

Question 1 – 10 marks

Zibras Developments Ltd is a UK VAT-registered property developer. During the quarter ended 30 September 2026, it undertook a mixed development project of newly built residential houses and commercial units for both sale and rental. No VAT was incurred on the purchase of the site.

Income and costs for the quarter were as follows (all amounts are exclusive of VAT):

Income

- Sale of newly built residential houses: £400,000
- Sale of newly built commercial units: £124,000
- Rents from the retained commercial units: £40,000
- Rents from retained houses: £60,000

Costs

- Construction materials used only for the houses for sale: £80,000
- Construction materials used only for the houses for rent: £160,000
- Construction costs relating to all commercial units: £100,000
- Fit-out costs for the commercial units sold: £30,000
- Legal and marketing costs relating only to the residential lettings business: £5,000
- Site overheads relating to the whole development: £20,000
- Fitted wardrobes for all the houses: £6,000

No option to tax has been exercised over the properties. The business uses the standard partial exemption method.

1. Calculate with explanations the net VAT payable to HMRC in the quarter ended 30 September 2026 VAT return. (7)
 2. Explain what Zibras Developments Ltd can do to improve its VAT recovery position (3)
- Total (10)

Question 1 – answer (350 words excluding marks)

The sale of newly built residential houses is zero-rated. The sale of the newly built commercial units is standard-rated at 20%. Lease income from the remaining commercial units is exempt because no option to tax has been made, and residential rental income is also exempt. [1]

Commercial unit sales: £125,000 × 20% = £25,000 [0.5]

Cost category	VAT amount	Treatment	Recoverable VAT	
Construction materials for new houses for sale	£16,000	Directly attributable to taxable zero-rated supplies	£16,000	[0.5]
Construction materials for new houses for rent	£32,000	Directly attributable to exempt supplies	£32,000	[0.5]
Construction costs relating to all commercial units	£20,000	Residual input VAT; 84% recoverable	£16,800	[0.5]
Fit-out costs for commercial units sold	£6,000	Directly attributable to taxable standard-rated supplies	£6,000	[0.5]
Legal and marketing costs for residential lettings	£1,000	Directly attributable to exempt supplies	£0	[0.5]

Site overheads	£4,000	Residual input VAT; 84% recoverable	£3,360	[0.5]
Developer-purchased fitted wardrobes	£1,200	Blocked input tax under the developer rules	£0	[0.5]

Residual recovery percentage: taxable supplies £524,000 ÷ total supplies £625,000 = 83.84%, rounded up to 84%. This percentage is applied to both the commercial construction costs that relate to all commercial units and the general site overheads. **[0.5]**

Total input VAT recoverable = £16,000 + £16,800 + £6,000 + £3,360 = £42,160 **[0.5]**

Net VAT payable is output VAT less recoverable input VAT.

£25,000 – £42,160 = £17,160 repayable **[1]**

Therefore, HDL is entitled to a VAT repayment of £17,160 for the quarter.

HDL could:

1. Consider exercising an option to tax over the leased commercial units, if commercially suitable, so that the lease income becomes taxable and more related input VAT becomes recoverable. However, the VAT profile of the tenants of the commercial units should be considered as if they are exempt or not VAT registered, they will be sensitive to incurring VAT on their rental charge. **[1]**
2. Review whether costs can be attributed more precisely to taxable activities, because directly attributable taxable input tax is recoverable in full, whereas residual input tax is only partly recoverable. **[1]**
3. Consider whether a special partial exemption method would produce a fairer recovery result if the standard method does not reflect actual use. **[1]**

Question 2 – 10 marks

Lottie is the sole shareholder in Silver Fleece Sheep Ltd, which owns and operates a sheep farm. Silver Fleece Sheep Ltd is registered for VAT. Lottie is 67 and has decided to sell the farm and retire.

The company owns grazing land for the sheep, farming machinery, some cars, the sheep and a farmhouse. There is no option to tax on the land.

Lottie has invited local buyers to make a bid either for the whole farm or for parts of it and is currently considering the following offers. All the potential buyers are registered for VAT.

Buyer 1 wants to buy all of Lottie's shares.

Buyer 2 already owns the farmland next to Lottie's farm. She wants to buy the farmhouse, farming machinery, land and sheep to operate as part of her own farm but does not need any of the cars. Silver Fleece Sheep Ltd will need to sell these separately to a second-hand dealer (Lottie did not previously recover VAT on the cars).

Buyer 3 wants to buy the whole farm and the assets, with the intention of converting it to a cattle farm over the next year or so, as he believes that could be more profitable.

Buyer 4 is a property dealer who wants to buy the whole farm and the assets but will immediately sell them on at a substantial profit to one of her clients who will continue to operate it as a sheep farm.

Buyer 5 wants to buy just the land and build houses on it. The other assets will be sold separately.

Lottie wants to complete a sale by June 2028.

- 1) **Explain the VAT liability of each of the above offers, including any input tax considerations.** (8)
- 2) **Explain the impact on the sales if there is an option to tax on the land (excluding the farmhouse).** (2)

Total (10)

Question 2 – answer (359 words excluding marks)

Buyer 1

The sale of shares in a company is VAT exempt and so no VAT should be charged. Any input tax incurred that is attributable to the sale of the shares is not recoverable. **[1]**

Buyer 2

Buyer 2 intends to continue to operate the farm as a sheep farm and it will therefore qualify as a Transfer of a Going Concern (TOGC) which is outside the scope of VAT. **[0.5]**

The sale of the cars is VAT exempt as VAT was not recovered on the purchase. **[1]**

Input tax incurred will be recoverable on costs incurred with respect to the TOGC. **[0.5]**

Buyer 3

This is likely to qualify as a TOGC. Even if HMRC were to consider that cattle farming is a different business to sheep farming, the farm will be operated initially as a sheep farm. No output tax would be due. **[1]**

Input tax will be recoverable on costs incurred with respect to the TOGC. **[0.5]**

Buyer 4

This cannot be a TOGC as Buyer 4 will immediately transfer the assets on to another party. **[0.5]** The sale will be a mixed supply, with the land and house being exempt from VAT, the machinery will be standard rated, the sheep will be zero rated and the cars will be VAT exempt. **[1]**

Input tax should be apportioned. **[0.5]**

Buyer 5

As Buyer 5 intends to immediately carry on a different kind of business the sale cannot be a TOGC. The land sale will be exempt from VAT.

The sale of the other assets would be as per Buyer 4. **[1]**

Input tax should be apportioned. **[0.5]**

Option to Tax

The option to tax will have no impact on the sale to Buyer 1 as the sale is solely a share transfer. **[0.5]**

For those transactions which are eligible to be treated as TOGC (Buyers 2 and 3), the buyer would also need to opt to tax the land and provide Lottie with a declaration that their option to tax would not be disapplied after the transfer. **[1]**

Where, TOGC treatment is not applicable (Buyers 4 and 5), Lottie would need to charge VAT on the land element and the machinery, but not the sheep, cars or farmhouse. **[0.5]**

Question 3 – 5 marks

Michael has been VAT registered since 2020. The value of his taxable supplies for the year ended 31 December 2026 was £1,100,000 and for the year ended 31 December 2027 is expected to be £1,250,000.

Michael normally submits his VAT returns and makes the VAT payments on time. However, he was late submitting his return for the quarter ended 30 June 2026. The return was submitted on 31 August 2026 and the payment was made on the same day.

Michael has the following debts outstanding which he has written off in the accounts, and on which he has paid the output VAT:

Customer	Invoice due date	Net Amount (£)
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Laneek Ltd	31 January 2026	1,000
Kaliib Ltd	30 April 2026	800

Michael has been considering joining the cash accounting scheme, the flat rate scheme or the annual accounting scheme.

1) Explain whether Michael will be able to join the cash accounting scheme, and if so whether he will also be able to join the flat rate scheme and/or the annual accounting scheme.

(3)

2) Explain how much bad debt relief Michael can claim in the quarter ended 30 September 2026, while he is not using any special schemes.

(2)

Total (5)

Question 3 – answer (178 words excluding marks)

Michael will be able to join the cash accounting scheme as there are reasonable grounds for believing that his taxable supplies for the next 12 months will not exceed £1.35 million, based on his current taxable supplies. **[1]**

Although Michael was late submitting his VAT return and payment for the quarter ended 30 June 2026, this is now up to date. **[0.5]**

If Michael joins the cash accounting scheme, he will still be able to join the annual accounting scheme **[0.5]**, but he will not be able to join the flat rate scheme. **[1]**

Bad debt relief is available where the output tax has been paid to HMRC, provided the debt has been written off in the accounts and the debt is over six months old. **[0.5]**

Michael can claim bad debt relief on the outstanding debt from Laneek Ltd as it is over six months old. £1,000 x 20% = £200. **[0.5]**

Michael cannot claim bad debt relief on the outstanding debt from Kaliib Ltd in the quarter ended 30 September 2026, as it has not yet been outstanding for six months. **[1]**

Question 4 – 4 marks

Anna started trading on 1 October 2025 and registered for VAT on 1 July 2026. Her business is fully taxable with no exempt income.

On 1 August 2025, Anna purchased a laptop for £2,000 plus VAT, which she intended to use in the business. However, the laptop did not allow the right programming for her business, so she gave it to her brother and purchased a new laptop in December 2025 for £3,500 plus VAT.

From 1 October 2025, Anna has paid for monthly advertising services, costing £100 plus VAT per month.

On 31 July 2026, Anna purchased a car for £18,000 plus VAT. The use of the car will be 70% for business use and 30% for private use 30%.

During the quarter ended 30 September 2026, Anna spent £2,000 inclusive of VAT on repairs to the car.

Calculate, with explanations, how much input tax Anna can reclaim in the VAT return for the quarter ended 30 September 2026.

(4)

Question 4 – answer (144 words excluding marks)

Laptops

VAT on August laptop cannot be claimed as it is no longer used in the business. [0.5]

The December laptop is still used in the business so VAT can be claimed.

$£3,500 \times 20\% = £700$ [0.5]

Advertising services

VAT incurred on services in the six months prior to VAT registration can be recovered in the first VAT return. (Jan 26- Jun 26). However, services received before 6 months are not recoverable. [0.5]

The advertising services during the quarter ended 30 September 2026 can be claimed.

$£100 \times 20\% \times 9 = £180$ [1]

Car

The input VAT on the car is blocked since there is personal use of the car. Only in specific circumstances can input tax on a car be claimed e.g., a pool car. [0.5]

However, the input VAT on the repairs is not blocked. $£2,000 \times 1/6 = £333$ [0.5]

Total VAT reclaimable = £1,213 [0.5]

Question 5 – 4 marks

Frank is a sole trader, making wholly exempt supplies of insurance. He owns 100% of the ordinary shares in Wamlynne Ltd, a company resident in the UK which makes fully taxable sales of hardware.

Frank also owns 80% of the shares in Lustavo S.L., a company resident in Spain which trades through a branch in the UK which has its own staff and equipment. Lustavo S.L makes wholly taxable supplies.

Wamlynne Ltd is already VAT registered and files its VAT returns monthly.

Explain whether Frank, Wamlynne Ltd and Lustavo S.L are eligible to form a VAT group and discuss VAT grouping consequences for this scenario. (4)

Question 5 – answer (143 words excluding marks)

An individual carrying on a business can form a VAT group with companies under their control [0.5], if that business and those companies have a fixed establishment in the UK (which includes a branch or office with its own staff and equipment). [1]

Therefore, Frank can form a VAT group with both Wamlynne Ltd and Lustavo S.L as both the control and establishment conditions have been met. To set up a new VAT group, a new VAT registration form (VAT1) should be submitted to HMRC in the name of the representative member and a VAT 50/51 is required to add members to the VAT group. [1]

As Frank's sole trader business is making wholly exempt supplies, his inclusion in the group would make the group partially exempt [0.5] and potentially affect the input VAT recovery for the group. A sectorised partial exemption special method should be considered. [1]

Question 6 – 4 marks

Wowwzer Ltd has been VAT registered for many years, selling standard rated goods to the general public.

Its taxable turnover in the next 12 months is expected to be no more than £85,000.

Wowwzer Ltd has therefore decided to deregister for VAT with effect from 1 September 2026.

The assets on hand on 31 August 2026 were as follows:

	<u>Cost (incl VAT)</u>	<u>Replacement value at 31 August 2026</u>
Standard rated stock for resale (Note)	900	800
Computers and office equipment	3,750	1,800
Car used 60% privately by the sales manager	26,000	18,000

Note: 25% of the stock for resale was purchased from unregistered businesses.

Explain why Wowwzer Ltd is allowed to deregister for VAT and calculate the output VAT that must be accounted for on Wowwzer Ltd's final VAT return. (4)

Question 6 – answer (143 words excluding marks)

Wowwzer Ltd is allowed to voluntarily deregister for VAT as its expected taxable turnover in the next twelve months is expected to be no more than £88,000. It should submit a VAT7 form. **[1]**

Output VAT is due where goods are on hand at deregistration and input tax has been claimed. This is treated as a deemed supply and is to prevent the deregistered person obtaining an unfair advantage over other unregistered persons by continuing to have use of those VAT-free goods. **[1]** If the VAT on the deemed supply is less than £1,000, then there is no deemed supply. **[0.5]**

<u>Asset</u>	<u>Output Tax (£)</u>
Standard rated stock for resale:	$800 \times 75\% \times 20\% = 120$
Computers and office equipment:	$1,800 \times 20\% = 360$
Car with private use	0
Total	£480 [1]

As this amount is no more than £1,000, the VAT payable is £0. **[0.5]**

Question 7 – 3 marks

Iain runs a business which has grown rapidly. The Financial Controller has highlighted some cashflow concerns, mainly due to customers taking longer to pay than usual and has suggested they offer a prompt payment discount to encourage customers to pay sooner.

Explain the effect of the discount on the VAT charge and on the supporting paperwork which will be issued to customers. (3)

Question 7 – answer (108 words excluding marks)

If the discount is taken, VAT is only due on the amount actually received. **[0.5]**

Iain should issue an invoice and charge VAT on the full amount. Iain then has two options to deal with any discount:

1. Any discount taken can be accounted for by the issue of a credit note, showing the VAT on that element. **[1]**
2. To avoid the need to issue a credit note, the invoice issued can include the terms of the discount, showing the date by which payment must be made. **[1]**

A statement must also be included to confirm that the customer can only recover input VAT based on the amount actually paid. **[0.5]**