

THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Domestic Indirect Taxation

November 2020

TIME ALLOWED
3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. You are a VAT specialist at a firm of Chartered Tax Advisers and have been contacted by Freda Daley, the owner of XO Cabs Ltd, which is a new client. XO Cabs operates a private hire taxi business and has recently been visited by HMRC. Freda has provided you with the following extract from a letter she has now received from HMRC about self-employed drivers:

- 1) You only account for VAT on the charges you make to them (booking fees; fees for the use of radios and taxi meters; and charges for the hire of cars used by them). As they appear to work only for you and under your direction, often using your cars, why hasn't VAT been accounted for on the fares charged?
- 2) Please explain why you have not charged VAT on invoices to account customers.
- 3) When hirers pay in advance for a hire by debit or credit card, you charge a fixed fare that is set off against monthly charges to the drivers but do not account for any VAT. Please explain the basis for this treatment.
- 4) I note that you have billed separately for insurance on some of the cars that you hire to drivers, and also in one or two cases, on cars owned by the drivers, without charging any VAT. Please explain the rationale for this.

Freda has also provided further information about the operation of the business.

There are a few employed drivers who are required to drive specified shifts using cars that the company provides. Most drivers are self-employed.

In relation to the self-employed drivers, some hire a car from the company, but many use their own vehicles. There are no formal contracts with these drivers, and they work on a "trust" basis. Drivers can choose when/whether to work and can take on "private" hires, although few drivers do so.

The account customers are local businesses who are billed monthly for journeys. The bill shows:

- 1) the name of the driver for each trip.
- 2) the metered fare for each trip.
- 3) an optional tip (10% of the metered fare).
- 4) an "account charge" of 5% to the bill total to cover administration.
- 5) a statement that the fare (and tip) is collected on the driver's behalf. This is also documented when the accounts are set up.

For the self-employed drivers, the fares and tips are treated as belonging to the driver, even if the money flows through the company as payments by account customers and fares collected via the company credit/debit card machine. The company has no information on cash fares paid to self-employed drivers.

Where payment is made in advance by credit/debit card, the company charges slightly more than the estimated metered fare as the agreed payment for the trip, and sets this off against sums due from the relevant driver at the end of each month for radio and meter charges and booking fees.

Continued

1. Continuation

Freda has provided details of income from account customers and credit/debit card receipts for the last four years:

<u>Year ended</u>	<u>Account customers</u> <u>(including tips and account charges)</u>	<u>5% Account charge</u>
	£	£
30/09/20	30,000	1,428.57
30/09/19	28,000	1,333.33
30/09/18	17,500	833.33
30/09/17	12,000	571.42

The company has “hire and reward use” cover under its insurance policy, which covers both company owned cars (whether used by employees or hired to self-employed drivers) and cars owned by self-employed drivers if they choose to insure through the company (the “block” cover often offers better rates than they can obtain independently). If car owning drivers take the cover, they are charged £50/week which covers the premium paid to the insurer plus a small margin to cover company administrative costs in providing it.

Freda said that during the visit, the officer mentioned something about reclaiming VAT on cars but that the company had not done so.

Requirement:

Draft an email to Freda Daley advising on the VAT issues she has raised.
(20)

2. You are Tara Ashford, a VAT specialist at Chartered Tax Advisers Mereguild LLP. You have received the letter below from Ben Booth, the Finance Director at Lizzellex plc. Lizzellex plc has two wholly owned subsidiaries: Lizzellex (White Goods) Ltd which manufactures white goods and Lizzellex (Car Parts) Ltd which manufactures car parts.

All companies are individually registered for VAT.

Ms T Ashford
Mereguild LLP
Mereguild Tower
Anytown
XY1 4XX

Lizzellex plc
Lizzellex Court
Anytown
XY7 6AB

28 October 2020

Dear Tara

Group restructuring

As you know, Big Bank plc is refinancing the group's debt. As a condition of the refinancing, it required us to undertake a viability study which we paid for at a cost of £375,000 plus VAT, although we and Big Bank plc jointly instructed the consultants to carry out the study, which was crucial to the survival of the group and was a key factor in the board's decisions on its future direction.

Although some parts of the viability study were confidential to Big Bank plc, the parts available to Lizzellex plc confirmed that due to the state of the motor industry, Lizzellex (Car Parts) Ltd is unlikely to be as profitable in the future as Lizzellex (White Goods) Ltd.

We have therefore decided to sell off the car parts business and focus on the more profitable manufacture and sale of white goods. We will probably sell the shares of Lizzellex (Car Parts) Ltd, but it is possible that instead Lizzellex (Car Parts) Ltd will sell the trade and assets. The business is operated from a freehold factory owned by the company and which is currently valued at £1,000,000. It also owns the freehold of a warehouse currently valued at £1.5 million that it has leased to Lizzellex (White Goods) Ltd since 1969. Under the terms of the lease, Lizzellex (White Goods) Ltd undertakes all maintenance of the property and undertook a significant refurbishment about five years ago at a cost of £200,000. The warehouse is used by Lizzellex (White Goods) Ltd to store finished goods. We plan to sell the freehold at its valuation to Lizzellex (White Goods) Ltd before we sell the car parts business.

The study also suggested consolidating our supply chain, which has led to the proposed acquisition by Lizzellex (White Goods) Ltd of Metal Bashers Ltd, one of our main suppliers. Metal Bashers Ltd is a UK company that produces parts for many of our fridges, freezers and washing machines. We expect to pay in the region of £10 million for the 80% shareholding owned by the investment company behind it.

The directors of Metal Bashers Ltd own the remaining 20% of the shares in the company and they will retain them. We expect the professional fees relating to this purchase to be in the order of £1 million.

Continued

2. Continuation

Lizzellex plc supplies (and is paid for) management services (accounting, legal services, corporate strategy, etc.) used by the two subsidiaries, which are wholly owned by it. Once we acquire Metal Bashers Ltd, we will also be supplying management services to it.

I would welcome your advice on the VAT, SDLT and Stamp Duty issues associated with these transactions, and the best way to proceed going forward.

Yours sincerely

Ben Booth

Requirement:

Draft a letter to Ben Booth advising on the VAT, SDLT and Stamp Duty implications of the issues he has raised, referring to relevant case law as appropriate. You are NOT required to discuss the Transfer of a Going Concern provisions. (15)

3. You are Sandra Kent, an Indirect Tax specialist at accountants Sobaka LLP. You have been asked to provide a briefing note to Mark Davies, a partner in the firm who is not a VAT specialist. He wants to understand the VAT issues that his new clients, Archie Potts and Kuska Ltd, might be facing. Archie is the sole shareholder and director of Kuska Ltd.

Kuska Ltd is a property developer and trader that buys run down properties at auction and renovates them for resale or letting. Most of the properties it buys are houses but it occasionally buys commercial buildings where it may also renovate them for sale or letting. On occasion, it may convert these commercial properties to flats and then sell them or retain them for letting. Archie has commented that he is confused because some of the contractors that his company uses on new builds and conversions do not charge VAT while others charge 20% VAT on everything. He has also heard about reverse charge VAT accounting for building work and wants to know if this will apply to Kuska Ltd.

Archie, in a personal capacity, has recently bought an old gamekeeper's lodge together with some adjacent land. The lodge was used for approximately 20 years as an office for a game and clay pigeon shooting business, but this ceased a couple of years before he bought it. Archie plans to convert the lodge into his family home and already has outline planning consent for the work, which will involve extending the property to create additional bedrooms, reception rooms and an indoor swimming pool. He plans to do much of the conversion himself but will use contractors for the parts that he is unable or unwilling to do himself. He would like advice on recovering the VAT he will incur on the conversion work.

At some point he may use the remainder of the land to re-start the game and clay pigeon shooting business, which he would operate as a sole trader.

Requirement:

Draft a briefing note discussing the VAT issues that Kuska Ltd and Archie may be facing. (15)

4. You are a Chartered Tax Adviser at DIT Tax LLP and your new client is Dedara plc, the parent company of a civil engineering group. You have received the following email from Ruby Lockhart, who is the tax manager at Dedara plc.

From: Ruby.J.Lockhart@dedara.co.uk
To: Jim.May@dit.co.uk
Date: 28 October 2020
Subject: Intragroup charges

Dear Jim

I hope you are well.

The group financial controller met with me last week to discuss the recharging of costs for 2019/20, which would normally have been done in July 2020. As a result of the acquisition of a business and the challenges of integrating this business, this process has been delayed and some payments were made by group companies based on forecasts instead. We have now invoiced everything except for a couple of charges, which I hope you can help me with.

These charges relate to the issue of indemnity cover by Dedara Insurance Ltd to Dedara UK Ltd and Dedara Italia SRL. The two subsidiaries jointly won a substantial contract for services on a large motorway project in Turkey, which will be completed in June 2022. The contract is expected to generate a 15% net margin, as per the following projections.

The Konyat AS project forecasted net profits for the years ending:

	<u>June 2020</u>	<u>June 2021</u>	<u>June 2022</u>	<u>Total</u>
	£	£	£	£
Dedara UK Ltd	3,750,000	4,500,000	6,000,000	14,250,000
Dedara Italia SRL	2,250,000	3,000,000	2,250,000	7,500,000

The customer, Konyat AS, required an enhanced contractual commitment from Dedara UK Ltd and Dedara Italia SRL, including contractual penalties in circumstances where there would be a delay or quality issues with their performance. As the financial consequences of non-performance on this contract would have been too onerous to Dedara UK Ltd and Dedara Italia SRL, the group decided to provide cover through Dedara Insurance Ltd, a captive insurance company. This was formally agreed on 5 July 2019, before the contract with Konyat AS commenced on 1 October 2019.

Dedara Insurance Ltd was formed last year (by the previous tax manager before I joined the group), as we had recognised that as the group has been expanding rapidly the cost of commercial insurance would be managed more effectively through a captive insurance company, where the premiums paid would stay in the group. All legal and regulatory formalities for setting up Dedara Insurance Ltd were completed in July 2019 and the entity applied for Insurance Premium Tax registration on 1 October 2019 and has been registered since that day. Dedara Insurance Ltd has had no other activity apart from the agreement to indemnify Dedara UK Ltd and Dedara Italia SRL in relation to the contract with Konyat AS. Nil Insurance Premium Tax returns have been filed for the calendar quarter accounting periods.

Continued

4. Continuation

Dedara Insurance Ltd agreed, under an enforceable contract, a premium of 25% of the net profit from the contract to be paid to it at the end of every quarter. Dedara UK Ltd and Dedara Italia SRL made payments to Dedara Insurance Ltd on account of this premium on 31 December 2019, 31 March 2020 and 30 June 2020, each totalling £80,000. No more payments will be made until the recharges are reconciled and invoices are issued. Now that this is going to happen, it has led me to consider whether, given the nature of the premium arrangements, this is actually a supply of insurance, and if we needed to register for Insurance Premium Tax in the first place?

Please can you explain the Insurance Premium Tax implications of the above transactions? If you have any questions, please do not hesitate to contact me.

Kind regards
Ruby

Requirement:

Draft an email response to Ruby advising on the Insurance Premium Tax implications of the transactions. All calculations are to be made up to 31 October 2020. (15)

5. You are Jane Trivet, a Chartered Tax Adviser at Nott & Coss LLP and you have just met with Jonathan Zipper who holds a mixed portfolio of commercial and residential investment properties, which he either renovates and resells or rents out to individuals and businesses. Jonathan has been in business and registered for VAT since 1995. He would like to retire later this year and has therefore been gradually disposing of properties.

He has asked for your advice in relation to the disposal of Poplar Barn, a single storey building, which was let until 31 October 2020 to a local dairy farmer, who used it as a storage facility for his business. Poplar Barn was opted to tax by Jonathan in August 1998 and the rentals have been subject to VAT. The farmer has recently built a new storage unit on his own land and decided to not extend the lease of Poplar Barn, which ended on 31 October 2020 and the property is now empty.

In March 2020, with the tenant's permission, Jonathan signed a Power Purchasing Agreement to let the entire roof out to a specialist company for an installation of solar panels. The lease of the roof itself is £10 a month but Jonathan receives a supply of substantially discounted electricity and at the end of the contract in February 2045 the ownership of the system will fully transfer to him with no additional charge. If Jonathan terminates the agreement before then, there will be a £6,500 charge for the removal of the panels. This would not be payable if the Power Purchasing Agreement is transferred to a new property owner. Jonathan shared some figures relating to the lease and the electricity generation, which show that Jonathan has received a discount of £1,380 on the electricity supplied to him since March 2020.

Jonathan has found a potential buyer for Poplar Barn: Sparkfly Day Nursery, which is a newly established OFSTED registered business, which intends to provide all-day childcare for pre-school children from the property and the solar panels fit with its environmental ethos. Sparkfly Day Nursery has already sourced a building contractor as it intends to refurbish the property, replace the roof and reinstall the solar panels, in time for 1 March 2021, when the childcare services would commence. Sparkfly Day Nursery is not registered for VAT and it would like the property sale to be made without VAT as it is not able to fund it.

Requirement:

Draft a letter to Jonathan advising on the VAT implications of the proposed disposal of Poplar Barn. You are NOT required to discuss any penalties or interest.

(20)

6. You are a Chartered Tax Adviser at Dempsey & Nesbitt Ltd, a tax advisory firm and your client is Jonco Stores Ltd, a chain of convenience stores. You have received the following email from Carly Croak, the tax manager at Jonco Stores Ltd.

To: Chase.Squire@dnt.co.uk
From: CCroak@Jonco.co.uk
Date: 2 November 2020
Subject: VAT queries

Dear Chase

I hope you're well. Further to our call last week, I have made progress with auditing the product file in the new system and I came across a couple of issues, which I hope you can help me with.

Product File Review

The product file was copied directly from our old system last year when we moved to the Point of Sale Scheme from the Direct Calculation Scheme 2 on 1 May 2020. Overall, I am satisfied with the VAT liability recorded in the product file although I have uncertainty regarding the VAT treatment of two products, which I hope you can help me with.

Product 1 – Sausage Rolls

Jonco Stores Ltd introduced in-store bakeries in 2015 allowing some products to be baked on the premises and offered for sale with reduced packaging. One of these products is sausage rolls, which are kept in a heated display cabinet in the bakery section and packaged in paper bags as requested by the customers. We don't have café areas where these could be consumed on our premises, so they have always been zero-rated. The sales of these sausage rolls were £2,360 in the quarter to 31 July 2020 and £1,968 in the quarter to 31 October 2020.

Product 2 – Promotional Packs

I have noticed that since 1 October 2020 Jonco Stores Ltd has been selling a VAT zero-rated promotional product in support of the 'Save Brit Bee' campaign. It is a set of two jars of honey with a ceramic honey spoon packaged in a decorative box and priced at £12.00, inclusive of a £3.00 donation to a national charity (Jonco Stores Ltd will make the donation to the charity when all sets have sold) and a margin of 30%. The jars and spoon were packed by our warehouse staff into boxes supplied by the charity free of charge. We sell the same honey jars separately at £3.50 each after a mark-up of 25%. The cost of the promotional spoon was £0.70. We sold a total of 150 sets in October 2020.

Continued

6. Continuation

Mobile Data Cards

I also wanted to ask your advice on the sale of mobile data cards which we have been selling in our stores for over a year now. We have been approached by a new intermediary who can source these cards at a much lower price and who also offered us the opportunity to expand into the wholesale market of mobile data cards. This fits with Jonco Stores Ltd's strategy to diversify the business and could be an easy win as the intermediary can introduce a seller and a buyer for five million £20 mobile data cards straight away. The entire transaction would be completed over five working days generating £950,000 of profit for Jonco Stores Ltd and we would not need to pay the supplier until the buyer has paid Jonco Stores Ltd. Is there anything I should consider from a VAT perspective in relation to this transaction?

If you have any questions or require additional information, then please let me know.

Regards

Carly

Requirement:

Draft an email to Carly advising her on the VAT implications of the sausage rolls, promotional packs and mobile data cards. (15)