operation of the ‘partial exemption’ rules. If you can provide me with details of the disposal costs, I can advise further on this.

Gift of building

If you reclaimed any VAT in relation to the construction of the garage, the gift of the garage will be subject to VAT. This arises since the property is less than three years old and a gift of land and a building is considered to be a supply of goods for the purposes of VAT. The value for VAT purposes is the price the charity would pay if it were to purchase an identical building.

You cannot provide the charity with a VAT invoice for a gift but it is possible to provide a tax certificate to the charity confirming that VAT has been paid on the gift. This may allow the charity to reclaim the VAT if it is using the building in connection with a business purpose, for example a charity shop.

There is a relief for charities which blocks the effect of an option to tax in some circumstances but this does not apply to new buildings. However, if you did not claim any VAT on the construction costs, no VAT will be payable on the gift.

If VAT is payable, it may be possible to reduce the amount of VAT due by selling the garage for a small sum to the charity instead of gifting the building. VAT would then be due on the amount paid. Provided you are not connected to the charity, HMRC cannot insist on an open market value in these circumstances.

Yours sincerely

A Tax Adviser

MARKING GUIDE

TOPIC	***MARKS***
Letter format	*1*
<u>Part 1)</u>	
Property A	
– *normal position on sale where option to tax exercised*	*½*
– *identifying in certain circumstances an option to tax can be revoked + consequences*	*½*
– *discussion re conditions*	
• *re interest in the property*	*1*
• *re capital item*	*1*
• *re grants of interest*	*2*
• *re goods and services*	*1*
– *form for revoking option*	*½*
– *information to be included on form*	*½*
– *position if conditions not met*	*½*
Property B	
– *identifying option to tax does not apply if property to be converted into dwelling*	*1*
– *position if certificate provided before exchange*	*½*
– *position if certificate provided between exchange and completion*	*½*
– *position if certificate not provided before completion*	*½*
Consequences if VAT not charged on sale	*<u>1</u>*
Max	*10*
<u>Part 2)</u>	
Identifying when gift would be subject to VAT	*1*
Explanation of value for VAT purposes	*1*
Discussion re VAT invoices + tax certificates	*1*
Identifying relief for charities re option to tax will not apply	*½*
Position if no VAT reclaimed re construction costs	*½*
Planning re sale of building for small sum	*<u>1</u>*
Sub-total	*5*
TOTAL	***15***

4. SMALL & CO

Our address

Your address

May 2020

Dear Mr Small

<u>VALUE ADDED TAX ASSESSMENT</u>

I am writing in response to your recent request for advice concerning how to contest the VAT assessment issued to your client.

An assessment made by HMRC is an appealable matter (see s.83(p) VATA 1994). Your client has a statutory entitlement to a review of the assessment by an officer not previously involved in the case. An offer of such a review should have been made by HMRC at the same time as the assessment was made. I would recommend this review as a first step in contesting the assessment. You must notify HMRC that you wish the assessment be reviewed within 30 days of the notification of the offer of a review and you should provide any additional information you have concerning adjustments to the accounts. HMRC must complete the review within 45 days (unless they agree an extension of time with you).

If HMRC uphold the original decision, you can lodge an appeal to the Tax Chamber of the First-tier Tribunal at the Tribunal Appeals Processing Centre in Birmingham. A Notice of Appeal must be served within 30 days of the date of the review decision. Alternatively, you can appeal directly to the Tribunal without a review. In this case, the Notice of Appeal must be served within 30 days of the disputed decision.

The Notice of Appeal must state:

- The appellant’s name and address
- The representative’s name and address
- An address for delivery of documents
- Details of the disputed decision, the result being sought and the grounds of appeal
- A copy of the disputed decision and the review decision (if any)

Generally an appeal cannot be entertained unless the tax in dispute has been paid or deposited with HMRC. An application can however be made to HMRC or the Tribunal to entertain the appeal without payment of the tax on grounds of hardship. You would need to provide evidence in support of any hardship application. If the tax is paid and the appeal is successful, interest may be due to your client under s.78 VATA 1994 - Interest in cases of official error. If tax is not paid on grounds of hardship and the assessment is upheld, default interest will be payable under s.74 VATA 1994.

The Tribunal will allocate the appeal to one of four categories.

- Basic cases which go straight to a hearing with minimal documentation. These are usually cases dealing with penalty charges.

- Default paper cases which are dealt with without a hearing unless one party requests it.

- Standard cases, and

- Complex cases which requires lengthy or complex evidence or have a substantial sum involved. Complex cases may be transferred to the Upper Tribunal.

It is likely that your appeal will be dealt with as a standard case. You may wish to instruct legal representation if the case is likely to proceed to a hearing, at which witnesses may be called or witness statements produced.

It is still possible for the parties to continue to discuss the case prior to any Tribunal hearing. If the parties reach an agreement, this has the same consequences as if the Tribunal had settled the case. One party must confirm the terms of the agreement in writing to the other. Your client can withdraw from an appeal by giving notice to the Tribunal. If he notifies HMRC that he does not wish to proceed, unless HMRC object, this has the same effect as if the appeal was settled by agreement.

With regard to costs, public funding would not be available for an appeal such as this and the First-tier Tribunal will generally only make an award of costs if it considers a party has acted unreasonably in bringing, defending or conducting the proceedings. It is unlikely that HMRC will have to contribute to your client's costs even if your client wins the argument and the assessment is discharged. Your client will therefore need to weigh the irrecoverable costs of taking an appeal against the amount of tax at stake and the prospects of success.

I trust this information is sufficient for your present purposes. If you require assistance with the appeal, we would be pleased to assist further.

Yours sincerely

A Tax Adviser

MARKING GUIDE

TOPIC	***MARKS***
Letter format	*1*
Discussion re entitlement to review	*1*
Time limit for accepting offer of review	*½*
Time limit for completion of review	*½*
Identifying review decision can be appealed	*½*
Time limit for notice of appeal	*½*
Identifying appeal possible without review + time limit	*1*
Contents of appeal	*1*
Noting requirement for tax to be paid	*½*
Potential hardship application	*½*
Discussion re interest	*1*
Possible categories of case	*1*
Identifying likely to be standard case	*½*
Advise re legal representation	*½*
Discussion re potential agreement prior to hearing	*1*
Potential to withdraw from appeal	*1*
Discussion re costs	*2*
TOTAL (MAX)	***10***

5. A LTD

Our address

Your address

May 2020

Dear Mr Brown,

VALUE ADDED TAX TREATMENT OF SALE OF COMPUTERS

Thank you for providing the details of the proposed sale of computers to B Ltd.

For the purposes of VAT, consideration means everything received in return for goods or services, that is to say not only cash amounts but the value of any goods and services received in return. Therefore the consideration for the sale of the computers consists of the total money payable and the value of the advertising services provided. In such cases, there is a special VAT rule which is that the value of the sale is taken to be the amount of money, together with the VAT chargeable that would have been paid by the purchaser if the payment had been made entirely in money (s.19(3) VATA 1994). In other words, the VAT-inclusive value is taken to be the total amount of consideration received in whatever form.

The key principles of establishing the monetary equivalent of non-monetary consideration were set out by the Court of Justice of the European Union (CJEU) in a case called Naturally Yours Cosmetics (C-230/87) which dealt with sales of products to party hostesses. The general rule which emerged from that case is that where the monetary value is not agreed between the parties the amount of the monetary equivalent must be arrived at subjectively from the viewpoint of the person receiving that consideration. In this case this is likely to be the equivalent of the cash payment and the value of the advertising services to be supplied.

Having established a subjective monetary equivalent of the total consideration, it will then be necessary therefore to apply the VAT fraction (1/6) to the consideration to establish the VAT due as output tax on your VAT return. The purchaser, B Ltd will be entitled to a VAT invoice (and may be able to reclaim the VAT.

The sale of the computers and standard software is a supply of goods and VAT will be chargeable when the sale is completed unless a VAT invoice is issued within 14 days of completion in which case VAT will be due on the issue of the invoice. The invoice must reflect the total value of the sale not just the monetary element. It will not be possible to defer payment of VAT on the instalment payments.

These VAT accounting arrangements are not affected by the fact that the initial payment is made by C Ltd. This is simply a case of part of the consideration being provided by a third party. VAT must still be accounted for on this amount. However no tax invoice should be provided to C Ltd since that company is not the recipient of the goods. If necessary a receipt in a form other than that of a tax invoice could be issued to C Ltd. Payment by C Ltd will not restrict B Ltd’s entitlement to reclaim input tax on the purchase of the computers.

In relation to advertising services provided to A Ltd, these are not supplied free of charge but again paid for by A Ltd with non-monetary consideration (the supply of the computers). It will also be necessary to place a subjective value on these services which is likely to be the value of the computers less the amounts paid or to be paid in cash.

Advertising services are likely to be continuous supplies of services within reg 90 of SI 1995/2518. VAT is due on these services by the supplier at the earlier of receipt of payment or issue of a VAT invoice by the supplier. Since consideration will be given by A Ltd to the supplier by the supply of the computers, a VAT invoice for the services should be issued by the advertising agency at the time of the sale of the computers. Even if the advertising services were a series of separate supplies, the supplier will still be required to account for VAT at the outset, since the supply of the computers will constitute an advance payment, which crystallises a VAT charge. A Ltd will be able to reclaim the VAT in the normal way and to the same extent as other business overheads. It will not be necessary for A Ltd to make any further payment in relation to VAT since the total consideration is satisfied by the supply of the computers.

You should also be aware of the cash flow effect of VAT on this transaction. A Ltd will have to account to HMRC for the output VAT due on the total consideration for the sale of the computers on the VAT return period covering the date of the sale. It should be possible to fund this from the initial cash payment. On the same VAT return, A Ltd will be able to reclaim as a credit the VAT on the whole of the advertising services to be provided by the purchaser.

Yours sincerely

A Tax Adviser

MARKING GUIDE

TOPIC	***MARKS***
Letter format	*1*
General definition of consideration	*½*
Application to sale of computers	*½*
Discussion of VATA 1994 s.19(3)	*1*
Reference to Naturally Yours Cosmetics case	*1*
General rule for determining non-monetary value established by case law	*1*
Calculation of VAT due to be charged by A Ltd	*½*
Identifying invoice due	*½*
Identifying tax point for sale of computers	*1*
Identifying not possible to defer VAT re instalments	*½*
Consequences of initial payment made by C Ltd	*2*
Discussion re the treatment by B Ltd of the provision of advertising services	*2*
Discussion re cash flow implications of transaction	*1*
TOTAL (MAX)	***10***

6. AB HOUSEBUILDERS LTD

NOTES FOR MEETING

Client	AB Housebuilders Ltd
Date	May 2020
Prepared by	A Tax Adviser

<u>Phase 1</u>

The purchase of the part exchange property will not be subject to VAT.

The letting of the part exchange property will be exempt – as will the eventual sale. Both under VATA 1994 Schedule 9 Group 1.

Any input tax in relation to the purchase, letting and sale will not be recoverable unless it is de-minimis under VATA 1994 SI 1995/2518 Reg 106.

Ordinarily SDLT is payable when a house is bought for £260,000. However, where a house-building company buys a home from an individual who is buying a new home from them, the purchase by the house builder is exempt from SDLT if certain conditions are met.

The individual must:

- have lived in the home as their main or only residence at some time during the two years before the house building company bought it
- buy a new home from the house building company
- intend to live in the new home as their main or only residence

In addition, the area of land that the house building company buys along with the old home must not exceed certain limits - normally 0.5 hectare.

The relief is found within Finance Act 2003, s.58A and Schedule 6A.

To claim this relief, you'll need to check the conditions are met and then enter relief code 08 in the SDLT return.

<u>Phase 2</u>

Input tax on costs related to phase 2 has been properly deducted initially since it was intended to relate to the zero-rated first grant by a person constructing a dwelling of a major interest in the building within VATA 1994 Sch.8 Group 5 Item 1.

The 2 year leases to the investment company will be exempt under VATA 94 Sch. 9 Item 1 and this represents a change of intended use from taxable to residual (exempt and taxable) triggering a clawback of input tax under SI 1995/2518 Regulation 108.

This situation has been considered by the High Court in the cases of Briararch and Curtis Henderson where it was held that the input tax should not be related exclusively to the exempt short lease but to the short lease <u>and</u> the subsequent taxable sale. The sale after two years would still be zero-rated because it would still be the first grant of a major interest by the person constructing the building (AB Housebuilders). As in Briararch etc the residual treatment should be allowed providing the intention to let is temporary and the intention to sell remains the ultimate goal. AB Housebuilders intends to let for two years before fulfilling its original sale intent which falls within the Briararch principles.

HMRC exceptionally allow housebuilders that do not operate a partial exemption method to carry out a simple de minimis check to establish whether an adjustment to input tax previously claimed is necessary (see information sheet 07/08). This calculation is based on the length of the lease compared with the economic life of the houses, which HMRC consider to be 10 years, and in this case produces the following result.

2 years (term of lease)

10 years (economic life of houses)

= $\frac{2}{10}$ x 4,100,000 x 20% (£4.1m* = £3.75m + £200k + £150k)

= £164,000.

An adjustment to input tax claimed is necessary therefore.

*VAT on carpets and white goods is not deductible (not "building materials", Sch.8 Group 5 Note 22) and the services of the sub-contract builders would have been zero-rated as being services in the course of construction of new dwellings (Sch.8 Group 5 Item 2). There would have been no VAT on own employee labour.

Normally it would be necessary for AB Housebuilders Ltd to use the standard partial exemption method. However since there were no exempt supplies in the period to 31 March 2020, the standard method would still leave 100% recovery of the now residual input tax. This may then require a standard method override calculation based on use of the input tax under S.I 1995/2518 regulation 107B.

However since AB Housebuilders Ltd does not currently operate a partial exemption method, the company can exceptionally base the clawback adjustment on an alternative calculation without first adopting a partial exemption method and without prior approval from HMRC so long as that calculation fairly reflects the use of costs in making taxable supplies. This is set out in HMRC Brief 44/08.

A calculation based on the expected values of supplies as follows is normally acceptable to HMRC for the purposes of the actual adjustment calculation and is preferred to a time basis which assumes an economic life of 10 years.

Estimated eventual sale value

Estimated eventual sale value plus estimated short let premiums and rents

Estimated eventual sales value = £8,750,000 (25 x £350,000)
Estimated rental value = £900,000 (25 x £1,500 x 24 months)

The clawback would then be calculated as follows.

8,750,000/(8,750,000 + 900,000) x £820,000 (£4,100,000* x 20%) = £743,523

Clawback £820,000 - £743,523 = £76,477

In order to avoid any clawback of input tax on development costs, AB Housebuilders Ltd could consider a sale of the houses to a group company which could be set up for the purpose and with AB Housebuilders Ltd having 100% control. The sale of the houses would then be zero-rated and no adjustment of input tax would be necessary. The new company should not be registered as part of a VAT group registration with AB Housebuilders Ltd since supplies between VAT group members are outside the scope of VAT and could not therefore create a zero-rated sale.

In principle SDLT would be payable on a sale to a connected company on not less than the market value (FA 2003 s.53). However a claim could be made for group relief under FA 2003 Sch.6.

The new company should then lease the houses to the investment company. The new company will not be VAT registered since the leases are exempt and it will not be able to recover any VAT itself. AB Housebuilders Ltd however will continue to benefit from full VAT recovery on development costs. No SDLT would be payable on the short leases to the investment company.

It has been considered whether these arrangements could be considered to be abusive following the principles of the Halifax case. An abusive transaction must produce a result contrary to the VAT legislation. HMRC consider that Parliament intended the construction of new dwellings to be zero-rated and this assumes there will be a first grant of a major interest on completion. HMRC Brief 54/08 confirms that HMRC do not consider such arrangements to be abusive where VAT recovery is restricted to development costs and not repair or maintenance costs. No disclosure of these arrangements would be required therefore.

Conclusion

In view of the amount of clawback involved, AB Housebuilders Ltd should consider the use of a first sale of a major interest to a controlled company. Otherwise, a clawback calculation based on estimated sales values should be made.

MARKING GUIDE

TOPIC	***MARKS***
Phase 1:	
VAT implications	*1*
SDLT relief on part exchanges for house-builders	*1*
SDLT relief conditions	*2*
Phase 2:	
Inputs original deducted re link to ZR intent	*1*
Change of intent creates a Reg 108 clawback	*1*
If exempt intent is temporary an apportioned clawback can apply	*1*
Briararch or Curtis Henderson	*1*
Simple de-min calculation and explanation	*4*
Eventual sale calculation and explanation	*4*
Input tax block on carpets etc	*1*
Sale of houses to group company discussion	*2*
SDLT group exemption	*1*
TOTAL	***20***

7. SUNNYVIEW HOMES LTD

VAT ISSUES TO FORM BASIS OF RESPONSE

Zero-rating of dwellings

The first grant by a person constructing a building designed as a dwelling of a major interest in the building is zero-rated under Sch.8 Group 5 Item 1 VATA 1994. This would cover a supply of a completed home by a developer such as SH:

- as long as a "major interest" is granted – this is the freehold or a lease exceeding 21 years in England & Wales, so an 80-year lease would qualify;
- as long as the building qualifies as a "dwelling" (see below).

The supply in the course of the construction of a building designed as a dwelling of any services related to the construction, such as the building services of SB, are zero-rated under Sch.8 Group 5 Item 2.

Holiday accommodation

The grant of an interest in a new building which constitutes holiday accommodation is excluded from exemption by Sch.9 Group 1 Item(1)(e) and notes 11 – 13 VATA 1994. This includes supplies of interests in new buildings which are excluded from zero-rating by Note 13 Group 5 Sch.8 VATA 1994.

This note provides that the grant of an interest in a building designed as a dwelling is not within item 1 if the interest granted is such that the grantee is not entitled to reside in the building (or part of it), throughout the year; or residence there throughout the year, or the use of the building or part as the grantee's principal private residence, is prevented by the terms of a covenant, statutory planning consent or similar permission.

However, following the case of *Ashworth* (VTD 12,924), a lease is not standard-rated as holiday accommodation if the property is actually occupied as a main residence and the property is not in a holiday park or a site held out as a holiday park. We would need to confirm whether this exception could apply to any of the potential customers. The sale would be exempt rather than zero-rated, because the planning consent would breach the terms of Sch.8 Group 5 Note 13.

If the building is holiday accommodation, the standard "all-in" premium for the 80-year lease would include VAT at 1/6: the supply would be £255,319 plus £51,064 VAT. The client will need to take this into account in calculating its required profit margins and therefore its pricing policy.

Significance of planning permission

The terms of the planning consent clearly mean that, in accordance with Note 13 Group 5, the properties will not be dwellings but will be treated as holiday accommodation. The fact that the planning authority and the residents may not take any notice of the terms of the consents does not make any difference. This point was tested in the case of *HMRC v Tallington Lakes Ltd*, Ch D 2007. This dealt with a caravan park but the point about planning permission was the same.

Note 13 applies only to supplies within Item 1 of Group 5 Sch.8. The supply of construction services will still be zero-rated within Item 2, regardless of the terms of the planning consent, provided that the building is "designed as a dwelling" (which appears to be the case).

Separate sale of plot and services

If SH sells plots of land rather than completed houses, if no anti-avoidance argument is taken by HMRC:

- the plots of land appear to be standard-rated because they are excluded from exemption by Note 11(b) Group 1 Sch.9 VATA 1994;

- the construction services would be supplied directly by the builder, whether SB or another firm, and could be zero-rated. If the contract is "design and build", all costs included within the contract price would enjoy VAT recovery, including building materials and architects' fees (see note on "not building materials" below).

Possible abuse of rights argument

In the case of *Lower Mill Estate Ltd* (TC00016), HMRC attacked an arrangement whereby customers could buy plots of land and building services separately as an artificial way of avoiding the purpose of the law, which was that new buildings of this type should be standard-rated on the whole amount paid by the customer. The First-tier Tribunal accepted this argument. The taxpayer appealed and the Upper Tribunal held that there were two, separate supplies stating "in our judgment, apart from any abuse or sham, it is not possible to combine supplies by two suppliers under two contracts so as to result in one supply for VAT purposes". The Upper Tribunal also held that the first limb of the two-part test for abuse was not met as, in the particular circumstances of the case, the tax advantage was not contrary to purpose HMRC has stated in its guidance that it considers that this case to be specific on its facts and does not have wide ranging impact. There it HMRC's considers that this arrangement has been implemented in order to avoid payment of VAT they will most likely seek to challenge it. However, the scheme is less likely to be artificial and abusive:

- if customers have a clear and free choice to use SB or another building firm, and this is not an apparent choice with no reality;

- the transactions of SB and SH are economically independent of each other, i.e. there is no cross-subsidy in respect of the prices.

DIY builders' scheme

Where someone buys a plot of land and has the property constructed, it will be possible for them to:

- receive the construction services zero-rated as described above;
- make a DIY builder's claim for VAT on materials under s.35 VATA 1994.

The conditions for the DIY claim broadly match those for zero-rating of new dwellings, but it has recently been held by the First-tier Tribunal that a DIY claim is permissible for someone building a holiday home, even if it is subject to the planning constraints described by the client (*Susan Irene Jennings* (TC00362)). HMRC have accepted in R&C Brief 29/2010 that this is the case, as long as the property is built for a non-business purpose. If the purchaser intends to rent the property out as an economic activity, then the DIY claim cannot be made (although it would be possible to register for VAT and recover some of the VAT charged as input tax).

VAT cannot be recovered under the DIY scheme on architects' fees, construction services which should have been zero-rated but were incorrectly charged by the builder, or items which are not building materials.

Building materials

"Building materials" means goods of a description ordinarily incorporated by builders in a building of that description, but does not include finished or prefabricated furniture (other than furniture designed to be fitted in kitchens), electrical goods or carpets. Building materials can be incorporated in a zero-rated supply of a building or building services, and are eligible for a DIY claim under s.35.

If goods are incorporated in a zero-rated supply which are not building materials, the supplier cannot recover the VAT as input tax (SI 1992/3222 art.6). HMRC have published extensive guidance on what they regard as building materials, but there are still sometimes disputes in Tribunal about individual items. If the builder or customer proposes to include something unusual, it will be worth considering in advance what the VAT treatment is likely to be.

Stamp duty land tax

Under the "standard format", the customers will pay a premium for a lease and will be liable for SDLT on the whole amount (including VAT). If the standard property costs £300,000, the SDLT will amount to £5,000. This will comprise the first £125,000 at 0%, the next £125,000 at 2% and the remaining £50,000 at 5%.

Under the revised format, it appears that the land element will fall below the threshold (£125,000), so there will be no SDLT on that. Services are not subject to SDLT, so the arrangement appears to avoid the charge to that tax altogether.

HMRC might try a parallel anti-avoidance argument to bring the whole amount paid by the customer within the charge to SDLT, but it would have to be on the basis of a "pre-ordained series of transactions with steps inserted only for a tax advantage". Such an attack seems less sustainable than the "abuse of rights" argument for VAT, as the arrangements do not appear to be pre-ordained.

Examiner's report:
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This was a tricky question which tested an area of the law that would be on the edges of most candidates' knowledge – the DIY builders' scheme. It was therefore pleasing to see that a majority of candidates were able to quote the recent case of Jennings and HMRC's subsequent change of view on how the DIY scheme operates in the case of a holiday home. Clearly many candidates are paying proper attention to recent developments.

Unfortunately, there was very little evidence that anyone understood the point of the Jennings decision. The distinction between Sch.8 Group 5 Items 1 and 2 is more central to the syllabus, and it was disappointing to see that no-one provided a convincing answer and very few scored any points on it.

In order to be sold zero-rated under Item 1, a building must be a "dwelling" as defined in the law. The planning consent is relevant to that. Accordingly, under the "normal" structure described in the question, the holiday homes cannot be sold to purchasers zero-rated. Many people realised that, but rather fewer realised that a holiday home is also excluded from exemption under Sch.9 Group 1. Perhaps a quarter of candidates realised that the sale of the new holiday homes would be compulsorily standard-rated, and the option to tax was wholly irrelevant.

What no-one appeared to realise (or state clearly) that the condition for zero-rating a supply of construction services under Item 2 is different. The building must be "designed as a dwelling". The builder only has to look at the plans, not at the planning permission. More than one candidate stated that the builder requires a certificate of use from the purchaser – that is only necessary if the building is to be put to a relevant charitable or residential use. That is the key issue in Jennings: it is possible for a DIY builder to buy in the services of a construction firm who will be able both to carry out the work ZR within Item 2, and to include building materials within that ZR supply using Item 4. The Tribunal therefore decided that there was no reason to deny a DIY claim on building materials bought directly by the DIY builder who was constructing a holiday home, because the purpose of the law is to make the two chains of supply broadly neutral.

A few candidates mentioned the case on which this question is loosely based, Lower Mill Estates. However, no-one mentioned the "abuse of rights" argument that succeeded for HMRC in that case. This was perhaps not surprising as so few candidates were able clearly to identify the difference in VAT treatment which would arise.

An important point on the DIY scheme that caused problems is that a DIY "new builder" can only recover VAT on the purchase of materials, not services. If the DIY builder uses a contractor to construct the dwelling, the VAT relief is given by getting the contractor to zero-rate the supply, not by making a s.35 claim.

The following points of exam technique also arose:

- *several candidates wrote letters. The scenario was presented in the form of a letter from a client, but the requirement simply said "explain". If the requirement does not clearly and explicitly tell you to write a letter, there is no need to do so.*

- *there were easy marks for making very obvious points about SDLT which were missed.*

8. MR JAY

Our address

Your address

2 November 2020

Dear Mr Jay,

VAT MATTERS

Thank you for your letter.

VAT Special Schemes

You are eligible to use the cash accounting scheme and also the flat-rate scheme for small businesses. I have set out the respective advantages and disadvantages of both these schemes below.

The cash accounting scheme requires you to account for VAT on your invoices to clients only when you receive payment. The scheme has therefore an automatic relief from VAT on bad debts. Against this, you can only reclaim input tax on your expenses when you have paid them. There are also additional accounting requirements in that you need to keep a record of payments made and received, cross-referenced to invoices, for example through a cash book. When payment is received in cash, you will, if required, have to endorse your own invoices when paid and have your own expense invoices similarly endorsed if you settle them by cash.

Applying the cash accounting principles to your VAT account for the quarter ended 30 September 2020, I have calculated that the cash accounting scheme would produce a small cash flow benefit (see example 2 in the Appendix to this letter).

You could also use the flat-rate accounting scheme for small businesses. This scheme applies a flat percentage to all your income, including your rental income without any allowance for input tax. You must still issue full VAT invoices to your VAT registered clients.

However I have recalculated your VAT liability for quarter ended 30 September using the flat-rate scheme and since the flat-rate applies to all income, including your rental income which is presently exempt from VAT, the use of the flat-rate arrangements would increase your VAT liability for that quarter (see example 3 in the Appendix to this letter).

However you may wish to consider another arrangement which has the advantages of cash accounting but none of the disadvantages. It is likely that for VAT purposes your professional trusteeship work is considered to be continuous supplies of services. There is a special VAT rule for this type of service which is that you account for VAT at the earlier of the issue of a VAT invoice or payment. Therefore if you could arrange to issue a request/demand for payment in respect of your services which does not constitute a tax invoice at the end of each month instead of a VAT invoice, you would only have to account for VAT when payment is received. You would issue a proper VAT invoice when payment is received. As with cash accounting, this arrangement has an automatic bad debt relief in relation to VAT. It has no impact on your input tax claims and therefore produces a greater advantage than cash accounting. It would also produce a substantial cash flow benefit in the quarter in which you implement the arrangements. Please let me know if you would like to pursue this idea.

The Trustees of the A plc Pension Plan

As you know, an employer may be entitled to treat input tax on costs relating to his pension fund as input tax of his business. In the event of insolvency, HMRC accept this entitlement passes to the insolvency practioner (the liquidator in this case).

In the event that the liquidator is unwilling or unable to claim the input tax, there is another avenue you could pursue. In a VAT Tribunal case, Capital Cranfield Trustees Ltd, it was held that the sole independent trustee of a pension fund is required to buy in professional services such as actuarial advice to allow him to fulfil his trustee responsibilities. Since you charge VAT on your fees to the Plan, provided these services were instructed by you in your role as independent professional trustee and invoiced to you, it may be possible for you to reclaim the VAT on these expenses through your own VAT returns. It would be prudent to agree this procedure with HMRC in advance.

Yours sincerely

A Tax Adviser

APPENDIX

Comparison of VAT account for quarter ended 30 September 2020

1) VAT account using standard VAT accounting

	£	£
Output tax		4,400
Input tax		
Overhead expenses (all deductible – see below)	1,100	
Office expenses (all deductible – see below)	37.50	
Computer expenditure (all deductible- see below)	320.00	
		1,457.50
Tax payable		2,942.50

Input tax on the computer bought on hire-purchase is immediately deductible

Partial exemption calculation

Total input tax of £1,457.50 is less than £625 per month on average and exempt supplies do not exceed 50% of total supplies.

[Credit would also be given for students stating that the input tax relating to exempt activity was de-minimis under Reg 106 rather than Reg 105A. The business appears to have a residual percentage in the region of 85% and consequently the input tax attributable to exempt activity would also have met the Reg 106 de-minimis conditions]

The exempt input tax is within the de minimis limits.

2) VAT account using the cash accounting scheme

Turnover is below £1,350,000 and there is a good VAT compliance record.

	£	£
Output tax		4,400
Debtors		(2,200.00)
VAT payments received		1,800.00
Input tax		
Overhead expenses	1,100	
Creditors (all deductible – see below)	(240.00)	
Office expenses (all deductible – see below)	37.50	
Computer expenditure (all deductible- see below)	320.00	
		1,217.50
Tax payable		2,782.50

Since the computer purchase is by way of hire-purchase, it is dealt with outside the cash accounting scheme

Partial exemption calculation

Total input tax of £1,217.50 is below £625 per month on average and exempt income does not exceed 50% of total income

[Credit would also be given for students stating that the input tax relating to exempt activity was de-minimis under Reg 106 rather than Reg 105A. The business appears to have a residual percentage in the region of 85% and consequently the input tax attributable to exempt activity would also have met the Reg 106 de-minimis conditions]

The exempt input tax is within the de minimis limits

3) VAT account using the cash based flat-rate scheme

Annual turnover is less than £150,000 and it is likely that the business would fall into the category of 'Business services not listed elsewhere' which has a 12% rate.

Total VAT inclusive turnover 28,000 x 12% = £3,360
Turnover calculated as 22,000 – 11,000 + 9000 = 20,000 x 120% = 24,000 + 4,000 rent.

No input tax deductible
Computer expenditure not allowable since the
VAT inclusive value is less than £2,000

Tax payable: £3,360

Examiner's report:
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This question, which tested some basic principles of special schemes, caused difficulty for a number of candidates. Although appropriate calculations and illustrations were asked for, few did so.

Many candidates devoted a disproportionate amount of time to considering the annual accounting scheme and some candidates spent time considering various partial exemption methods even though it was clear that Mr Jay fell within the de-minimis limits.

Few candidates gave proper consideration to the prospect of recovery of fees incurred by the pension plan other than some general commentary on the rules for input tax deduction.

9. MR CREAM

1)

The company is not required to register for VAT under the test in para. 1(1) (b) Sch1 VATA 1994 since its expected taxable turnover in any future period of 30 days will not exceed the registration limit. However, the company exceeded the VAT registration limit of £85,000 under the test in para. 1(1) (a) Sch 1 VATA 1994 at the end of July 2020 when the cumulative turnover reached £87,754. It should have notified its liability to register to HMRC by 30 August and been registered with effect from 1 September 2020 under para. 5 Sch 1 VATA 1994.

Calculation of net tax due

	£
Output tax (£45,407 x 1/6)	7,568
Input tax on general expenses (£361 +£359 + £360)	(1,080)
Pre-incorporation expenses	-

Regulation 111(1) (b) S.I 1995/2518 gives HMRC a discretion to allow recovery of VAT on services prior to incorporation provided to a person who becomes a member, officer or employee of the company and receives reimbursement from the company. However, this is subject to the 6 month rule in regulation 111(2) (d). Since the services in relation to the business plan were supplied more than six months before the effective date of registration, no VAT is recoverable.

VAT on computer	(400)

VAT is recoverable on the purchase of the computer in accordance with regulations 111(1) (a) and 111(2) (b) S.I. 1995/2518 since the goods are still on hand at the date of registration and purchased less than 4 years prior to registration

Net tax	6,088

The amounts shown as VAT on the invoices issued by the company prior to its VAT registration are not due as VAT to HMRC since no tax was chargeable on any services provided prior to the company's date of registration. However, HMRC can recover these amounts under para. 5 Sch. 11 VATA 1994 as a debt due to the Crown.

2)

Since the company has failed to notify HMRC by 30 August 2020 of a liability to register for VAT, the company is liable to a penalty under para. 1 Sch. 41 FA 2008. The company is also liable to a penalty under para. 2 Sch. 41 FA 2008 in relation to the issue of invoices showing an amount attributable to VAT whilst an unauthorised person (not registered for VAT).

The penalty is calculated as a percentage of 'lost revenue'. The potential lost revenue in relation to the failure to notify the company's liability to register is the net tax due from the date the company should have been registered to the date the company notified HMRC i.e. from 1 September to 30 November 2020. The potential lost revenue in relation to the invoices is the amount shown as VAT on those invoices.

The level of the penalty is 100% for a deliberate and concealed failure, 70% for a deliberate but not concealed failure and 30% for any other failure. HMRC consider a failure to be deliberate if the company knew it was required to notify its liability to register and was able but chose not to do so. Since the company was unaware of its liability to notify, it is likely that the penalty for failure to notify its liability to register will be 30% of the net tax due which is £1,826. However, provided the company makes an unprompted disclosure of its failure to notify, that is to say it discloses the failure at a time when it has no reason to believe HMRC has or are about to discover the failure, the penalty may be reduced. A disclosure is made by telling HMRC of the failure, helping to quantify the VAT liability and giving HMRC access to the records to check the amount of tax due. In considering the quality of the unprompted disclosure, it is the practice of HMRC to allocate up to 30% of the possible total reduction for telling them of the failure, 40% for helping them and a further 30% for giving access to records. Depending on the timing, nature and extent of the disclosure, the penalty of 30% could be reduced to as low as £nil since less than 12 months has elapsed since the failure to notify.

Since the issue of the invoices is deliberate, the penalty is likely to be 70% of the amount shown on the invoices which is £500.00. An unprompted disclosure of the issue of the invoices could reduce the penalty to not less than 20%. The same consideration and weighting will be given to the quality of the disclosure in terms of telling, helping and giving access as for failure to notify. Interest may also be payable on the amounts of ‘VAT’ shown on the invoices.

HMRC must assess any penalty within 12 months of the expiry date of the appeal period for any tax due and it must be notified to the taxpayer. The penalty is then payable within 30 days. An appeal to the First Tier Tribunal may be made against both the imposition and amount of the penalty. An appeal against a penalty is treated in the same way as an appeal against an amount of tax due except that the penalty does not have to be paid before an appeal can be entertained.

Where a penalty is payable by the company in relation to a deliberate act or failure which is attributable to an officer of the company, that officer is liable to pay such portion of the penalty as HMRC may specify. Mr Cream himself therefore may be liable to a portion of the penalty in respect of the issue of VAT invoices prior to registration.

No penalties are payable if the failure is not deliberate and the company satisfies HMRC or the First-tier Tribunal on appeal that it has a reasonable excuse for the failure. Reasonable excuse for these purposes does not include insufficiency of funds, reliance on another person or continued failure to notify after the reasonable excuse has ceased. The issue of invoices would be considered a deliberate act and no reasonable excuse could apply in these circumstances.

It is also unlikely that the company has a reasonable excuse in relation to the failure to notify its liability to register since it had failed to take any steps to check its taxable turnover against the VAT registration limits.

Examiner's report:
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Most candidates made a good attempt at this question. Most identified the correct effective date of registration and calculated the arrears accurately, although some considered the pre-incorporation expenditure to be recoverable whereas in fact it fell outside the six month rule for services.

Most candidates dealt with the new penalty regime adequately although some confined their answer to a general commentary without considering the rules in the context of Mr Cream’s particular circumstances.

10. MR BLUE

Our address

Your address

2 November 2020

Dear Mr Blue

DEDUCTION OF INPUT TAX

Thank you for your letter which deals with a topical and contentious issue.

In order to claim a credit for input tax on professional services, a VAT registered business must broadly satisfy three conditions:

- Firstly, there must have been a supply of goods or services made to the claimant which is chargeable to VAT in the UK;
- Secondly, there must be evidence of the VAT charged in the form of a tax invoice or alternative evidence acceptable to HMRC; and
- Thirdly, the input tax must be used by the registered person for the purposes of his taxable business activities (broadly sales which are subject to VAT). I will consider these points in turn in the context of your situation.

<u>Is there a supply made in the UK subject to VAT?</u>

This aspect can be disposed of fairly easily. The tax invoices issued by the providers of professional services demonstrate that the services are provided by UK VAT registered suppliers, that the services are supplied in the UK and are subject to VAT.

<u>Did BBB Holdings Ltd receive the supply of services?</u>

Input tax can be deducted only by the person who received the supply and this may not be the person who paid for the services or holds the tax invoice. This point has been considered in a number of VAT Court cases.

It is an established VAT principle that the contractual position is not determinative of the supply position. In Commissioners of Customs & Excise v Reed Personnel Services Ltd, the point at issue was whether a nursing agency was supplying nurses as agent or principal. The High Court confirmed that whilst contractual arrangements govern the private law position, they do not necessarily define the supply position which is a matter of fact for a tribunal.

In Redrow Group Plc, Redrow met the charges of estate agents of sellers of existing properties who purchased a new house from Redrow. In deciding that Redrow was entitled to claim input tax, the House of Lords set out four key factors to consider:

- Whether some form of agreement exists between the supplier and the person seeking to claim input tax;
- Whether the person seeking to claim input tax has undertaken to pay for the services (and has paid for them);
- Whether the person claiming input tax has received something of value for his business which forms part of its onward taxable supplies of goods and services; and
- The fact that another party also receives a benefit as part of the same transaction does not deprive the claimant of the right to input tax deduction.

Redrow was applied in Mono Global Ltd, where company directors commissioned a report on the company's profitability. HMRC argued that the report was used by outside investors in determining whether to invest in the company. The Tribunal held that the company was the prime beneficiary and accordingly it was entitled to recover the VAT charged as input tax. Any benefit to outside investors was incidental.

The application of the Redrow case was also considered in the High Court decision of C & E v Jeancharm Ltd.

A company employed the son of its managing director, and provided him with a car, which was insured by the company for both private and business use. The son drove the car while drunk and was involved in a fatal accident. He pleaded guilty to causing death by dangerous driving and was sentenced to four years' imprisonment. The insurance company paid for the driver's defence, but paid the solicitors net of VAT. The company paid the VAT and reclaimed it as input tax. HMRC disallowed it as unrelated to the business.

The Tribunal allowed the company's appeal, but the High Court overturned the decision. The supply was made to the defendant not the business therefore the VAT was not the business's input tax.

In Newcastle United plc v CRC, Newcastle United Football Club said that it engaged footballers' agents in order to negotiate players' contracts. It remunerated the agents for the service. The agent charged VAT on its fees and the club claimed this as input tax. HMRC said that the agent did not represent the club, but rather supplied services to the player, regardless of who paid for those services. They disallowed the claim. The case was heard twice by the Tribunal after being returned by the High Court for further consideration and the second Tribunal allowed the appeal.

The above cases lend support to the view that the services of the solicitors and accountants jointly instructed by the three individuals as directors of BBB Holdings Ltd were supplied to the company for the purpose of its business notwithstanding that another party may also have enjoyed some benefit. In the case of the solicitors instructed by the bank, there is no direct contractual relationship between BBB Holdings Ltd and the solicitors.

The 2010 case of *Airtours Holiday Transport Ltd* should not have any bearing on this. In this case a large holiday company suffered financial difficulties, and agreed that a major accountancy firm (PwC) should liaise on its behalf with its banks, bondholders and other creditors, and prepare a detailed report on its financial status. The company reclaimed input tax in respect of the relevant supplies. HMRC issued assessments to recover the tax, on the basis that the supplies had actually been made to the company's creditors, rather than to the company itself.

The Courts did not consider that Airtours received any benefit for its business in the same way that Redrow did. It did not start by needing PwC's report to place before the institutions; the institutions started by wanting the report for themselves, as the agreement states. The benefit to Airtours was that PwC's report might lead to continued finance from the institutions for which Airtours was willing (or was forced) to pay. In reality, the institutions were contracting with PwC for the provision of the services, and the involvement of the company in the agreement was only in order to make sure that it had to pay for those services.

So, whilst Airtours shows that joint instructions will not always guarantee recovery, the circumstances are quite different to those of BBB Holdings. In Airtours the bank needed information to continue its financial support ie the bank instigated the appointment of PWC. In BBB it is seeking new funding and joint instructions should enable input recovery on those costs.

<u>Is there evidence to support input tax deduction?</u>

VAT regulations require that at the time of claiming input tax, the claimant must hold a tax invoice or such other evidence as H M Revenue & Customs direct. The invoices issued by the solicitors and accountants should satisfy the requirements of a VAT invoice but, for the avoidance of doubt the invoices should disclose the following:

1. An identifying number;
2. The tax point;
3. The date;
4. The name, address and VAT number of the supplier;
5. The name and address of client;
6. A description of the services; and
7. The amount payable, the VAT rate and VAT amount.

It appears that BBB Holdings Ltd will hold valid tax invoices addressed to the company to support input tax deduction.

In relation to invoices issued by the bank's solicitors, in Telent plc (formerly Marconi) the VAT Tribunal accepted that in accordance with Law Society rules, a solicitor can only invoice the client who instructed him. These invoices will therefore be addressed to the bank. However, HMRC do have discretion to accept alternative evidence to support input tax deduction by BBB Holdings Ltd and may exercise this discretion in favour of the company, but they are more likely to say that the solicitors' supplies were made to the bank therefore the input tax is not recoverable by BBB Holdings.

<u>Is the input tax used by BBB Holdings Ltd for the purposes of its taxable supplies?</u>

BBB Holdings became a member of the Green Holdings' VAT group registration and the invoices were issued once it had joined the group. Following the decision in Kingfisher, a VAT group is treated as a single taxable person with its supplies deemed to be made to or by the representative member. HMRC confirm in its partial exemption public notice that where a holding company incurs input tax on costs that do not relate to actual taxable or exempt supplies (for example, input tax on acquisition costs), this may be treated as part of the general overhead input tax of the VAT registration as a whole. This means that if the holding company is a member of a VAT group, the costs will be a general business expense of the whole group. Since the Green Holdings' VAT group makes only taxable supplies, VAT will be recoverable in full on the acquisition costs.

This situation is however very similar to the recent case of BAA Ltd. In this case ADIL was set up as the acquisition vehicle which subsequently joined the target group BAA after acquisition. The Court of Appeal ruled that ADIL had not carried on an economic activity at the relevant time. That time was when it incurred the liability to pay the VAT; at that point, its only intention was to take over BAA, which was an investment transaction within the principles of the *Polysar* case, rather than relating to an intention to make taxable supplies of goods or services.

The FTT had been wrong in law to find any connection between the inputs incurred by ADIL and the outputs later made by the BAA group. The inputs were only incurred in connection with the takeover of BAA, and were unconnected with any outward supply that either ADIL or BAA had intended at that time to make.

<u>Conclusion</u>

There are some arguments to support recovery of VAT, certainly on the costs of BBB Holding Ltd's own advisers. Unfortunately, the case of BAA Ltd is very similar to the situation under consideration and as a result HMRC are likely to rely on this decision to prevent the recovery of input tax.

You should also bear in mind that Finance Act 2007 introduced financial penalties for errors on VAT returns. In view of this, prior to making the input tax claim, we recommend you write to H M Revenue & Customs seeking agreement to the input tax deduction. We can draft a suitable letter for you. If H M Revenue & Customs refuse deduction, we can then consider whether to pursue the matter further by way of review and/or appeal.

Yours sincerely

A Tax Adviser

<u>Tutorial Note</u>:

Credit would be given for students discussing the impact LMUK may have on input tax recovery. Apportionment may be in point if part of the supply is deemed to be supplied to a third party rather than the claimant.

Examiner's report:
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Many candidates provided a very creditable answer to this question. Most demonstrated a good knowledge of the principles of input tax recovery, an awareness of recent case law developments and the ability to apply these to a practical situation.

11. WALRUS LTD

Our address

Your address

1 November 2020

Dear John

HMRC LETTER

Thank you for your recent letter enclosing HMRC correspondence. In relation to their challenge to your VAT recovery, this is based on whether or not the VAT you paid was properly chargeable as this is not always the case where a business is sold. I will therefore set out below the details of when the so-called Transfer of a Going Concern provisions apply:

<u>TOGC basic conditions</u>

Normally the sale of the assets of a VAT registered or VAT registerable business will be subject to VAT at the appropriate rate. Where certain conditions are met however, the sale of a business qualifies as a transfer of a business as a going concern for VAT purposes (‘TOGC’). This is then deemed neither a supply of goods nor a supply of services, falls outside the scope of VAT and therefore VAT is not chargeable.

The main conditions are:

- the assets must be sold as part of the transfer of a 'business' as a 'going concern';
- the assets are to be used by the purchaser with the intention of carrying on the same kind of 'business' as the seller (but not necessarily identical);
- where the seller is VAT-registered, the purchaser must be VAT-registered already or become so as the result of the transfer;
- in respect of land that would be standard-rated if it were supplied, the purchaser must notify HMRC that he has opted to tax the land by the relevant date, and must notify the seller that his option has not been disapplied by the same date;
- where only part of the 'business' is sold it must be capable of operating separately; and
- there must not be a series of immediately consecutive transfers of 'business'.

It is important to be aware that the TOGC rules are mandatory and not optional (ie, the vendor cannot choose to charge VAT) so it is important to establish from the outset whether the sale is or is not a TOGC.

If VAT is charged when it should not have been, as the purchaser you will not be able to reclaim this amount as input tax, because there was no taxable supply. The vendor should then cancel any tax invoice issued and provide you with a refund of the VAT charged. Normally this will be by issue of a credit note or document giving similar effect.

It seems that the officer is probably correct that both sales were of businesses as a going concern and VAT should not have been charged.

I suggest you contact Ming Ltd and Gordon Limited as soon as possible to effect recovery of the VAT that has been incorrectly charged.

Capital Goods Scheme – outline

Where a taxpayer incurs more than £250,000 + VAT on a capitalised refurbishment or on land and building assets, the asset thus purchased or created falls within the capital goods scheme. This requires the initial VAT recovery to be adjusted over 10 periods (usually annual) to reflect the use of the asset over its economic life.

Businesses' VAT years usually run to the end of March, April or May dependent on their VAT stagger. Adjustments to the initial VAT recovery on items caught under the scheme (leading to payments to or from HMRC) are usually reported in the second VAT return following the VAT year end. However, where you purchase an asset under the capital goods scheme as a TOGC, the sellers interval ends on the day before the transfer and adjustment intervals for the purchaser then run annually thereafter. Essentially the purchaser inherits the capital goods scheme from the seller but the remaining intervals run to the anniversary date of transfer.

Capital Goods Scheme – records

In addition to the standard record-keeping requirements for VAT of which you are aware, you are also required to keep the following records for the purposes of the Capital Goods Scheme:

- description of the capital item;
- value of the capital item;
- amount of input tax incurred on the capital item;
- the amount of input tax reclaimed by you on the capital item;
- the start and end date of each interval, including the first;
- when adjustments are due; and
- the date and value of disposal (if the item is sold before the end of the adjustment period).

Although records must only be kept for six years, it is advisable to maintain CGS records for as long as adjustments may be necessary.

Capital Goods Scheme - TOGC

If a capital item is transferred to you as part of a TOGC then you, as the new owner, assume responsibility for any adjustments of input tax required under the scheme for the remainder of the adjustment period. As purchaser you should have confirmed with the vendor of the Mercury Building whether it was covered by the scheme and details of the adjustments already made. The refurbishment carried out before your purchase sounds like it qualifies as a capital good scheme asset. Therefore, if the officer is correct that your insurance business is VAT exempt, you may need to repay some of the input tax claimed by the original owner on this previous refurbishment as it is still within the 10 year life of the scheme.

Capital Goods Scheme – refurbishment

In order to be sure that adjustments are needed, you should verify with the vendor what the refurbishment costs included and whether or not they were originally capitalised. If not capitalised, the expenditure would not fall within the scheme and you would have no adjustment to make.

Also, certain items of expenditure are not included – typically goods should only be included in the value to be adjusted if they become part of the fabric of the building. If the refurbishment value (taking into account the exclusions below) falls below £250,000, no adjustments will be due under the scheme.
It may be that the refurbishment actually involved items that did not become part of the fabric of the building and were later removed - which would perhaps explain why the building did not look "refurbished" when you purchased it.

<u>Lost or destroyed assets</u>

If the refurbishment has been stripped out since it occurred, then even if it did qualify under the scheme this would be counted as a destroyed or expired asset and no further adjustments would be needed in respect of the remaining complete scheme periods.

<u>Insurance intermediary exemption</u>

Of course, even if the refurbishment has not been stripped out and does fall within the scheme, an adjustment in relation to your occupation of one of the floors will only be necessary if the insurance introduction business carried on is properly VAT exempt as the officer alleges.

<u>Insurancewide</u>

The joined cases of Insurancewide and Trader Media concerned the VAT liability of click-through websites similar to your operations. The Court of Appeal concluded that, even where the role as insurance agent or broker was specifically disavowed by the company, the substance of what is done is more important in determining VAT liability. Whether a taxpayer is an insurance broker or agent depends on what they do.

The companies in the cases provided more than an advertising click-through service as they appraised and selected the insurers with whom they had referral agreements based on pricing and offering and their website captured information on the clients' requirements and matched these against appropriate potential insurance providers.
The services provided were therefore exempt as insurance intermediary activity. If your services are akin to those in these cases, it seems that, again, the officer is correct and an adjustment of VAT under the Capital Goods scheme will be due.

Given the lengthy fact-based nature of the case, I suggest we meet to discuss your business in more detail so that I can determine whether you fall within the exemption principles outlined therein.

Please do not hesitate to contact me should you have any further questions.

Yours sincerely

T Adviser

<u>Tutorial Note:</u>

Students should get credit for raising the issue of whether Walrus Ltd expected to occupy the property for an exempt purpose when they bought it from Gordon Ltd. Probably not so Walrus was correct to confirm that the option to tax would not be disapplied.

Examiner's report:
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Candidates were able to score well on the basic conditions for TOGC and the outline of how the Capital Goods Scheme operates. Better candidates considered the impact financially for the client and there were some useful illustrative calculations in that regard.

Most scripts picked up on Insurancewide, but there was variety in the level of detail provided, with some candidates losing potential marks by merely mentioning the case name without demonstrating a grasp of the basic underlying facts or arguments. The best responses tied the case to HMRC's policy to date as evidenced in the Public Notice.

12. SMALLCHANGE ACCOUNTING LTD

MEMORANDUM

To: Smallchange Accounting Ltd
From: T Advisor
Subject: Non Business/Private Use

In general, as previously discussed, input tax is VAT incurred for business purposes and only input tax is potentially recoverable through the VAT return (subject to partial exemption rules). UK legislation provides that where goods or services are purchased for use both for a business and a non-business purpose, the VAT should be apportioned, with only that proportion which relates to the business activity being treated as input tax [s 24(5) VATA 1994]

However, where a person incurs costs partly for business and partly for non-business use, he was until 2010, initially entitled to full input tax recovery if he wishes to apply the principle established in the Lennartz case by the Court of Justice of the European Union (CJEU). This is what I presume your clients are referring to.

The consequence of this initial full recovery was that, to the extent that the goods or services are later put to a private or non-business use, output tax will be due on the supply that is deemed to take place. These are the two sides of the so-called "Lennartz principle".

The application of the Lennartz principle in the UK has undergone a series of changes due to developments in European case-law and changing interpretation of the principle by HMRC.

From 22 January 2010 Lennartz was no longer available when there was non-business use. This effectively meant that charities could not use Lennartz on any purchases from that date – they had to apportion recovery under s.24(5). Consequently, when your charity bought the computer in 2019 they would not have been permitted to use Lennartz. The correct apportionment treatment was applied.

Further changes introduced by the EU and consequent UK legislation from 1 January 2011 mean that taxpayers buying land, property, ships, boats and other vessels or aircraft can only claim VAT to the extent that the asset is used for business purposes and subject to any partial exemption restriction.

As your sole trader incurred VAT on construction work in 2019 they too would not have been permitted to use Lennartz. The correct apportionment treatment was applied.

To accommodate any changes in the use of the asset, the Capital Goods Scheme has been widened from 1 January 2011 so that it not only caters for changes in the exempt/taxable use of an asset, but also the business/non-business use. This will be relevant for the charity's purchase of the £60,000 computer. Initial recovery will be based on taxable use in the year of purchase. If there is any change in the taxable to exempt/non-business use over the next four years the capital goods scheme will take account of those changes.

Your sole-trader client does not have an asset which is within the capital goods scheme. The client would have claimed a proportion of input tax in 2018 and as long as that was a reasonable claim no further adjustments will be required.

13. XESSUS LTD

1) Durdum Ltd

The issue of a credit note constitutes the adjustment of consideration for the supply under reg.38 SI 1995/2518 rather than a claim for bad debt relief or the correction of an error. The four-year time limit for s.80 VATA 1994 repayment claims or adjustment of errors does not apply to reg.38 adjustments.

The adjustment should be made using the same VAT rate as the original invoice. The VAT payable portion of the VAT account (and Box 1 of the VAT return) should be reduced by £8,575 (£50,000 x 98% x 17.5% which would have appeared on the original invoice) in the quarter to 30 April 2020.

2) Nampech Ltd

A bad debt relief claim can only be made between 6 months and 4 years + 6 months after the later of the time of the supply and the due date for payment of the debt (reg.165A SI 1995/2518). As the normal terms of trade applied, this period would have expired on 5 February 2020.

Unless the company can show that a later due date was formally agreed (unsuccessfully argued by the taxpayer in the case of Resteel Trading Ltd TC00185), no relief can now be claimed for this bad debt.

It is also not possible to obtain the same relief by issuing a credit note, because this would not represent a true adjustment to the consideration or a cancellation of the supply.

3) Madstop Ltd

The original invoice would have shown output tax of £12,000 (£60,000 x 20%) and a gross value of £72,000. This should have been the amount claimed in Box 4 in July 2017.

On receipt of £40,000, Xessus Ltd must repay a proportion of this by adding it to Box 1 of the current return (to 30 April 2020) in accordance with reg.171 SI 1995/2518. The "promise to pay the balance" has no effect until the money is actually received.

(40,000/72,000) x 12,000 = £6,667 due to HMRC

4) Anessam Ltd

Payments on account are allocated to the earliest supply first unless they are allocated by the debtor to a later supply and settle it in full (reg.170(2)). The payment of £40,000 should therefore be allocated to the earlier July 2019 invoice as the debtor nominated August 2019 invoice was not settled in full.

The outstanding amounts are then:

Date	Gross		VAT
	£		£
10 July 2019	8,000	(8,000/48,000) x 8,000 =	1,333
16 August 2019	60,000		Nil
18 September 2019	60,000		10,000
31 December 2019`	120,000		20,000

The claim cannot be made earlier than 6 months after the due date for payment, which fell 30 days after the invoice date in each case. The 30 April 2020 return can therefore include a claim for the July and September invoices, but the December invoice cannot be claimed until the July return.

Box 4: £1,333 + £10,000 = £11,333

MARKING GUIDE

TOPIC	***MARKS***
Durdum Ltd: *Reg 38 consideration adjustment (1), four year rule n/a (1), same VAT rate as original invoice (1), calculation of VAT (1)*	*4*
Nampech Ltd: *Time limits (1), no claim available as time limit expired 5/2/17 (1), later due date agreed? (1), credit note n/a (1)*	*4*
Madstop Ltd: *Original claim amount (1), Box 1 adjustment in Qtr 30/4/18 (1), £6,667 due (1)*	*3*
Anessam Ltd: *Allocated to earliest invoice (1), not invoice specific as not paid in full (1), correct allocation of the £40k (1), July and September invoices claimed on 30/4/18 return (1)*	*4*
TOTAL	***15***

Examiner's report:
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Answers to this question on bad debt relief were disappointing with few candidates demonstrating any experience of dealing with bad debt relief or ability to apply the law to different situations. It is basic examination technique to "answer the question". The question asks the candidates to "explain the correct VAT treatment of each of the above matters...setting out how any relief is claimed". It is unlikely that there are marks allocated for copying out s.36 VATA 1994, or for copying out sections of the regulations.

On the other hand, there clearly are marks for identifying the specific elements of the law that are relevant to the situations described; applying those relevant parts of the law to the situations; and stating explicitly how the relief is claimed or adjusted, e.g. in Box 4 for a bad debt claim and Box 1 for the reversal of a claim. Reciting all the rules at length is unlikely to leave enough time to deal with the specific scenarios that the examiner has chosen to test.

Only a few candidates properly appreciated the significance of the trade discount which is described at the end of the question – it affects the VAT charged on the supplies in (1) – (4). Those who ignored it still obtained credit for correct comments on slightly incorrect figures.

Two very straightforward points were missed by many candidates:

- *In (3), the invoice was for £60,000 plus VAT, but the receipt was £40,000. There is nothing in the question to suggest that anything more was received in respect of VAT. So the £40,000 is a gross amount. Too many candidates were unable to produce a sensible calculation of the clawback of bad debt relief in this circumstance.*

- *In (4), the due date for the September invoice falls in October; 6 months after mid-October is mid-April; a bad debt claim can be made in the return for the quarter to April. Several candidates identified that the due date for payment was relevant, but could not that 6 months after October falls in April. There is no substitute for taking proper care over basic calculations.*

There were a number of more technical points which only a few knew:

In (1), there is a crucial difference between an agreed reduction in consideration following a dispute, and a bad debt. Some appreciated that it is not possible to issue a credit note as an alternative to claiming bad debt relief, but did not understand that the credit note was appropriate in the circumstances described in the question, and would lead to a reduction in output tax rather than a claim in Box 4.

In (2), the legislation gives the time limit for making a claim as 4 years and 6 months from the due date for payment – not from the end of the return period in which the due date fell. Partial credit was given for identifying the cap as an issue, but this rule should be applied at face value rather than in some different way. A surprising number of candidates think that the time limit runs from the date the debt is written off in the accounts.

In (4), most candidates were aware that there is a rule about the allocation of payments to invoices (reg.170), but failed to read the whole of it and therefore did not realise that the customer's allocation would be ignored in these circumstances.

14. BILL SMITH

To: Mr B. Smith, Tax Manager, Blue Group
Subject: VAT implications of the provision of staff
From: A Tax Adviser
Date: 4 May 2020

General VAT position

The supply of staff employed by one company to another is subject to VAT. This was established some time ago by the Court of Appeal in the case of CCE v Tarmac Roadstone Holdings Ltd. This applies even where the companies are group companies and the contractual arrangements are with one company but require the employees to work for other group companies.

It is likely that HMRC have not identified this point in the Blue group since Blue Holdings plc is not VAT registered and will not therefore have been the subject of any assurance visits by officers of HMRC.

You therefore need to consider what steps to take to deal with the historic VAT position and also how to arrange matters in the future.

Historic position

Blue Holdings plc should have registered for VAT when the reimbursements for staff from other group companies had either exceeded the VAT registration limit or were expected to exceed the VAT registration limit in the next 30 days (para. 1(1) (a) or para. 1(1) (b) Sch 1 VATA 1994. The company should therefore review its turnover and the VAT registration limits and notify its liability to register to HMRC as soon as possible.

VAT will then be payable on the reimbursements received from group companies. Provision of staff is a continuous supply of services with a tax point arising at the earlier of receipt of payment or the issue of a tax invoice. Since Blue Holdings plc will not have issued any tax invoices, the tax point will arise at date of payment. The arrears will be calculated by applying the appropriate VAT fraction to the gross amounts received. Blue Holdings plc will be able to issue VAT invoices for these amounts to the group companies. Since these companies are fully taxable, they will be entitled to claim credit for these amounts as input tax.

However calculating arrears of VAT using the VAT fraction may leave Blue Holdings with insufficient funds to meet the VAT debt since the reimbursements received from other group companies will have been fully expended in paying salaries and other costs. To deal with this, depending on the agreements with the other group companies Blue Holdings plc could treat the reimbursements received as exclusive of VAT and issue VAT invoices for the additional amounts of VAT due at the rate prevailing at the time of supply but, in any event, the group companies will be able to recover these amounts.

As a result of registering for VAT, Blue Holdings plc will be entitled to credit on VAT paid on costs and expenses since its date of registration including VAT paid on any assets on hand at the date of registration and services received in the six months prior to the date of registration. This will allow recovery not only of VAT on the direct costs of administering the staff arrangements but also of other overhead costs and expenses, for example audit and accountancy costs, provided that Blue Ltd holds tax invoices or satisfactory alternative evidence to support a claim to recovery.

Since the failure to notify occurred sometime in 2017, Blue Holdings plc will be liable to a penalty for its failure to notify a liability to VAT registration. A full unprompted disclosure to HMRC accompanied by quantification of the arrears of tax would minimise the penalty.

<u>Future arrangements</u>

<u>Single VAT registration</u>

Blue Holdings plc can remain separately registered for VAT and charge VAT on the salary and other reimbursements from the group companies. The distribution and wholesale companies will be able to reclaim this VAT if Blue Holdings provides them with a tax invoice. There would be no net VAT cost therefore but there will be the administrative cost of arranging VAT payments and, depending on the VAT quarters of the group companies, there may be some cash flow disadvantage.

There is likely to be a VAT cost in relation to VAT charged to the financial services company since this company is likely to be totally or partially VAT exempt and will therefore have a restriction on its amount of recoverable VAT. This irrecoverable VAT would potentially be an allowable expense in computing taxable profits.

<u>VAT Group registration with the distribution and retail companies</u>

Since the group is under common control, Blue Holdings plc could, in the future, register as a VAT group with the existing companies. Members of a VAT group registration share a common VAT number and submit a single VAT return. No VAT is chargeable on services provided between members of a VAT group and therefore this would remove the administrative burden of Blue Holdings plc charging VAT and the other companies reclaiming the VAT from H M Revenue & Customs.

Since the VAT group would be fully taxable for VAT purposes, Blue Holdings plc could reclaim VAT on the costs of supplying staff as well as its other overhead costs.

However members of a VAT group are jointly and severally responsible for any VAT due by the group and all the member companies would have to be comfortable with this arrangement.

VAT would still be payable on reimbursements received from the financial services company and this is still likely to create a VAT cost if the financial services company cannot recover all the VAT on its costs.

<u>VAT group registration with the existing companies and the new financial services company.</u>

Formation of a VAT group registration with all the companies including the financial services company would not only remove the administrative requirement to charge and account for VAT on staff supplied to other group companies, but would also produce an actual VAT saving, in that it would not create any irrecoverable VAT in the financial services company since no VAT would be chargeable on staff provided to it.

HMRC have the power to refuse an application for VAT group registration on grounds of protection of the revenue. However, they have stated that they will not use this power when the saving flows from the normal consequences of VAT group registration, which is the case here.

There are also some anti-avoidance provisions which prevent the inclusion of joint venture companies in VAT groups but these provisions only apply where the joint venture company makes supplies to other group companies rather than receives supplies from other group companies, which is the case here.

However since a VAT group is treated as a single taxable person, exempt income of the financial services company will become income of the VAT group registration and may restrict recovery of VAT not only on costs of the financial services company but on overhead costs of the group. Partial exemption calculations will be necessary and it may be necessary to apply for a special method of apportioning input tax. Also since the financial services company includes a third party investor, there may be difficulties concerning agreement to joint and several liability for VAT due by the group as a whole.

VAT group registration including Blue Holdings plc and the financial services company

A VAT group registration could be formed between Blue Holdings plc and the new financial services company. This would avoid a loss of VAT on provision of staff to the financial services company, but the group would be partially exempt with a restriction on recovery of VAT on the direct costs of the financial services company as well as some possible restriction of VAT recovery on the overhead costs of the group.

Again the presence of the third party investor in the financial services company may be an obstacle to VAT grouping in view of the joint and several liability position noted above. It would still be necessary for Blue Holdings plc to account for VAT on the provision of staff to the other group companies although as noted above, the other companies should be able to claim an input tax credit for this VAT.

Joint contracts of employment

No VAT charge arises on the supply of staff between companies if the staff concerned have joint contracts of employment with both companies. However the present arrangements which simply require the employee to work for other group companies are not regarded as joint contracts of employment for this purpose.

A recent tribunal case has provided some guidance on the criteria for joint employment arrangements. In CGI (Europe) Ltd, the arrangements were held in substance and reality to be a supply of services rather than a supply of staff. However this is unlikely to be an issue in your case since the employees concerned work under the direction of the different group companies rather than under the control of Blue Holdings plc.

However the introduction of joint contracts of employment would raise a number of business issues, not least that the employees may acquire additional employment rights and your human resources division would have to consider this situation carefully.

Staff secondment concession

HMRC operate a concession in circumstances where staff are seconded from one company to another and the recipient company pays the employees' salary directly to the employee. Although strictly the satisfaction of another party's liability to pay salaries would amount to consideration, in these circumstances HMRC disregard the payments for the purpose of Value Added Tax.

The terms of the concession are that the employer must not be an employment business within the meaning of the Employment Agencies Act 1973 and the recipient business must:

a) exercise exclusive control over the allocation and performance of the employee's duties during the period of secondment;

b) be responsible for paying the employee's remuneration directly to the employee; and/or

c) discharge the employer's obligations to pay to any third party PAYE, NICs, pension contributions and similar payments relating to the employee.

The concession does not apply if the secondment of the employee is done with a view to the employer deriving any financial gain from the secondment or any other arrangements with the recipient business.

This raises the matter of whether Blue Holdings plc would fall within the definition of an employment business within the meaning of the Employment Agencies Act for the purposes of the VAT Statement of Practice and therefore be unable to benefit from the concession. An employment business is defined as a business of supplying persons in the employment of the person carrying on the business, to act for, and under the control of, other persons in any capacity. We could consider this position further if required.

<u>Conclusion</u>

The use of joint contracts of employment would raise a number of human resource issues, including asking all employees to sign new contracts and the provision of additional employment rights.

The staff secondment concession, even if available, would require the payroll functions to be carried out in the individual companies which would be counter to the group strategy and require substantial administrative change and duplication of tasks.

On balance, the best solution may be the formation of a VAT group including all the group companies. This would remove the administrative burden of issuing VAT invoices and create a real VAT saving in the case of staff provided to the financial services company.

This would also allow the holding company to recover at least a proportion of VAT on its overhead costs since, although the financial services company will introduce some exempt income into the group, there will also be a substantial amount of taxable income generated by the other group companies.

The main issue is that the third party investor in the financial services company would have to be comfortable with the joint and several liability provisions for group VAT. It may also be necessary to apply for a group partial exemption special method. Lastly, you would need to consider whether the formation of a group would bring the companies within the scope of the monthly payment of VAT on account rules.

Once you have considered our comments, we would be happy to carry out a feasibility exercise using projected values.

<u>Tutorial Note:</u>

It is doubtful whether this level of detail is achievable within the allotted time. Students should ensure they have covered the key issues rather than aim for the level of detail in the examiners answer. In particular the group registration point should be summarised more succinctly by students.

A good student answer would be structured as follows:

<u>Part 1</u>
- *SR supply of staff*
- *Late registration*

<u>Part 2</u>
- *Single VAT registration (not ideal for financial services company)*
- *Group VAT registration*
- *Joint employment contracts*
- *Staff secondment concession (briefly)*

Examiner's report:
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This question tested some basic concepts about supply of staff and alternative strategies to mitigate the VAT cost. A surprisingly high number of candidates failed to identify the standard-rated supplies of staff, some considering them to be exempt, outside the scope of VAT or even benefitting from the staff secondment concession (even though it was clear that a recharge was made).

A number of candidates considered a future structure without commenting on the historical position: as ever candidates will benefit from a careful reading of the requirements of the question.

Many candidates identified the opportunity for joint employment arrangements and the use of a VAT group. Some candidates wasted time by considering the position of 'pure' holding companies which was not in point since the company in question was making taxable supplies. Other candidates spent time dealing with the VAT grouping registration procedure which was clearly not required in the context of the question.

15. BTSKY LTD

Client:	BTSKY Ltd
Subject:	VAT Treatment of wholesale SMS services
Prepared by:	A Tax Adviser
Date:	4 May 2020

Background

Wholesale SMS services are regarded as wholesale telecommunication services by HMRC.

Under the normal VAT system, when a VAT registered business sells goods or services, it charges the customer VAT which the seller pays to HMRC. The seller also issues a VAT invoice to the customer and, if he is VAT registered and will use the goods or services for the purposes of his own sales which are subject to VAT, the customer can then reclaim the VAT paid to the seller from HMRC.

In some industry sectors however including trading in wholesale telecommunications, a form of VAT evasion known as "missing trader fraud" has emerged. In a typical "missing trader fraud", the seller does not pay the output VAT collected to HMRC but the purchaser is still entitled to reclaim it from HMRC. The result is that the Treasury is effectively financing the customer's VAT refund.

In response to the escalating threat of VAT fraud in connection with wholesale telecommunication services, the government introduced new legislation for the supply of wholesale telecommunication services within the UK with effect from 1 February 2016.

Reverse charge mechanism

From 1 February 2016 HMRC introduced a so called "reverse charge accounting mechanism" under which it is the customer, rather than the supplier, who accounts to HMRC for the output VAT on the wholesale supply of telecommunication services. There is no 'de minimis' rule excluding supplies under £5,000 as there is in the case of mobile telephones and computer chips.

Purchase of wholesale SMS services

The seller should not charge the company any VAT and obviously the company should not pay any VAT to the seller. The seller should provide you with an invoice indicating that the buyer will account for VAT (see below for details). The company must account for output tax on the purchases in box 1 of the VAT return but should not enter the value of the purchases in box 6. Since the company will use the purchase for the purposes of its taxable transactions i.e. an onward sale, the input tax on the reverse charge purchases can be reclaimed via box 4 of the VAT Return. This is not affected in any way by the arrangements under which the next purchaser will account for VAT under the reverse charge on the subsequent sale. The value of the purchases should be included in box 7 of the return. This procedure is essentially an accounting mechanism and will have no impact on the company's cash flow.

Sale of wholesale SMS services

The company should not charge VAT on the resale of the wholesale SMS services since the purchaser will account for VAT under the reverse charge mechanism. The company must issue an invoice showing all the information normally required to be shown on a VAT invoice and also annotate the invoice to make it clear that the reverse charge applies and that the customer is required to account for the VAT.

The amount of VAT due under the reverse charge rules must be clearly stated on the invoice but should not be included in the amount shown as total VAT charged. The precise wording is not prescribed in law and either of the following would be acceptable:

- customer to pay output tax of £X to HMRC
- UK customer to pay O/T of £X to HMRC

Alternatively, any of the following would also be acceptable, provided that the amount of VAT is shown elsewhere on the invoice (but not as total output tax charged):

- VAT Act 1994 Section 55A applies
- s55A VATA 94 applies
- customer to account for the VAT to HMRC
- reverse charge supply – customer to pay the VAT to HMRC
- customer to pay VAT to HMRC
- UK customer to pay VAT to HMRC

The company does not show any output tax due in box 1 of its VAT return but should enter the value of the sales in box 6.

The company will not be required to complete a Reverse Charge Sales List in relation to transactions falling under the reverse charge mechanism for wholesale telecommunication services.

The reverse charge mechanism would not apply when selling SMS services to a member of a corporate group for onward supply within that corporate group, and where the corporate group members consume the SMS services. Where BTSKY has received confirmation of such intent they should charge VAT to the corporate member.

Time of supply

The supply of telecommunication services is a continuous supply of services. The tax points are therefore the issue of a VAT invoice or the receipt of payment, whichever is earlier.

Please let me know if you require any further information.

Tutorial Note:

Tolley have updated the question to the cover the more recent reverse charge extension to wholesale telecommunication services. HMRC Brief 1/16 provides useful detail.

Examiner's report:
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This question originally tested the recently introduced reverse charge on trading in emissions allowances. A number of candidates simply reproduced the contents of HMRC brief 28/10, which addresses a related matter but is not directly on point. The question requirements were clear and again this illustrates that candidates must read the requirements carefully and answer them directly.

16. RED & YELLOW BRICKS LTD

Tax Adviser & Co
Our address

The Finance Director
Red & Yellow Bricks Ltd
Your address

4 May 2020

Dear Mr Jones

VAT TREATMENT OF PROPERTY TRANSACTIONS

Thank you for your letter. I have set out the VAT implications of the transactions below.

Sale of retail development to an investor

Ordinarily the sale of the new retail units would be subject to VAT since these are new commercial buildings and in any case an option to tax has been exercised over the development. This would enable the company to reclaim all the VAT incurred on the costs of the development.

However in some circumstances properties can be transferred free of VAT if the development is considered to be the transfer of a letting business as a going concern. In their published guidance, HMRC accept that, where agreements for lease have been signed, even though the tenants are not yet in occupation, a property letting business may be being carried on. They also accept that a property transfer that involves the sale of a mixture of let and unlet properties can also be eligible to be disregarded as a VAT supply under the transfer of going concern rules.

This relief (which is mandatory if the conditions are satisfied) applies where the purchaser is VAT registered or obliged to be registered at the effective date of the purchase and intends to use the assets for letting purposes. Since the retail units are new commercial properties and also opted, it is important that before completion of the sale, the purchaser confirm it will carry on the same or a similar business and that it notify HMRC of its option to tax the properties and also confirms in writing to you that its option to tax will not be disapplied by anti-avoidance provisions. This is unlikely to be in point in this case but should be confirmed. If any of these conditions are not met, VAT will be chargeable on the retail units.

If the transfer is treated as a going concern, the company will have to consider the position in relation to input tax on the development and on the expenses of the sale. Since the company has opted to tax the retail premises and intends to sell the units on long leases, all supplies from the developments will be or would have been fully taxable.

In view of this, there should be no restriction on recovery of VAT on the development costs. Similarly, since the disposal costs relate to a fully taxable development, HMRC now accept that input tax on these costs can also be recovered in full.

There will be no VAT consequences for the company from giving a rent guarantee. If payments are made under the terms of the guarantee, these will be compensation for loss of income rather than payment for any right over land. The investor should not charge VAT on any guarantee payments therefore. The only exception to this would be if the company acquires any rights of occupation in the property as a result of the guarantee payments. Similarly there will be no VAT implications of the rent adjustment.

Since the companies are connected, the value for SDLT purposes will be not less than the market value of the development, excluding VAT.

Sale to Housing Association

When a property has been opted to tax, the option normally extends to a disposal of the property. However an option to tax has no effect if the property is sold to a Housing Association which intends to build houses on the site. For this relief to apply, prior to completion, the purchaser must give a certificate on Form 1614G certifying that it is a registered housing association and that the land will be used for the construction of houses after any necessary demolition. This is a legal requirement.

The certificate must be given before the price for the grant to the recipient by the seller is legally fixed e.g. exchange of contracts. If the certificate is issued after this date, the seller is not obliged to accept the certificate but may do so at its discretion.

However this relief is only available for the part of the site which will be used for the construction of housing. VAT will still be payable on the part to be used for the retail complex and it will be necessary to agree an apportionment of the sale proceeds between the two parts. It is also likely that the road will fall within the definition of a new civil engineering work and be subject to mandatory VAT, irrespective of the effect of the option to tax. A value will also have to be apportioned to the road therefore. A tax invoice should be issued in relation to the parts which are subject to VAT.

VAT incurred on the construction of the road will remain recoverable in full since the sale of the road will be subject to VAT. However there will be clawback of a proportion of the VAT incurred on professional costs since the sale will now be part exempt (re dwellings) and part taxable (re retail). This will be repayable on the VAT return for the period in which it becomes apparent that their original taxable intentions would not be fulfilled.

The transaction will be exempt from SDLT provided the purchase is funded with the assistance of a public subsidy or the housing association is a non-profit registered provider of social housing or a registered social landlord controlled by its tenants.

Sale of building to a charity

An option to tax has no effect where a building is sold to a charity which confirms that the property or part of the property will be used solely for relevant charitable purposes other than as an office. Use for a relevant charitable purpose in this context means use by a charity otherwise than in the course or furtherance of a business.

There is no statutory requirement for the purchaser to provide a certificate of the intended use but, before completion, you should obtain written confirmation from the purchaser that it intends to use part of the building solely for a relevant charitable purpose.

H M Revenue & Customs interpret “use as an office” in the sense of a headquarters administrative office and the working office should be accepted as part of the charitable use. However the area used as a cafeteria is unlikely to qualify as charitable use. In applying the “solely” test, H M Revenue & Customs apply a de minimis level of 5% but this will be breached in this case.

Therefore the option to tax will not be excluded in relation to the cafeteria area. It will be necessary to apportion the sale proceeds therefore between the exempt part and the area subject to VAT, and a VAT invoice issued in respect of the non-charitable use area.

The sale of 90% of the building as VAT exempt will trigger a clawback of part of the VAT reclaimed on the purchase. The amount repayable will be calculated in accordance with the company’s partial exemption method and repayable on the VAT return for the period in which it becomes apparent that their original taxable intentions would not be fulfilled.

The sale will be exempt from stamp duty land tax provided the charity intends to use the greater part of the property for qualifying charitable purposes. The transaction must not have been entered into for the purpose of avoiding SDLT and the relief will be withdrawn if, within three years, the property is used other than for qualifying charitable purposes.

Construction of new office

VAT incurred on the purchase of materials for the new office will be recoverable but only to the extent permitted by the company's partial exemption method.

The use of in-house labour may give rise to a VAT charge under the provisions relating to the self-supply of construction services. Broadly these rules provide that where a person provides construction services to himself with an open market value of £100,000 or more, that person must charge himself VAT as if he had purchased the services from a third party. In this instance the VAT charge will arise on a market value of £140,000 and output tax of £28,000 must be accounted for on the return for the period in which the work is completed. However, as with the building materials, Red & Yellow Bricks Ltd will only recover a proportion of this VAT in accordance with the company's partial exemption method. The development will therefore give rise to a VAT cost in the company.

If the value of the materials and services exceed £250,000, adjustments to the amount of input tax reclaimed will be necessary each year in accordance with the capital items rules. We can advise further on this if required. There will be no SDLT consequences of this development.

Please do contact me if you require further information.

Yours sincerely

A Tax Adviser

Examiner's report:
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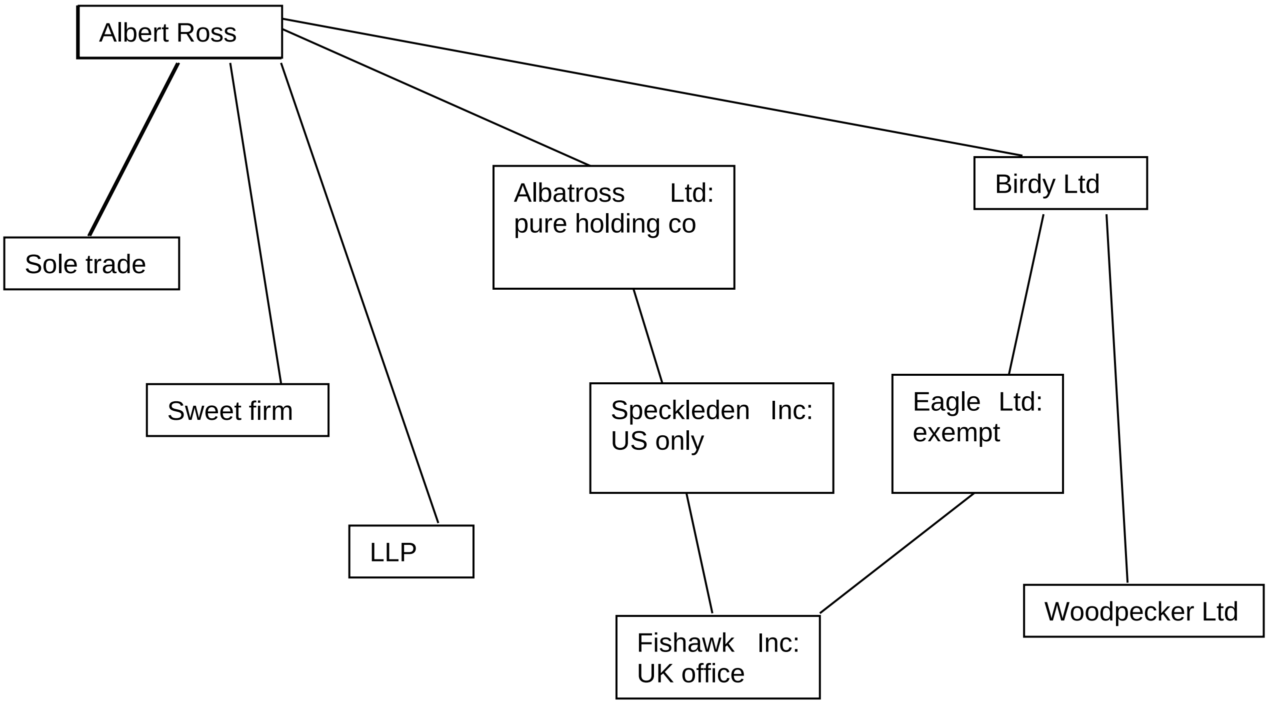
This question dealt with the VAT and SDLT treatment of various property transactions. It was disappointing that only a few candidates recognised the opportunity for transfer of going concern treatment in the first part of the question. A number of candidates spent time considering the possible disapplication of the option to tax under anti-avoidance rules even though it was clear that the connected company would not occupy the property.

Most candidates recognised the opportunity to disapply the option in relation to the sales to the housing association and the charity although some candidates overlooked the point that an apportionment was possible between exempt and taxable in relation to the charity sale.

Several candidates did not address the SDLT aspects of the question. The SDLT treatment was in fact relatively straightforward in most cases and many candidates could have earned additional marks by a quick reference to the SDLT legislation.

17. ALBERT ROSS



<u>Eligibility for grouping</u>

Group registration is permitted under s.43A VATA 1994 where two or more bodies corporate are established in or have a fixed establishment in the UK and are controlled by the same person, being an individual, business partnership or company, or one controls the other.

In this case, Albert Ross is the single person who can count as controlling bodies corporate which would then qualify under the above rule.

The sole trade and the partnership with Mrs Ross are not bodies corporate and therefore cannot be group registered.

The limited liability partnership is a body corporate and is controlled by Ross. It therefore appears to be eligible for grouping with other companies he controls.

Albatross Ltd is a pure holding company and is therefore not eligible for registration in its own right. However, UK policy is to allow such a company to be grouped with taxable trading companies. The European Commission did not believe that this was compatible with the VAT Directive and had instituted infringement proceedings against the UK (and several other member states) at the Court of Justice of the European Union (CJEU). In 2013 the CJEU ruled that the UK practice was compatible with the VAT Directive hence confirming that holding companies can be grouped with trading subsidiaries.

Speckleden Inc appears to have no UK establishment and therefore cannot be part of a UK VAT group.

Birdy Ltd meets the control and establishment criteria and can be grouped.

Eagle Ltd is wholly exempt and therefore not eligible for registration in its own right. Once again, UK policy allows it to be grouped with other companies.

Woodpecker Ltd is not controlled by Ross (the indirect holding of 50% is not enough). It is therefore not eligible for grouping. It may however be included if Birdy Ltd has the casting shareholder vote or has the right to appoint or remove a majority of its board of directors.

Fishawk Inc is controlled by Ross (effectively 100% through control of two 50% holdings). Provided the UK office constitutes a "fixed establishment" (sufficient human and technical resources to make or receive supplies), it is eligible for grouping. This appears likely as it must be one of the 6 businesses currently separately registered for VAT.

<u>Summary</u>

Eligible: LLP, Albatross Ltd, Birdy Ltd, Eagle Ltd, Fishawk Inc

Not eligible: sole trade, partnership with wife, Speckleden Inc, Woodpecker Ltd

Bonus point: including an exempt company such as Eagle should be considered carefully. It may increase recovery in respect of overheads of that company, and avoid the need to charge VAT on intra-group supplies which that company could not recover; but it may also restrict recovery on group overheads because the exempt turnover would have to be taken into account.

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This was a relatively easy question, but the marks still had to be earned by applying the law correctly. Once again, candidates should read the question and consider whether it is appropriate to copy out the legislation: a mark might be given for a good statement of the conditions in s.43A, but the much more important part of the answer was to apply those conditions to the different businesses described.

Some of the basic errors which appeared too often were:

- *writing down that members of a group have to be "bodies corporate", but then including the sole trade consultancy and the partnership with the wife (which cannot be a body corporate, given that it is contrasted with a LLP described in the next point in the question);*
- *failing to give a conclusion on whether a company could be in or out*
- *failing to consider whether Fishawk's UK office would constitute a fixed establishment*
- *including a company in which the group held only 50%. It is possible that a 50% shareholder might also have a casting vote, and a bonus mark was given for mentioning this.*

A bonus mark was given for accurate description of the infraction proceedings currently being taken against the UK by the Commission and for describing the significance for these companies.

18. STRONGWINDS

Our address

Your Address

1 November 2020

Dear Sirs

VAT IMPLICATIONS OF WIND FARM DEVELOPMENT

Thank you for your letter concerning the above development. I have set out my comments on the VAT consequences below.

Strongwinds Ltd

Future supplies of energy from this development will be taxable supplies i.e. they will be subject to VAT. VAT registration is mandatory when the company's cumulative turnover in any period of 12 months exceeds the VAT registration limit of £85,000, or if at any time it expects its turnover will exceed the registration limit in the following 30 days.

Strongwinds Ltd's initial funding has come from equity investment and loans, neither of which constitutes taxable supplies for the purposes of VAT registration. However, consideration should be given to the treatment of the grant income. This type of payment will only give rise to a VAT liability when it constitutes consideration for supplies of goods or services (see the case of Keeping Newcastle Warm). In Strongwinds Ltd's case, the grant does not subsidise any services supplied by the company; Strongwinds Ltd is merely required to comply with the conditions attached to the use of the funds. In these circumstances therefore the grant payments are outside the scope of VAT. Since Strongwinds Ltd will not make taxable supplies until 2022 therefore, there is presently no legal requirement for the company to register for VAT.

However Strongwinds Ltd has already incurred VAT on professional costs and is likely to incur substantial amounts of VAT on the acquisition of sites and construction costs prior to any sales being made. Once a company is VAT registered, it can reclaim VAT on all costs which relate to its taxable supplies and may also reclaim VAT incurred prior to registration on goods on hand and services received in the six months prior to registration. If Strongwinds Ltd delays registering for VAT until it breaches the mandatory VAT registration threshold, once registered it is likely to be able to recover VAT incurred on site costs since freehold land is considered to be "goods" for this purpose. However much of the VAT incurred on professional and contractors' services may fall outside the 6 month limit with the result that the VAT may not be recoverable and become an additional cost for the project. In any event, for cash flow purposes, it would be useful for Strongwinds Ltd to be able to reclaim credit for VAT spent as the project develops.

In order to recover VAT payable on development costs, Strongwinds Ltd can apply for VAT registration as an 'intending trader'. It was established some years ago in the Court of Justice of the European Union (CJEU) in a case called Rompelman that a person who carries on activities preparatory to the making of taxable supplies is to be treated as carrying on a business and entitled to be registered for VAT. This entitlement is now contained in UK VAT law. In order to be registered as an intending trader, the company should provide HMRC with objective evidence of its intention to make taxable supplies in the future. The feasibility study commissioned by the company, application for planning permission and documents relating to the acquisition of sites should be sufficient for this purpose. It is not necessary for the company to evidence the exact date when it will commence making taxable supplies or the value of the supplies.

Subject to satisfactory evidence, intending traders are normally registered for VAT from the date of their application. However it is possible with the agreement of HMRC to be registered from an earlier date. This date cannot be more than 4 years prior to the date of the application. An application for a retrospective date must be made at the time of the application since the date of registration cannot be amended later. The objective evidence referred to earlier must also show that the company was carrying preparatory business activities at the date requested. The company should therefore consider an application to register from 1 September 2018 (or within six months of this date) since this would allow recovery of VAT incurred to date on development costs.

If the company registers for VAT with effect from 1 September 2018 (say), it will be able to claim repayment of VAT incurred on previous and future costs. This VAT recovery is subject to the company holding proper VAT invoices in respect of items of expenditure but will not be restricted as a consequence of the receipt of grant income. This VAT can be reclaimed through the company's VAT returns. Since the company will not pay any VAT on sales until 2021, it may be beneficial for the company to make an application to submit VAT returns on a monthly basis rather than quarterly which is the normal procedure. This will assist cash flow in the development stages and the company can revert to quarterly returns at a later date.

Eastwinds plc

The rent and service charges made by Eastwinds plc to Strongwinds are exempt from VAT, the service charges being seen as further consideration for the lease as long as they are provided under the terms of the lease. These amounts do not count for the purpose of assessing liability to VAT registration. Charges for telephone and computer services would potentially be subject to VAT but are presently below the registration limits. These services are categorised as continuous supplies of services for VAT purposes and a tax point (the time at which VAT becomes chargeable) will arise when payment is made. By the time payment is made by Strongwinds, these amounts may have reached a level which ordinarily would create a liability for Eastwinds to register for VAT since a business has a requirement to register at any time if its expected turnover in the following 30 days will exceed the VAT registration threshold. However the Court of Appeal has held in B J Rice and Associates that the continuous supply of services provisions cannot operate to bring into charge services performed before the date of VAT registration. Since future charges by Eastwinds plc are likely to fall below the VAT registration limits, there will be no requirement for Eastwinds plc to register for VAT. Even if any VAT were chargeable, it would be reclaimable by Strongwinds Ltd with no resulting net cost.

If Eastwinds plc does not register for VAT, it follows that it will be unable to reclaim any VAT on costs and expenses. In the future, therefore Eastwinds plc may wish to consider a VAT group registration with Strongwinds Ltd, nominating Strongwinds Ltd as the representative member of the group. A single VAT number would apply to the two companies and Strongwinds Ltd, as representative member, could deal with the administrative requirement to submit VAT returns. No VAT would arise on any recharges from Eastwinds plc to Strongwinds Ltd, regardless of the level of the charges. Since members of a VAT group of companies are treated as a single entity for VAT purposes, this arrangement would entitle Eastwinds plc to recover VAT on future expenditure. You should be aware however that this arrangement would also make Eastwinds jointly and severally liable for any VAT due from Strongwinds Ltd.

Project not completing

In the event that the project does not proceed because the company is unable to obtain the necessary planning permissions/licences and the sites are sold, the company will need to consider the VAT consequences. Ordinarily the sale of land is exempt from VAT and in the case of Strongwinds Ltd, this would result in a clawback of any VAT reclaimed on the purchase of the sites.

This could be avoided by the company opting to charge VAT on the sale of the land and we can provide further information on the mechanism for opting to tax if required. The company will also have to de-register for VAT since it will no longer have an intention to make supplies subject to VAT. This will give rise to a number of VAT issues. Provided the intention to trade is frustrated by matters outside the control of the company, generally it will not be required to repay any of the VAT it has reclaimed. However a consequence of VAT de-registration is that any assets held by the company will be deemed to be sold to the company at their market value at the date of registration. This would create a deemed exempt sale of the land with similar consequences to an exempt sale of the land i.e. a clawback of VAT reclaimed on the purchase. A taxable sale of the land using an option to tax prior to de-registration is clearly desirable therefore. Any other assets held by Strongwinds Ltd will also be deemed to be sold to the company at the date of registration giving rise to a possible further VAT cost. However VAT is waived if the amount involved is £1,000 or less.

<u>Sale of the business</u>

The VAT consequences of a sale of the business will depend on whether Eastwinds plc sells the shares in Strongwinds Ltd or Strongwinds Ltd sells the business as an asset sale. If a disposal is by way of a share sale, the VAT registration of Strongwinds Ltd will continue uninterrupted provided it is a single company registration and Strongwinds Ltd will continue to reclaim VAT and account for VAT on future sales through its existing VAT number. If a VAT group registration is in place, however this will have to be cancelled since the control requirements will no longer be met and each company will have to address its own future VAT registration position. Following the sale, Eastwinds plc will have no liability for any VAT due from Strongwinds plc subject to any warranties and indemnities in the sale contract. Any VAT incurred on the costs of the sale will not be recoverable by Eastwinds plc.

If Strongwinds Ltd sells the wind farm business and assets, in principle the assets will each be subject to VAT at the relevant rate. However where a business is sold as a going concern, the assets may be sold free of VAT subject to conditions. These are principally that the new owner is VAT registered or becomes liable to register for VAT as a result of the business transfer and the new owner will use the assets in the same kind of business. The wind farms will be classed as civil engineering works and therefore would ordinarily be subject to VAT on a sale in the first three years following completion of construction. In view of this an additional rule applies on a transfer of a going concern which is that the purchaser must notify an ‘option to tax’ over the wind farms to HMRC prior to the transfer. We can provide further detail on this if required but Strongwinds should ask to see evidence of the option to tax.

Once it has sold the business, Strongwinds Ltd will have to de-register from VAT unless it intends to carry on another taxable business activity. If the company has retained any assets, it will need to consider whether a VAT charge will arise on de-registration as noted in the comments about the project not completing. VAT incurred on the costs of the sale of the business which are invoiced after de-registration may be reclaimed by an application to H M Revenue & Customs on form 427.

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This question offered some straightforward marks to candidates who had a good knowledge of the VAT registration rules. Some candidates restricted their answer to a general commentary on the rules and did not score highly as a result. Candidates should always apply their knowledge of statute and case law to the facts presented in the question. Candidates who achieved high marks provided a thorough explanation of the conditions for intending trader registration and their relevance in this case.

The last part of the question requirement indicated that 5 marks were available for the answer but few candidates provided sufficient detail in this part to secure full marks.

19. WILL JACKSON

Your Address Our Address
Date

Dear Will

VAT ASSESSMENTS

Thank you for your letter of 1 November. I have set out below my comments on the points you raised.

<u>The rules</u>

HMRCs power to raise assessments is set out in s.73 VAT Act 1994. If they believe that a VAT return is wrong, they can raise an assessment “to the best of their judgement” to correct the amount declared by the trader. The courts have considered what is meant by “to best judgement” many times, and have specifically approved the use of extrapolation. HMRC are not required to identify every transaction as a trader should do when accounting for VAT; provided they have some evidence on which to base the assessment, and have used that evidence honestly and logically, the assessment will be in principle valid.

Assessments are also subject to time limits. An assessment can always be raised within 2 years of the end of a return period. In the absence of dishonesty, an assessment cannot be raised more than 4 years after the end of a return period. In between 2 and 4 years, HMRC are not allowed to raise an assessment more than 12 months after having all the facts in their possession which are sufficient to base the assessment on – or, to put it another way, they must show that they have discovered an important fact in the 12 months leading up to the issue of an assessment. If they have not learned anything new in the last 12 months, they cannot raise an assessment more than 2 years after the end of the period.

<u>Application to your situation</u>

It appears that the assessments raised for the periods to March and June 2016 are out of time as 28 September 2020 is more than 4 years after the end of those periods. HMRC should readily accept this and vacate the assessments.

It also appears that the assessment for September 2016 is out of time because, from the information you have provided, it can only be based on evidence that HMRC have had for more than 12 months. It is required to be based on evidence; you have not provided anything new since March 2018; they must therefore have had all the information they required for more than a year. They may try to argue that they discovered a material fact during the last year – if so it will be necessary to consider that and respond. However, past cases have established that a court decision is not something that will “start the clock again”. They should not have been taken by surprise by the court decision in March 2020: they should have raised assessments for past periods long before that.

You say that you have written to query the assessments. Please fax me a copy of the letter you sent so I can see how you expressed that query. It is likely that HMRC will in any case interpret your query as asking for a formal review of the decision to assess, but that is what you should ask for within the 30 day period. HMRC should then confirm or amend the decision within a further 45 days, whereupon you have the right to appeal to the First-tier Tribunal if still not satisfied. If HMRC fail to complete the review in 45 days (and do not ask for an extension of time), you must lodge an appeal within 30 days of the time running out (their failure to give a response is treated as confirmation of the original decision).

In my view, a review is likely to result in the vacation of all three assessments, but there is an outside possibility that they may try to defend the one for September 2016. The review will have to specify the grounds on which the decision to assess is justified, so we will be able to consider whether it is worth appealing.

Request for information

HMRC must raise an assessment for the December 2016 period no later than 31 December 2020 to satisfy the 4 year deadline. However, they must also obtain further facts within the 12 months leading up to the assessment. This is an awkward situation for you: if you answer their questions, you will validate the assessment. If you delay or fail to co-operate, you could make it impossible for them to raise an assessment, but you have to consider whether that is a proper course of action.

Officers of HMRC have the power to require taxpayers to provide information or produce documents if that is “reasonably required” to enable the officer to check the taxpayer’s tax position (para.1 Sch 36 FA 2008). If an informal request does not produce the answers, the officer can issue an “information notice” which specifies a time limit for production (which must again be “reasonable”).

The power to require information and documents is not time restricted. The opening of an enquiry into a self assessment return is a very specific rule, and it is not even clear whether how the Sch 36 FA 2008 power relates to it. There is certainly no such limitation for a VAT enquiry. Given that you have lost a case in the Court of Appeal and were therefore on notice that HMRC disagreed with your position and were likely to want to assess in respect of that disagreement, I do not think that it would be possible to argue successfully that the request for this information was “unreasonable”. Even if your accounts department is busy leading up to Christmas, I believe that they could make the point that the information should be relatively easy to identify the supplies that were treated as zero-rated, and if they have given you several weeks’ notice you cannot claim that the deadline is unreasonable.

Penalties and interest

If you have to pay VAT for a past period on the basis of an assessment, you will certainly be charged interest from the due date from that earlier period until settlement. HMRC regard interest as mere “commercial restitution”, without requiring any blame to attach to the late payment.

All the returns fall under the new penalty regime. Under the new regime a penalty requires “careless” or “deliberate” understatement of the VAT liability. While you had a VAT Tribunal decision in your favour, it could not be said that continuing to treat the supplies as zero-rated was “careless”. So it would be possible to resist penalties on that basis.

However, the situation changed when you lost the argument in the Court of Appeal. HMRC can then argue that you knew that the earlier returns were wrong and you should have made adjustments accordingly. In March 2020, all the periods that they want to assess were still in time for you to make a voluntary disclosure to correct the VAT. This is an area in which the rules have recently changed and there is as yet no case law, so it is hard to be sure about how the courts will view the matter. On the one hand, when you made the returns they were based on a reasonable view of the law supported by a Tribunal decision; on the other hand, failing to correct them after the Court of Appeal’s judgment could be regarded as “deliberate understatement”.

In my view, the failure to make the adjustment – effectively, waiting for HMRC to make an assessment, which they have then failed to do – cannot be penalised in this way. However, returns for periods which were submitted after the Court of Appeal judgment should certainly be filed in accordance with that judgment, or they would be open to penalties.

Conclusion

I trust that this information is useful to you. If you wish to clarify anything further, please do not hesitate to contact me. If you require any assistance in dealing with the out-of-time assessments, I will be happy to help.

Yours sincerely,

Chris Turpin

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It was pleasing that some candidates (sadly, only a very small minority) could identify a case that was relevant to these facts – the Weight Watchers decision made this a reasonably topical subject. Dealing with assessments and time limits is always an important practical matter, but it seems that candidates are not comfortable discussing these rules. Overall answers to this question were poor.

A minority of candidates gave a clear and accurate explanation of the time limits – 2 years, 12 months and 4 years – and how they interact with each other. Although the better answers identified that the 4 year time limit ruled out some of the assessments, almost no-one could apply the 12 month rule to the facts. This is an important principle and should be better known. A startling number of candidates did not even refer to the four year time limit (which was fairly well signposted by the raising of an assessment for September 2015 on 28 September 2019).

Candidates should remember that a client only wants relevant information in a letter and therefore commenting on the time limits for assessment where fraud and criminal conduct is concerned was not required.

Some candidates were aware of one of the more tricky points that was tested here. HMRC get one year from the knowledge of facts sufficient to raise an assessment. It has been held in court that a court decision is not something that starts the one year clock running – it is not a new piece of information for HMRC, because it only confirms what they thought the law was. It isn't a 'fact' in relation to the client. They should have raised protective assessments for the periods concerned while they were arguing the case in court. There were some good discussions which suggested that some candidates knew what a protective assessment is.

There were variable answers on the question of 'best judgement' in assessments. One point that is widely misunderstood: the expression is derived from s.73 VATA 1994, not from the court's decision in the Van Boeckel case. That court decision helped us to understand what the statutory expression means in practice. These distinctions are important – if you are arguing a point of law with HMRC, you need to know what the law is, and why.

Bonus marks were given for other reasonable points raised in answers, such as the requirement to pay disputed tax before the Tribunal will hear an appeal (but not while a review is going on), and also the suggestion that the client asks for more time to provide the requested information.

Candidates should be aware that a vague comment such as 'interest will be due' is unlikely to gain any marks (even if the correct statutory reference is given) – it is necessary to give some further details, such as the date that interest will start to accrue and when it will stop. This is a letter to a client: what client would be happy to be told something so uninformative?

20. FARMER GILES

To: colleague@taxadvisers.co.uk
From: an.adviser@taxadvisers.co.uk
Date and time: xxx
Subject: Farmer Giles and Sir Archie Fettrich

Thank you for your e-mail. I have set out below my views on the VAT aspects of these two situations.

1) Farmer Giles

The first question is whether the cash coming in from LFSS should have been put through Farmer Giles' company VAT return. It appears that the activities are kept separate; however, if company assets are used to support LFSS' activities, HMRC could argue that it is an extension of the company's business. In that case, they would assess for output tax on supplies going back four years (and would allow input tax on related costs to be deducted). Penalties are likely to be 30% for careless error under Sch 24 FA 2007, but HMRC might argue that the omission was deliberate with a 70% penalty tariff.

As long as company assets are not used, it should be possible to resist such an argument. The next question is whether HMRC could require registration by a business splitting direction under paras. 1A/2 Sch 1 VATA 1994. This seems relatively unlikely as there does not appear to be any artificial separation of activities which are more naturally regarded as one: if Farmer Giles' own land was used, a direction might be sustained, but this appears to be something quite separate from his farming business. A direction would only have effect from the date it is issued.

The third issue is whether Farmer Giles should register LFSS either as an unincorporated association or as a sole trade. It appears to be a business within the definition of s.94(2)(a) VATA 1994 (the provision by a club or association for a subscription or other consideration of the facilities or advantages available to its members), It is not clear whether it has exceeded the registration threshold in the last year (£4,000 x 20 = £80,000; the threshold is £85,000), but it may have done so before that, in particular in the first year when the contributions were higher. If it should have registered and failed to do so, urgent action will be required to minimise exposure to penalties.

On the other hand, there is a strong argument that this is not a business activity at all. It is similar to the facts of the *Lord Fisher* case, because Farmer Giles himself takes part and pays his own contribution. Although it satisfies many of the tests of business activity established in that case (mentioned below in more detail), it could be strongly argued that the LFSS is not "primarily concerned with making supplies for a consideration". There are differences (in particular, the fact that Giles has to buy in and apparently supply on the shooting rights), but these were held to be unimportant in the similar recent Tribunal case of *EG Harrison* (TC01205). In my view, any attempt by HMRC to charge VAT on this activity could be resisted.

Even if HMRC were to argue successfully that LFSS is making supplies for a consideration, it could also be argued that they qualify for exemption under the cost sharing exemption within VATA 1994 Schedule 9 Group 16.

Tutorial Note:

It would have been reasonable to start with the business v non-business discussion and conclude non-business based on Lord Fisher principles. An outline of registration and aggregation could then follow just in case the business argument prevailed.

2) Sir Archie Fettrich

By contrast with Farmer Giles, Sir Archie has treated his hunting activities as business. It appears that he makes a large loss (the cost of the helicopter, even spread over a number of years, must substantially exceed the revenue from selling meat), so HMRC might argue that it is not "economic activity" and therefore does not justify a deduction of input tax.

The tests of a business which were set down in *Lord Fisher* are:

1. Is the activity a serious undertaking earnestly pursued?

2. Is there a reasonable measure of continuity?

3. Is there a certain measure of substance in the turnover?

4. Is the activity conducted in a regular manner in accordance with recognised business principles?

5. Is the activity predominantly concerned with making supplies for a consideration?

6. Are the taxable supplies that are made similar to those made by people who seek to profit from them?

1, 2 and 6 are clearly satisfied. The possible points of argument are:

3. The turnover is small, but Sir Archie says he hopes to increase it. It is certainly not insignificant.

4. The fact that the costs appear likely always to exceed the revenues may count against this being a "sound business". However, it is not essential to make a profit for VAT to be charged and recovered, as long as taxable supplies are made for a consideration.

5. It appears that the activity is mainly concerned with making supplies for consideration – the sales of meat. HMRC might make something under 4 and 5 of the fact that Sir Archie does not charge people to take part in the hunting – a "sound business" might do so to maximise its revenue. However, it may be that assistance in the hunting is worth as much as Sir Archie might otherwise charge.

Overall, it appears that this is a business activity for VAT purposes and input tax is in principle deductible. In the fairly similar case of *Mark Ziani de Ferranti* (TC01288), the Tribunal accepted that input tax on a helicopter was deductible on the basis of zero-rated sales of venison.

There are two other issues which HMRC can raise. The first is the private use of the helicopter. There is no question that a percentage should have been disallowed on the purchase, as the *Lennartz* approach (100% claim upfront) is not permitted for purchase of aircraft after 1 January 2011. This ought to be notified to HMRC without delay to minimise the client's exposure to penalties. On the facts stated, the disallowance should be 20% (private use) x 20% x £300,000 = £12,000; there should be a similar disallowance of running expenses since then. Claiming 100% on an asset with private use might not be regarded as 'careless' but 'deliberate behaviour' with a higher penalty rate; unprompted disclosure will only reduce the penalty to zero if the error counts as careless.

As the helicopter was purchased after 1 January 2011, it falls within the revised Capital Goods Scheme. Differences in private use over a five year period should be reflected in CGS adjustments each year. If 80% of the input tax was originally properly claimed on the basis of an expectation of the private/business split, the actual private use in the year to 31 March 2020 should be compared with this and an adjustment made accordingly in the return to September 2020.

The second point is whether there is a barter transaction with the friends who take part in the hunting for no apparent consideration. They are providing a service to Sir Archie in return for something for which he might charge them. It is unlikely that any valuation of this has been agreed between the parties; using the principles of the *Empire Stores* case, the barter would have to be valued according to the costs which Sir Archie is prepared to pay out in order to obtain the services. It is not clear that there are such costs (as the business does not bear any expenses for the participants), so it would be hard for HMRC to sustain an assessment based on barter.

Tutorial Note:

It would have been reasonable to focus on the Ferranti case rather than Lord Fisher and then expand on other areas such as Lennartz, apportionment, CGS, disclosure, penalties etc.

Examiner Note:

There were a large number of points and issues in this question and more marks were available on the marking guide than the 15 maximum for the question. A good score would be obtained by a candidate who identified a range of issues and discussed them sensibly. It was not necessary to identify and discuss everything that appears in the model answer, or write about them so fully.

MARKING GUIDE

TOPIC	***MARKS***
1) LFSS	
Part of farming company business?	*1*
Business splitting direction?	*1*
Sole trade/association	*1*
Mention of s.94	*1*
Registration threshold considered	*1*
Lord Fisher	*1*
Possible bonus mark for good statement of Lord Fisher tests	*1*
Bonus mark for mention of recent case (Harrison)	*1*
Cost sharing exemption	*1*
Maximum for part 1) (9 marks available)	*8*
2) Sir Archie Fettrich	
Basic issue: economic activity or not?	*1*
Consideration of Lord Fisher tests Conclusion – either way, as long as justified	*3*
by discussion	*1*
Bonus mark for mention of de Ferranti case	*1*
Private use of helicopter identified as a problem	*1*
Correct treatment: disallowance (not Lennartz) and CGS	*1*
Discussion of barter	*1*
Maximum for part 2) (9 marks available)	*8*
TOTAL (MAX – in theory 16 marks available for 1 + 2)	***15***

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There were a number of issues which candidates could identify and comment on in each of the two scenarios that would have earned marks. Too many candidates failed to identify the full range of issues, and too many made basic mistakes.

Several candidates were aware of the recent cases (Harrison and de Ferranti) which were highly relevant to these situations. Not all could accurately recall the outcomes of those cases – both went in favour of the taxpayers and would have been helpful to the clients in this question.

The section on the helicopter was generally well done, with most candidates correctly stating that Lennartz accounting is no longer possible and noting that the capital goods scheme should be applied. However, only a minority followed through to note that the client had therefore overclaimed £12,000 of input tax, and hardly anyone suggested that something should be done about this – it is too large for an adjustment through the VAT account, so a voluntary disclosure would be essential.

It was also good to see many candidates being able to reproduce the 6 tests of a business from the Lord Fisher case. However, it was surprising that many concluded from this that the first taxpayer was probably in business – some specifically commented that Lord Fisher had been held to be carrying on a business, which is not the case.

Several commented on the advantages of voluntary registration for the first taxpayer. It ought to be obvious that the output tax liability would exceed the input tax recoverable – the business just about breaks even, it has non-VATable costs, and the customers cannot recover VAT charged to them. Surely a VAT advisor must understand that basic point – it cannot be advantageous to be registered. The contrast with the second taxpayer, who has zero-rated outputs and therefore wants to be able to treat the activity as business, ought to be obvious.

21. FRESCO PLC

1) Payments on account

The amount of POA is set by SI 1993/2001. The reference period for the year to 31 March 2020 will be the four quarters to 30 September 2019 (art.11(a)(a)). The total payments on returns for those four quarters is £4.4m, so the POA due on 31 May 2020 is: £4.4m/24 = £183,333

2) Revising payments on account

Under SI 1993/2001 art.13, POA can be reduced if the VAT liability for any four quarters ending after the end of the reference period is less than 80% of the liability for the reference period. The four quarters to 31 March 2020 have a total liability of £3.4m, so as VAT manager I could apply to have the POA due on 31 May 2020 reduced to: £3.4m/24 = £141,667

As long as my application is made in sufficient time for HMRC to approve the reduced payment before 31 May, the reduction can apply immediately after their approval.

3) Default surcharge

POA traders are liable to default surcharge under s.59A VATA 1994. The late submission of the return in September 2019 will have triggered the issue of a surcharge liability notice which runs until September 2020. The late payment of a POA due on 31 March 2020 is the first default in the surcharge period and is therefore subject to a 2% surcharge. The amount of £4,000 therefore appears to be correct.

It is unlikely that the circumstances can constitute a reasonable excuse. The accounts department appear to have been merely careless. The fact that a surcharge liability notice is in force should make them particularly aware of the need to take care.

The other defence which has featured in many recent surcharge cases is the argument that the penalty is “disproportionate” and therefore contrary to the principles of EU law. HMRC do not accept that this is valid, as Parliament created the rules of s.59 VATA 1994 and UK traders are subject to the will of Parliament. However, in the case of *Enersys Ltd*, the First-Tier Tribunal chairman declared that he could not in good conscience confirm a penalty of over £130,000 for a trader being one day late making a payment.

There have been many unsuccessful attempts by traders to apply the Enersys decision. Total Technology (Engineering) Limited was one of the few cases that successfully applied Enersys but this decision has now been reversed – a penalty cannot be dismissed simply because it is harsh. The penalty would need to be “manifestly unfair” to be overturned but this is proving very restrictive in its application. It is therefore likely that the surcharge will have to be paid.

The more recent case of Posnett approved a default surcharge penalty of £217, 701 for being one day late so it very much seems like Enersys was a one-off. The penalty will more than likely stand.

Examiner Note:

“Payments on account” is a non-core area of the syllabus. Accordingly, time has been allowed in this question for the candidates to find the rules in SI 1993/2001 and apply them.

MARKING GUIDE

TOPIC	***MARKS***
1)	
Reference period	*1*
Calculation	*1*
Correct statement of rules/reference to legislation	*1*
Sub-total	*3*
2)	
Explanation of rule	*1*
New reference period	*1*
Calculation	*1*
Sub-total	*3*
3)	
Consideration of whether surcharge is correct	*1*
Reasonable excuse?	*1*
Disproportionate - discussed	*2*
Sub-total	*4*
TOTAL	***10***

Examiner's report:
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The first 6 marks on this question were for a non-core area of the syllabus, so time was allowed for candidates to look up the regulation and remind themselves of the rules. Needless to say, this required the candidates to know that there would be a regulation and to have some awareness of the rules which could be refreshed. Some candidates appeared never to have heard of POA for large traders; others were unable to identify the significance of the 'reference period' for calculating POA, without which the difference between part (1) and part (2) was impossible to see.

Many candidates wrote a great deal for the 4 marks on default surcharge – too much. However much they were expecting to see 'disproportionality' come up in the exam, they could surely only earn 3 of the 4 marks for writing about it. In the event, more was required – a consideration of reasonable excuse and confirmation that the surcharge had been correctly issued would both be important in practice.

Most candidates were well prepared to discuss the principles of Enersys and did so reasonably well. Some were over-optimistic that the argument would succeed, which seems unlikely here. Several quoted the highly relevant case of St. Gobain, but more than one believed that the company had succeeded in getting its surcharge overturned – that was not so.

22. BARN CONVERSIONS

Mr H Baggins
Sunningdale Farm
Burford
Oxon OX54 3HA

8 May 2020

Dear Horace

VAT & SDLT – BARN CONVERSIONS

Thank you for your letter of 1 May

<u>Conversion of the Haycroft and Burford barns</u>

I propose to deal with the position in relation to Haycroft and Burford barns initially as the position is relatively straight forward.

Contrary to what the builder has said, provided that the necessary planning consents/building approvals for the conversion works have been obtained and they result in essentially self contained dwelling, they will be subject to VAT at the reduced rate of 5%, as opposed to standard rated. The fact that the consent relating to Burford Barn restricts its use to the provision of accommodation to a farm worker will not preclude VAT relief.

VAT incurred on Burford Barn will be recoverable in full since the building will be used in the course of the partnership's business.

The gift of the freehold interest in Haycroft Barn to Lizzie will represent a deemed zero rated supply by the partnership of a converted dwelling, and accordingly it will be entitled to recover in full VAT associated with the supply.

In the absence of any form of consideration passing from Lizzie to Jane and yourself for the converted barn, there will be no charge to SDLT.

Alternatively, the unconverted barn could be taken out of the partnership. The conversion could then be undertaken privately and any VAT incurred on the conversion would be recovered via the DIY housebuilder scheme.

<u>Windrush Barn</u>

You have advised that on completion of the works to Windrush Barn the units will be rented to small enterprises and, for very good reasons, the partnership is averse to charging VAT on the lettings. That being so, the leases will be VAT exempt and, in principle, VAT incurred on expenses directly and indirectly associated with these supplies ("exempt input tax") will be irrecoverable.

However, the legislation provides an administrative easement which allows a VAT registered trader to recover in full exempt input tax which is, on average no more than £625 p.m. (£1,875 a VAT quarter), and does not exceed 50% of all input tax incurred in a VAT quarter. Invariably VAT on expenses do not accrue evenly over a longer period, so the legislation allows taxpayers at the end of their "tax year" (I explain the scope of this later) to recalculate the exempt input tax incurred and if it is less than £7,500 (£625 x 12), recover the tax in full.

Where the annual de minimis limit of £7,500 is met, but exempt input tax has not been claimed for the VAT accounting periods falling within the tax year because the monthly/quarterly de minimis limit were breached, this tax may be recovered in full by making an entry either on the taxpayer's VAT return for the final accounting period of the tax year, or on its return for the first accounting period in the following tax year. Conversely, where a taxpayer has met the de minimis limit in a VAT accounting period(s) within a tax year, but over the full tax year the annual de minimis limit of £7,500 is breached, exempt input tax previously claimed must be refunded to HMRC.

The partnership's tax year will be the 12 months to 31 March unless it has agreed another period with HMRC - you should satisfy yourself on this point. In the first tax year in which a VAT registered person incurs exempt input tax, the annual de minimis limit of £7,500 is prorated - assuming the builder renders his first invoice in respect of Windrush Barn in November 2020, the annual de minimis limit for the partnership's tax year 2020/21 will be £3,125 (£7,500 x 5/12).

During the partnership's tax years 2020/21 and 2021/22 it will not be making any exempt supplies, so the only exempt input tax will be that arising on the builder's invoices for the works to Windrush Barn. However in the tax year 2022/23, it will be making exempt supplies to the value of £30,000, as well as taxable supplies. In that tax year, the exempt input tax incurred by the partnership will include not only the VAT charged on the builder's Windrush Barn invoices but also (a) VAT on expenses directly relating to securing tenants, for example, agents' and solicitors' fees and (b) a small amount of VAT on the partnership's overhead expenses which may be said to be fairly and reasonably attributable to the exempt supplies made in 2022/23.

You have advised that VAT incurred on the partnership's general overheads is of the order of £12,000 p.a. Given that the value of VAT exempt annual rents from the letting of the units is expected to be £30,000 in 2022/23, and taxable supplies made by the partnership will be of the order of £2,000,000, the proportion of exempt supplies to the total value of all projected supplies is, rounded down, 1% (i.e. £30,000/2,030,000). On this basis, the VAT arising on the partnership overhead expenses which could be said to be fairly and reasonably attributable to the partnership's exempt supplies in 2022/23 will be, on average, £120 p.a. (£30 per quarter).

Proceeding on the basis that the builder invoices the partnership for work done on Windrush Barn in line with the schedule set out in your letter, by way of an illustration of the rules that I have outlined:

Quarter/ tax year to:	"Exempt input tax"			De minimis limit	Exempt input tax recoverable?	Adjustment to VAT return
	Overhead expenses	Builder's charges	Total			
	£	£	£	£		£
12/20		1,000	1,000	1,250	Yes	
3/21		2,000	2,000	1,875	No	
6/21		1,600	1,600	1,875	Yes	
Tax year 20/21		3,000	3,000	3,125	Yes	Reclaim 1,875
9/21		2,400	2,400	1,875	No	
12/21		2,000	2,000	1,875	No	
3/22		4,000	4,000	1,875	No	
6/22	30	3,000	3,030	1,875	No	
Tax year 21/22		10,000	10,000	7,500	No	
Tax year 22/23	30	3,000	3,030	7,500	Yes	Reclaim 3,030

Although the de minimis limit will be met in the VAT accounting period ending 31 December 2020, it will be breached in the quarter for the VAT period ending 31 March 2021. However, when the adjustment for the tax year 2020/21 is made, the tax previously disallowed in the March 2021 quarter may be reclaimed when the partnership submits its 30 June 2021 return.

Although on the face of it, the majority of the VAT to be incurred on Windrush Barn will be irrecoverable, all is not lost. As the tax point of the builder's services in relation to the Barn is the earlier of payment or the issue of a tax invoice, should he be prepared to vary the tax points, the de minimis limits could be met. For example, if the builder were to delay invoicing say, £15,000 of his March 2022 invoice until June 2022, although the exempt input tax on the greater invoiced sum would not be recoverable that quarter, it would become recoverable when the 2022/23 adjustment came to be made.

While the rules are complex, I hope that I have illustrated that by careful attention to detail, the partnership may be able to recover VAT of £16,000 which may otherwise be lost.

My analysis above is premised on the basis that the builder will issue separate invoices for his work. On the other hand if he were to issue a single invoice each month for the work done to all the barns without distinguishing the quantum relating to each building, under general principles the VAT charged would fall to be treated as a general overhead, and given that the partnership would not be making exempt supplies in the tax years 2020/21 and 2021/22 and the proportion of exempt supplies to the total value of supplies made in 2022/23 would be just 1%, the partnership would be able to recover all of the input tax incurred on the builders' works. Although there is anti-avoidance legislation which over rides the application of what is known as the standard partial exemption method, it will not apply here because the level of exempt input tax claimed is insufficiently high to trigger its application.

Finally, turning to SDLT, given that the net present value of the rents payable over the terms of the leases will not, on the figures that you have mentioned, exceed £150,000, SDLT will not be payable.

I hope that I have covered the issues that you have raised in your letter fully.

Best wishes
Sara

Tutorial Note:

Annual calculations would have been given equal credit to the quarterly calculations given the time constraints in the question.

MARKING GUIDE

TOPIC	***MARKS***
Presentation of response	*1*
Haycroft and Burford Barns	
(a) identifying the liability status of the builder's services on works to Haycroft and Burford Barns	*1*
(b) recovery of VAT charged on Burford Barn	*1*
(c) identifying deemed zero rated supply of Haycroft Barn and right to claim associated input tax	*2*
(d) SDLT treatment of transfer of freehold of Haycroft Barn.	*1*
Windrush Barn	
Application of de minimis limits to input tax incurred on Windrush Barn:	
(a) implications for partnership of making exempt supplies and the requirement that it attribute input tax;	*1*
(b) identifying monthly and annual de minimis limits and tests	*1*
(c) application of de minimis limit to periods 12/20 and 6/21	*1*
(d) application of de minimis limit to periods 3/20, 9/21 - 6/22	*2*
(f) longer period calculation for 2020/21 and how adjustment to be effected (NB candidates must display knowledge of how the de minimis limit for 2020/21 is arrived at - no marks are to be awarded if a candidate assumes that it is £7,500)	*2*
(g) longer period calculations 2021/22and 2022/23 on the basis that payment schedule is maintained and how the adjustments are to be effected	*2*
(h) identifying variation to payment schedule to ensure full recovery of all input tax incurred	*2*
(i) identifying option of treating all VAT incurred on builder's invoices as non attributable and the application of the over-ride	*2*
(j) application of SDLT to leases	*1*
TOTAL	***20***

23. AXCESS

MEMORANDUM

From: Douglas Manager
To: Dermot Partner

Dear Dermot

AXCESS

I refer to your note of 1 May.

Exemption - welfare services

Under UK VAT law, the provision of welfare services by a charity is exempt from VAT by virtue of item 9, Schedule 9, VATA 1994. "Welfare services" are defined in note 6 of Group 7 as "services directly connected with (a) the provision of care ... or instruction designed to promote the physical or mental welfare of ... disabled persons or (b) the care or protection of children and young persons".

The equivalent provisions under EU law are contained in Article 132(g) and (h) of the Principal VAT Directive. They extend exemption to "the supply of services ... closely linked to welfare and social security work" and "the supply of services ... closely linked to the protection of children and young persons" by bodies governed by public law - they include charities.

While the Courts interpret the exemptions narrowly, the Court of Justice of the Eueopean Union (CJEU) in *EC v Germany* [2002] EUECT Case C-287/00 ruled that the exemptions should not be interpreted especially narrowly if it will result in an increased cost in the delivery of social services.

As will be apparent, exemption under EU law is wider in its scope than UK law covering as it does all services linked to social security work, as opposed to care, etc services. The Courts are required to interpret UK VAT law in a manner which makes it consistent with EU law. Accordingly, exemption applies to all services supplied by a charity which are directly linked to social security work.

That being so, I consider that the services described in paragraphs (1) and (2) of your memorandum qualify for exemption, although under a strict interpretation of UK law, exemption probably would only extend to the services described in paragraph (1). Should the value of the contract relating to "sibling days" be significant, there may be merit in asking HMRC to confirm in writing that the service is VAT exempt on the analysis that I have set out.

Development of database

Although supplies by a charity of "welfare advice or information" is chargeable to VAT at the reduced rate (Group 9, Schedule 7A, VATA 1994) - here it seems doubtful that Axcess is supplying such a service, but rather it is providing consultancy services. If so, these services will be chargeable to VAT at the standard rate. On the face of it, VAT charged by AXcess will be reclaimable by the LA under the provisions of s33, VATA 1994.

Recovery of VAT on works to school buildings

The provision of education by, among other entities, a school (as defined in the Education Act 1996) or essentially a non profit making body which applies surpluses arising from its educational activities in furtherance of them is VAT exempt - VATA 1994, Schedule 9, Group 6. Accordingly, were AXcess to deliver the service, its service would be exempt and it will be unable to recover VAT arising on the proposed works.

There are two alternative mechanisms perhaps open to AXcess:

1) the LA contract for the works to be carried out before the school is transferred to AXcess and the works are funded by Axcess indirectly by say, an adjustment being made to the payments that it would otherwise receive for the delivery of the services on the LA's behalf. Under this proposal, the LA may be able to recover the VAT charged under the rules pertaining to LAs, but there are likely to be a number of technical impediments to overcome and intuitively I expect that the LA would not be keen to proceed on this basis unless it was the only option open to it;

2) you say that the LA has a statutory responsibility to provide these educational services in which case all VAT incurred by it will be recoverable under the terms of s.33 of the VAT Act. That being so, I suggest that instead of AXcess supplying the educational services, they be supplied by a trading subsidiary which does not have "eligible body" status.

In these circumstances, its services will be standard rated, as opposed to exempt, thereby allowing the trading subsidiary to recover in full VAT on expenses associated with the delivery of the service. It is essential that the trading company has the necessary human and technical resources to provide the service. While HMRC may invoke the principle abuse of law to strike down the arrangements, this type of arrangement has been adopted by other charities and HMRC officers have gone along with them. In any case, it is doubtful whether the principle of abuse of law would necessarily apply in these circumstances.

I hope that this note meets your immediate requirements.

Regards,

Doug

MARKING GUIDE

TOPIC	***MARKS***
Identifying scope of VAT exemption on welfare services:	
(a) item 9, Group 7, Schedule 9 VATA 1994	*1*
(b) "welfare services"	*1*
(c) EC law Art 132(g) & (h) of the Principal VAT Directive	*1*
(d) UK law to give effect to EU law and, on the face of it EU law is wider in its scope	*2*
(e) Conclusion on scope of exemption on welfare services	*2*
VAT status of services relating to assistance in developing a database and recovery of tax charged by LA	*2*
Recovery of VAT on building works:	
(a) Supply of educational services by AXcess exempt with no right to recover associated input tax	*2*
(b) Identifying solutions which enable AXcess to proceed with bid, for example:	
(i) LA undertakes the works and recovers the VAT;	
(ii) Provision of services through wholly owned subsidiary of AXcess which does not have eligible body status.	*4*
(up to 4 marks to be awarded at the discretion of the examiner based on the solutions offered by candidates and their likely efficacy)	
TOTAL	***15***

Examiner's report:
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(a) only a minority of candidates identified that the services set out in paragraphs (1) and (2) of Dermot's memorandum were possibly exempt as the provision of "welfare" services and then went on to analyse the scope of the exemption. No candidates considered whether the equivalent provision in the Principal VAT Directive allowed AXcess to exempt services supplied in relation to the "sibling days". Credit was given where candidates identified that the services might qualify for exemption as educational services. Similarly credit was given where candidates considered - and concluded - that the supplies might be outside the scope of VAT, with discretionary marks awarded for a full analysis as to why this could be a tenable alternative.

(b) no candidate identified that the supply in paragraph (3) of Dermot's memorandum could be subject to the reduced rate (Group 9, Schedule 7A, VATA 1994)

(c) the final part of the question was not handled well - possibly on account of time pressure.

IPT ANSWERS

24. HOME REPAIRS LTD

£100 insurance policy sold to householders

- IPT is only due on risks in the UK. This includes the policies sold in GB, which includes the Scilly Isles, but not the ROI, the Isle of Man or the Channel Islands.

- Thus, 20,500 taxable policies have been sold. The rate of IPT due is 12%.

- Although the items insured are domestic appliances, none of the premium goes to the vendor of the appliances; Home Repairs Ltd is not connected to the vendor of the appliances and is not a supplier of domestic appliances.

- The amounts received are inclusive of IPT so the amount of IPT due is £219,643 (20,500 x 100 x 3/28).

Insurance policy sold to hotel group

- The consideration for the insurance for IPT purposes will include the interest fee that is charged (s.72(1) FA 1994). Thus, the premium will be £20,730.

- The premium needs to be apportioned between the hotels in the Republic of Ireland and the UK. S.69 Finance Act 1994 requires the apportionment to be fair and reasonable.

- It would be possible to apportion this between the number of hotels, 80/20 but as the cost of insurance in the Republic of Ireland is higher this needs to be taken into account and a weighting needs to be applied for the 10% higher cost.

- This means that the proportion of the fee relating to the UK is £16,259 (20,730 x 80/102).

- As the premium is a gross cost, the IPT due is £1,742 (3/28 x £16,259). (The rate is 12% as the same principle as detailed above for the individual householders applies here)

Free warranty on kettles for fee of £10,000 a year

- There is no IPT due on the free warranties or administration fee (not contracts of insurance).

Extended warranty on kettles

- The extended warranties sold by Black Pots Ltd will be subject to IPT at the higher rate.

- This is because the insurance is arranged through the vendor of the goods who receives a proportion of the income (para.3(2) Sch.6A FA 1994).

- The full £10 is subject to IPT as there is no deduction for any commissions retained. As the premium is a gross amount the amount of IPT due is £1,250 (7,500 x 1/6).

Sale of extended warranties by Home Repairs Ltd

- The higher rate does not apply to the sale of the extended warranties by Home Repairs Ltd.

- This is because the contract is not arranged through the vendor, Home Repairs Ltd is not connected to Black Pots Ltd and no fee is paid to Black Pots Ltd in connection with this contract.

- As the premium is a gross amount the amount of IPT due is £1,286 (10 x 1,200 x 3/28).

- HMRC may argue that the fee charged for administering the free warranties has been reduced to enable Home Repairs to get access to the database.

- This reduction could be argued as being consideration payable to Black Pots Ltd; a fee paid to Black Pots Ltd in connection with the contract.

- If that argument is successful, the higher rate is applicable on the extended warranties sold by Home Repairs Ltd (para.3(2)(c) Sch.6A FA 1994).

MARKING GUIDE

TOPIC	***MARKS***
General points	
– IPT only due on UK risks	*½*
– Definition of the UK	*½*
Policies sold to householders	
– Number of policies liable to IPT	*½*
– Rate of IPT – 12%	*½*
– Justification for standard rate	*½*
– Premiums IPT inclusive	*½*
– Calculation of IPT	*½*
Policy sold to hotel	
– Includes interest	*½*
– Calculation of premium	*½*
– Need to apportion premium for overseas risk	*½*
– Apportion fair and reasonable	*½*
– Apportionment for number of hotels and cost higher in Republic of Ireland	*½*
– Calculation of UK premium	*½*
– Calculation of IPT – 12% rate	*½*
Free warranties/admin fee	
– No IPT as not contracts of insurance	*½*
Extended warranties through Black Pots	
– Liable to IPT at higher rate	*½*
– Justification of higher rate	*½*
– No deduction for commission	*½*
– Calculation of IPT	*½*
Extended warranties sold by Home Repairs	
– Liable to IPT at standard rate	*½*
– Justification of standard rate	*½*
– Calculation of premium	*½*
– Calculation of IPT	*½*
Final points	
– Total IPT due	*½*
– HMRC arguments about administration fee being consideration and therefore higher rate applies	*2*
TOTAL (MAX)	***10***

25. MLU

MEMORANDUM

To: Direct tax team
From: T Adviser (Indirect tax)
Re: IPT Implications
Date: xx/xx/xx

IPT – arrangement and administration fee

Legislation was inserted into FA 1994 (which applies to premiums received on or after 24 March 2010) and whether these types of fees have to be included in the amount of the premium for IPT purposes. Prior to this date, the High Court case of Homeserve applied to determine the amount of the premium. This memo will look at the current position only as the client has only been providing these policies for the past five years.

Current position

As stated above, legislation was enacted into the FA 1994 and this effectively reversed the Homeserve decision. The premium does not include a commission or fee which is provided under a ‘separate contract’. A sub-section was inserted into s.72 which clarifies the meaning of a ‘separate contract.’

Where four conditions are satisfied, the contract is not treated as separate.

This is where:

1) An individual enters into the contract;

2) That individual is required to enter into the administration contract as a condition of entering into the insurance contract;

3) The amount charged to the individual for the administration fee is not open to negotiation by them; and

4) The amount charged to the individual under the insurance contract is arrived at without a comprehensive assessment having been undertaken of the individual’s circumstances that might affect the level of risk

Thompson Limited and MLU (whose model looks highly comparable to that of the case of Homeserve) should look at the conditions in the legislation and if each one is satisfied then MLU should have applied IPT on the £15 administration fee, as it is treated as part of the premium.

Note that HMRC can generally go back four years to collect underpayments of IPT (unless the loss of IPT was brought about deliberately, in which case there is a 20-year time limit). Therefore, assuming that if any underpayments have been made (and assuming they aren’t deliberate), HMRC will only be able to collect the IPT on them for the last four years.

Boiler warranties

The higher rate of IPT will apply to an insurance premium relating to certain electrical domestic appliances if the contract is arranged through or supplied by, inter alia, a person who pays a portion of the premium to the supplier [Sch 6A FA 1994 para 3(2)(c)(i)]. This would seem to cover Thompson Ltd and they are registrable for IPT as a taxable intermediary under s.53AA FA 1994 with a requirement to account for the higher rate of IPT on the fee charged to the insured.

Late registration

A person who fails to notify HMRC that he is liable to be IPT-registered faces a penalty of a maximum 30% of the potential lost revenue (where the failure is due to a careless mistake).

Thompson Ltd could face this penalty unless they can demonstrate that there was a reasonable excuse for their failure to notify. This cannot include insufficiency of funds or reliance on another person (eg, accountant, advisor).

Insurer's position

MLU will need to account for the higher rate in respect of the whole premium (including the portion paid away to the boiler supplier) in the case of the extended warranties. In relation to the plumbing and heating cover, it can continue to account for IPT at the standard rate on the amount charged for the cover, including the administration fee charged by Thompson Limited, if the contract is not "separate" for IPT purposes.

Tutorial Note:

All relevant points would receive credit. For example, mentioning:

- *that the location of the risk determines the liability to IPT and not the location of the insurer*
- *that the Belgian company could appoint a tax representative if it wished (although this is not obligatory)*
- *mentioning the Policy Administration Services case*
- *mentioning that penalties can apply to any incorrect returns and that prompt disclosure could reduce them*

MARKING GUIDE

TOPIC	***MARKS***
Memo format	*½*
<u>Introduction</u>	
Only providing policies for five years, so current position (from 24.3.10) is the only one relevant	*1*
Legislation defines whether the fee is included	*½*
<u>Current position</u>	
Reversal of Homeserve in legislation	*1*
Four conditions	*2*
<u>Boiler warranties</u>	
Higher rate	*1*
Why higher rate applies	*1*
Taxable intermediary	*1*
<u>Late registration</u>	
Max 30% penalty	*1*
<u>Insurer's position</u>	
Conclusion	*1*
TOTAL	***10***

Examiner's report:
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Most candidates demonstrated awareness of the Homeserve decision and were able to quote appropriately from the law as to the definition of "premium" - though a number got confused when describing the criteria for treating a fee as charged under a "separate" contract.*

The majority of scripts picked up the application of the higher rate to the extended boiler warranties although again some explanations as to why this was so lacked clarity and a firm grasp of the legislation. Some candidates were unaware that appointment of a tax representative is now optional rather than obligatory. The best candidates demonstrated commercial awareness in their advice to colleagues as to the best course of action for the client going forward.

**Tutorial Note: When this question was set it covered the position both before and after 24.3.10, so a more detailed discussion of Homeserve was required at the time.*

26. INSURANCE CLIENTS

MEMORANDUM

To: TK Bashem, Audit Partner
From: Indirect tax team
Re: IPT queries
Date: xx/xx/xx

In response to the points you raised in your memo:

1) <u>IPT tax points</u>

IPT should be accounted for based on the relevant tax point. The basic tax point is the receipt of the taxable premium by the insurer (s.49 and s.72(1) FA 1994). Receipt for this purpose may sometimes include the receipt by third parties of commissions and fees which are deemed part of the premium.

However, the law provides for a Special Accounting Scheme (also known as the “Written Premium Method”) which allows an insurer to account for tax on the premiums by reference to the date the amounts are entered into his accounts as due even if this is later than the actual receipt or the due date. (S.68 FA 1994 and Regs 20 – 28 SI 1994/1774 give the details.)

In outline, the insurer must notify HMRC that he wishes the scheme to apply from a date which must be on or after the notification itself following which the insurer will be permitted to account for tax by reference to the date each premium is written into the accounts rather than when received.

Reg 24 SI 1994/1774 deals with excess amounts under the special accounting scheme. Where what is received exceeds what was written as due, this is treated as a separate premium amount (subject to possible market value direction rules). Where this excess is entered into the records as due, the date of such entry will be the tax point. Otherwise the excess shall be treated as received on the date as at which the original premium amount was entered in the records as due.

<u>Tutorial Note:</u>

If the assumption was made that ‘overpayments’ meant that the client had accounted for too much IPT and mentioned regulation 25 instead, equal credit would be given.

As regards bad debts, credit for IPT paid on premiums which were entered in the records but never received is possible to the extent the insurer can satisfy HMRC that the amount will never be received (s.55(2) FA 1994 and Reg 25(1) SI 1994/1774 refer).

2) <u>Guarantee Premium</u>

This client appears to be in a similar situation to that at issue in the tribunal case of GPI v HMRC. The guarantees themselves are <u>not</u> contracts of insurance and therefore there is no liability for the contractor to register and account for IPT on the receipt of them.

The amount charged under the guarantee premium could only be liable to IPT if it was a commission/admin charge that related to a taxable contract of insurance. If the amount that the client is charging is a figure that they have fixed and is nothing to do with the insurance contract, that the insurer has no control over, then it will not be liable to IPT. The Insurer will only account for IPT on the amount due to them under the insurance contract itself.

3) Errors

The limits for voluntary disclosure are the greater of £10,000 and 1% of turnover - up to an overall maximum £50,000 (see Reg 13(3) SI 1994/1774). The "turnover" should be calculated by reference to the entry in box 10 on the IPT return (net value of taxable premiums (excluding tax)). FYO Ltd may be right but you will need to verify that your client's turnover is high enough to allow them not to disclose separately.

Where an error falls below this threshold it may be corrected on the return without notifying HMRC. As you know, a careless error can be subject to a penalty of up to 30%, but this can be mitigated to zero if an unprompted disclosure is made. Correction of the error in accordance with the regulations does not protect against such a penalty if the original error was "careless": it is still necessary to disclose to ensure full mitigation. If you can provide me with more detail as to what caused the error in question (and of course confirm whether it falls under the threshold) I can advise further as to DOR Ltd's best course of action.

4) Credit guarantees and Homeserve

Only insurance contracts are potentially subject to IPT (s.70 FA 1994). Case-law (Prudential Insurance Company v Inland Revenue Commissioners (1904) 2 KB 658) indicates that insurance contracts require three key elements:

i) A premium being paid;
ii) The insured being indemnified against loss from an uncertain event;
iii) The insured having an insurable interest – i.e. he would otherwise suffer the loss in question.

Credit guarantees may not fall within this definition, in which case they would not be subject to IPT. The Public Notice (IPT 1, paragraph 4.12) gives a number of possible indicators that a contract is an exempt credit guarantee agreement rather than an insurance contract, but it is probably better that you ask for some sample agreements so that we can make a determination with the full facts before us.

On the question of administration agreements related to insurance agreements, HMRC changed the legal definition of premium (s.72 FA 1994) after losing the Homeserve High Court case, which had held that amounts charged for administration of a standard-rated insurance contract but under a "separate" contract notified in writing to the insured were not subject to IPT. Now such a contract would not be treated as "separate" where four conditions are met (s.72 (1AA-1AE) FA 1994):

i) The insured is an individual entering into the contract in a non-business capacity;

ii) The insured is unable or unlikely to enter into the contract without also entering into the insurance contract;

iii) Neither the price nor the terms of the contract are open to negotiation by the insured; and

iv) The amount charged to the insured is arrived at without a comprehensive assessment of the individual circumstances which might affect the level of risk.

If the administration agreements meet the conditions above then Karam Ltd should be accounting for IPT on the amounts charged by Azov Ltd – and care will need to be taken to ensure the relevant amounts are notified to Karam Ltd with sufficient notice for them to be included in the correct IPT return period.

5) Criminal Penalties

I would expect HMRC to consider civil penalties in the first instance. However, if they believe the behaviour is serious enough to merit criminal prosecution, possible offences would include fraudulent evasion or the furnishing of a false document (i.e. the IPT return in question). Paras 9 and 10 Sch 7 FA 1994 give further details and confirm that, on summary conviction (Magistrate's Court), the penalty could be a fine of the higher of up to three times the amount of tax or £20,000 and/or imprisonment for up to six months. A Crown Court could impose an unlimited fine and/or a prison sentence of up to seven years.

Examiner's report:
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Some candidates still persist in setting out everything they know about the tax instead of tailoring responses to address the question. While relevant correct points receive credit, it does not assist the examiner if he needs to hunt for these points and the student is wasting time which could be spent earning marks elsewhere.

*The examiner was surprised at how few candidates answered comprehensively and coherently on the Homeserve point given the case's topicality.**

The best scripts picked up the Prudential case point and realised that there might not be a definitive answer without further information – as is often the case in practice.

Only the weakest candidates failed to get full marks on the criminal penalties section – although some persisted in setting out the new civil penalty regime when this had specifically not been requested.

**Tutorial Note: This question was set when Homeserve was topical. The answer today would focus on the legislative change, as detailed above.*

27. COVERSURE INC

Our address

Your address

Date

Dear

IPT

Further to our conversation, I have detailed below the answers to your queries concerning IPT.

Liability to Register for UK IPT

Coversure Inc will become liable to register for UK IPT if it intends to make supplies of taxable insurance contracts, where the risk is located in the UK.

The sales of travel insurance, which you intend to make, are taxable insurance contracts. The risk is located in the UK where the travel insurance falls under one of the following categories:

1) The contract covers travel and has a maximum duration of four-months and is 'taken out' (or 'entered into') in the UK. 'Taken out' means that the person taking out the insurance was in the UK when it was booked. For bookings via the internet, this means if the person books it from the UK.

2) For travel contracts exceeding four months, if the person who took it out is 'habitually resident' in the UK when they took it out. 'Habitually resident' means having been resident for (generally) a one-year continuous period.

Therefore, as you are intending to sell to UK individuals you are likely to be liable to UK IPT and will need to become registered.

Travel insurance is liable to the higher rate of IPT, which is currently 20%.

Registration for IPT

You must register for IPT within 30 days of having formed the intention to receive taxable premiums. This is done through completion of form IPT1 and can be done online. There is no threshold before registration applies. The date you receive your first premium will be the effective date of registration.

Even though you do not have a place of business in the UK you will still be responsible for submitting IPT returns. If you wish, you could appoint a tax representative to do this for you. However, you are still liable for the IPT due. Therefore, ultimately HMRC will pursue you for any underpayments.

Accounting for IPT

You will be required to submit quarterly IPT returns. This is done online. The return and payment are due by the end of the month following the quarter. If you pay by electronic means, then you are given a 7-day extension to the above deadline for the payment only.

You will need to account for IPT based on the tax point. The tax point is generally the day you receive the premium. You can as an alternative use the date the premium is due to you or entered in your records. You must notify HMRC if you wish to use this method.

The premium is the amount charged to the insured and is deemed IPT inclusive. Therefore, you will be required to account to HMRC for $^1/_6$ of each taxable premium.

You must keep records relating to your insurance contracts. They must be kept for six years.

I hope that this covers your queries. Please contact me should you require any further information.

Yours sincerely

A N Adviser

MARKING GUIDE

TOPIC		***MARKS***
Letter format		*1*
Liability to register		
– *Intention to make taxable supplies*		*½*
– *Risk in the UK*		*½*
– *Travel insurance is taxable*		*½*
– *Max 4 months = 'taken out' rule (or 'entered into')*		*½*
– *Definition of 'taken out' (or 'entered into')*		*1*
– *More than 4 months – 'habitually resident' rule*		*1*
– *Need to become registered*		*½*
– *Rate of IPT on travel insurance (HR)*		*½*
	Max	*6*
Registration for IPT		
– *Deadline and form*		*1*
– *Threshold and effective date of reg'n*		*1*
– *Overseas issues*		*2*
• *Registration*		
• *Tax representative*		
• *Liability of insurer*		
	Max	*4*
Accounting for IPT		
– *Quarterly online returns*		*½*
– *Deadline for payment*		*1*
– *Tax point*		*2½*
• *Receipt*		
• *Due/entered in accounts*		
• *Tax inclusive*		
– *Records*		*1*
	Max	*5*
TOTAL		***15***