Institution **CIOT - CTA**
Course **Adv Tech Domestic Indirect Tax**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Exam ID **10926**

Answer-to-Question-_1_

Business and Non-Business Activities

The Northern Lakes Foundation has a number of different activities of which some are business and some are non-business.

The income from grants is non-business. Although in the Colchester Institute Upper Tribunal case it was found that grant income was exempt rather than non-business, HMRC disagrees with this decision and will not enforce it.

Income from donations and fundraising are also non-business.

The letting of property, hire of facilities, and fishing and boat permit charges and educational/training fees are all business activities using the two stage test from the Wakefield College case.
Stage 1 - the activity results in a supply of goods or services for consideration
Stage 2 - the supply is made with the purpose of obtaining income therefrom.

As these supplies are all business activities, the VAT liability of each supply will need to be considered.

Independent Boat Users

The permits granted to independent boat users do not fall within paragraph m of VATA 1994 Sch 9 Group 1 as the exception doesn't apply where the grant of facilities is for a series of ten or more periods and does not allow exclusive use. The permits are likely to be annual so apply for more than ten periods and do not allow exclusive use as the lake is also used by club members and other independent boat users.
Therefore, these are taxable at the standard rate.

Educational/training fees

As NLF is an eligible body, educational/training fees will be exempt under VATA 1994 Sch 9 Group 6.

As NLF has a mixture of taxable and exempt supplies, it is partially exempt for VAT.

Lease Granted in September 2003

The lease term is 21 years. The supply of a interest in or right over land is exempted under VATA 1994 Sch 9 Group 1.

However, a first grant of a major interest in a commercial property less than three years old is a standard rated taxable supply. Any element of the lease relating to property will be standard rated due to this exception as the lease is 21 years so is a major interest.

Another exception listed in VATA 1994 Sch 9 Group 1 is the grant of facilities for playing sport or participating in physical recreation. The boat supplement charges fall within this exception as it is physical recreation. As a result, VAT is chargeable at the standard rate on this element of the lease.

New Lease

Any new lease granted will comprise two elements, the rent and boat supplement charges. The boat supplement charges will remain standard rated due to the exception above.

However, the element of the lease relating to property will no longer fall within the exception for commercial property as it is no longer the first grant of a major interest (having had a previous major interest granted) and is no longer less than three years old.

The element of the lease relating to property will therefore be exempt subject to an option to tax.

Northern Lakes Foundation (NLF) can choose whether to opt to tax the land. The option will apply to the entire land including property.

If opted, all supplies made in relation to the property will become taxable at the standard rate so VAT will be charged on the entire lease.

Where a lease is granted solely for a relevant charitable purpose, the option to tax has no effect, so the supply is exempt. However, the Hardrada Sailing and Kiteboarding Club (HSKC) is not a charity so this will not apply.

Decision to Opt

In deciding whether to opt to tax or not, NLF will need to consider the impact on its VAT recovery, along with the impact on HSKC.

By not opting to tax, the element of the lease for rent will be an exempt supply. This will mean that input tax cannot be recovered on that supply. It will also reduce the overall input tax recovery rate for NLF as it increases the proportion of exempt income in the partial exemption calculations.

VAT charged to HSKC on the lease is not recoverable as their supplies are mainly VAT exempt and they are not VAT registered. The option to tax would therefore have a negative impact on HSKC as it is an increase to the cost of the lease, which cannot be recovered.

Stamp Duty Land Tax (SDLT)

The grant of the lease is chargeable to SDLT, which would be payable by the lessee (HSKC). For leases, SDLT is charged on the net present value of the lease payments.

The consideration for SDLT purposes includes VAT, so if VAT is included on the lease, this will increase the amount of SDLT due.

Where the amount of the lease is fixed for the first five years, the net present value is calculated by using the annual amount of the lease and the number of years of the lease. HMRC's lease tables will show the net present value chargeable to SDLT.

However, as the leases is variable due to the boat supplement being based on numbers of members, the amount of the lease will need to be estimated for the first five years and the NPV on each calculated using the lease tables. The highest estimated amount for the first five years will then be used as the "year 6" value and the lease factor for 21 years will be applied. The total of the "year 6" NPV and the NPV for the first five years will be the consideration on which the SDLT is calculated.

Based on the £8,500 plus VAT total lease value in the past year, it is unlikely that the NPV of the lease will exceed £150,000 and therefore no SDLT will be chargeable.

Recommendation

Opting to tax will be beneficial for NLF as this results in better input tax recovery for them due to the increased proportion of taxable supplies.

Although the VAT charged on the lease has a negative impact on HSKC due to the VAT being irrecoverable and the potential (but unlikely) increase to the SDLT charged, the existing lease includes VAT so it is unlikely that HSKC will refuse the lease as their circumstances will remain the same under the new lease as they are now.

Therefore, NLF should opt to tax. They must notify HMRC via VAT form 1614A within 30 days of the decision to opt.

----------ANSWER-1-ABOVE----------

----------ANSWER-2-BELOW----------

Answer-to-Question-_2_

As Hermitage Hall was constructed by the University itself, a major interest has never been granted previously. The grant of a 25 year lease will therefore be the first grant of a major interest.

Student accommodation may fall into the categories of either dwellings or relevant residential purpose (RRP). The first grant of a major interest in either of these is zero rated under VATA 1994 Sch 8 Group 5.

Where the option is available for student accommodation to be treated as either dwellings or RRP, dwellings is preferable, as there is no certification requirement and no self-supply for a change of use within ten years.

However, to qualify as dwellings the accommodation must comprise of self-contained living accommmodation. This is not the case for Hermitage Hall. Therefore the only option available for zero-rating is RRP.

To enable the grant of the lease to AJU Enterprises Ltd (AJU) to be zero-rated as RRP, AJU must provide the Univeristy with certification that it will be used solely (at least 95%) for relevant residential purposes.

The zero-rating of the grant of the lease will enable full recovery of the VAT incurred of £1.4m on the refurbishment project by the University.

AJU is a subsidiary company, so the grant of the lease will be exempt from SDLT as it is within a 75% group.

The refurbishment would fall within the Capital Goods Scheme (CGS) as the cost exceeds £250,000 so the use of the property would need to be monitored for a ten year period. As the lease is for 25 years and the break clauses do not fall within the first ten years, the supply of the property will be fully taxable for the CGS adjustment period so there will be no clawback of the VAT recovered for the University.

For AJU, the short term rents to students will be exempt from VAT. As AJU is outside of the VAT group of the University, this exempt income has no detrimental impact on the input tax recovery for the Univesity.

A long lease to a subsidiary for the purposes of recovering input tax on a zero-rated grant of major interest is a fairly common structure and would be seen as perfectly acceptable by HMRC.

However, HMRC may have an issue with the University providing financial support to AJU. Where options to tax are concerned, there is specific anti-avoidance legislation to disapply an option to tax where exempt use is anticipated and there is occupation by the grantor/financier.

This does not apply in these circumstances as the property will not be occupied by the University and there is no option to tax involved.

However, there is general anti-avoidance legislation that can cover circumstances that aren't specifically prohibited by legislation but are structured in a way that is designed for the purposes of obtaining a tax advantage and it is dishonest.

There have been several cases where this has occured and HMRC can treat the parties involved as jointly and severally liable for the tax avoided and any penalties involved.

The University and AJU will need to consider whether any disclosure is required under DASVOIT. This normally applies to promoters of schemes, and the duty of disclosure falls on the promoter. However, it does also apply to schemes conceived "in house". The University and AJU will need to consider whether the hallmarks listed in DASVOIT apply.

It is however perfectly acceptable to structure businesses in such a way as to obtain a tax advantage, provided that it is not done in a dishonest way.

The market value of the lease payable by AJU and the market value of the interest on any financial support, means that the structure is likely to be considered a legitimate structure, which whilst implemented for the purposes of obtaining a tax advantage, is not done in a dishonest way. It is unlikely therefore that HMRC will take any issue with the proposed arrangement.

---------------ANSWER-2-ABOVE---------------

----------ANSWER-3-BELOW----------

Answer-to-Question-_3_

Mixed Use
The purchase of the property is treated as one transaction as it is under a single land registry title.

Land transactions can either be treated as residential or mixed use.

The annual licence to the farmer is for a very small amount. This is not enough to show a genuine business use. The amount is likely to be roughly similar to the cost of the upkeep of the land.

The licence cannot be considered as for the purposes of obtaining an income. Therefore, as the rest of the property was a dwelling, the property is not a mixed-use property. Residential rates should therefore have been applied.

Higher Rate of 15%
The higher rate of 15% can apply to an interest in a single dwelling of over £500,000 when purchased by a company which is the case here.

However, this rate is for anti-avoidance purposes, designed to prevent residential properties being purchased in companies and resold, replacing Stamp Duty Land Tax (SDLT) with Stamp Duty at a much lower rate.

The 15% rate does not apply because the property is used for trading purposes. The occupation by an employee does not prevent

this relief from applying.

SDLT Calculation

The rates that should have applied to the transaction are the normal residential rates plus:

- an additional 2% as Sabi Investments is a non-UK resident company
- an additional 3% as the property is purchased by a company and the interest exceeds £40,000

£125,000	5%	£6,250	
£125,000	7%	£8,750	
£675,000	10%	£67,500	
£575,000	15%	£86,250	
£1,500,000	17%	£255,000	
		£423,750	Total

The SDLT has in fact been underpaid by £284,250 rather than £269,250.
It appears that HMRC has not applied the non-resident 2% surcharge.

Assessment

The assessment is incorrect. Sabi can ask for a review or appeal straight to a first tier tribunal within 30 days. For a review, HMRC would respond within 45 days (or if no response is received, there is no change to their original assessment).

As the correct amount is higher than the assessment it would no be beneficial for Sabi to ask for a review or appeal.

Penalty Notice

The penalty amount of 15% has already been adjusted for the co-operation of the company (telling 30%, helping 40%, access 30%).

As the penalty is already at the minimum amount for a prompted disclosure, it can only be reduced if Sabi can show that they took reasonable care, which would using involve showing that advice from a qualified professional was taken.

----------ANSWER-3-ABOVE----------

----------ANSWER-4-BELOW----------

Answer-to-Question-_4_

Lease Surrender
A lease surrender is a supply by the tenant to the landlord. The supply is exempt subject to an option to tax.

The Edbridge House lease was not opted to tax.

However, as the supply is by the tenant, the liability of the lease surrender depends on an option to tax by Alpha Insurance Ltd (Alpha) which would only have occured if Alpha was subletting (and is unlikely anyway as Alpha will probably only have exempt supplies so is not eligible to be VAT registered).

Therefore the lease surrender payment will be exempt from VAT.

Dilapidation Payment
The dilapidation payment paid by Alpha to Lahn Developments Ltd represents a claim for damages. This is not consideration for a supply of goods or services so is outside the scope of VAT.

Erton House Lease
The real estate election exercised by Lahn Developments Ltd (Lahn) means that all properties held are opted to tax. An option to tax does not need to be notified to HMRC for new properties purchase, will automatically be opted. The lease of Erton House will therefore be standard rated as it will automatically be opted (from the date the land is acquired) under the real estate election.

<u>Beta Insurance (Beta)</u>
Beta is a financier of the development. As Beta will be occupying in excess of 10% of Erton House, they are deemed to be in occupation under the option to tax anti-avoidance provisions.

As an insurance company, Beta will be using the building for exempt purposes.

The option to tax will therefore be disapplied in relation to the lease to Beta. This will mean that the lease is exempt rather than standard rated.

Lease to Insurance Companies

Insurance companies operate in an exempt sector. Many will only have exempt income and be unable to register for VAT.
This means that any VAT charged on the leases will be irrecoverable for the insurance companies. Effectively, this increases the cost of the lease.
In order for the leases to be competitive and more attractive to insurance companies as potential tenants, it would be beneficial is some or all of the lease could be exempt rather than standard rated so that no VAT is charged.

Revoking the Option To Tax

Under a real estate election, it is possible to revoke the option to tax on a property by property basis.

Given that the option to tax will be disapplied (have no effect) in respect of the Beta lease, and that the property is expected to be leased to insurance companies where an exempt lease would be preferable, it is recommended that the option to tax on Erton House is revoked.

Liability of Leases

On the assumption that the option to tax is revoked, the element of the lease relating to the exclusive occupation of the building will be exempt. There are however various other elements of the lease.

The right for tenants to install servers and computing facilities is part of their right of occupation and enjoyment of the property so is exempt.

The supply of electricity (for business purposes) is standard rated. The Calingrove case found that there was a single supply of caravan pitches with an ancillary supply of electricity. The same principles apply to the electricity supplied as part of the lease of Erton house. There is a single supply of the lease with an ancillary element for the supply of electricity. Therefore there will be no separate standard rated supply of electricity. This would only occur if there was an optional separate payment for electricity based on usage. The liability for the electricity will therefore follow that of the main supply of the lease, and will therefore be exempt.

The use of meeting rooms is the hire of facilities so is exempt.

Catering is standard rated. Where catering is supplied to

employees, the value of the supply is deemed to be the monetary consideration only. This does not make the use of the subsidised restaurant and exempt supply, it simply means that the value of this supply as part of the lease is reduced to nil for VAT purposes.

Gym membership is standard rated as it is an excepted item under VATA 1994 Sch 9 Group 1 (note m).

Parking is standard rated as it is an excepted item under VATA 1994 Sch 9 Group 1 (note h).

There are two elements of the lease that will be standard rated. VAT will be chargeable on the amount of the lease that relates to these elements. This VAT is of course irrecoverable by the insurance companies. However, these appear to be a relatively small part of the overall lease so the impact of this is fairly small.

----------ANSWER-4-ABOVE----------

----------ANSWER-5-BELOW----------

Answer-to-Question-_5_

VAT Group

As of June 2023 Amlow Investments LLP (Amlow) owns 60% of the share capital of Fabby Food Ltd (Fabby) and 100% of the share capital of Fhosst Catering Ltd (Fhosst).

Amlow therefore controls both companies (control is based on ownership of share capital so Mr Turner right to profits does not override Amlow's control.

Amlow, Fabby and Fhosst are all eligible to join a VAT group with each other as both Fabby and Fhosst are controlled by Amlow.
The group does not have to include all three companies. Fabby and Fhosst could form a group together as they are under common control.
Amlow could form a group with either of the other two companies.

Implications of a VAT Group
If the companies form a VAT group, intra group supplies will be disregarded.

The management charges are a standard rated suppy. As Amlow is partially exempt, 90% of the VAT on the management charges is irrecoverable without a VAT group. With a VAT group, these supplies would be disregarded so there would be no irrecoverable VAT on management charges.

If Amlow is included in the group, the group as a whole would be partially exempt. The fact that Amlow has exempt supplies then impacts input tax recovery for the group as a whole. Given that Amlow's exempt residential rents would form almost half of the turnover of the group, this impact would be significant so Amlow being included in a group is not recommended.

Fabby has a monthly VAT return currently. If grouped, the cash flow benefit of the monthly return is lost. However, the amount is very small compared with the other amounts involved so this will not form a significant part of the basis of the decision of whether to form a VAT group.

A VAT group would not be recommended. This is due to the loss of Fabby's cash flow benefit and the inclusion of Amlow in a VAT group having a more detrimental impact than the irrecoverable VAT on the management charges.

Other Recommendations For Mitigating VAT Costs
If Amlow set up a subsidiary company outside of the VAT group and the residential properties were transferred to that company, the initial transfer would be exempt. There would be a "one-off hit" to recoverability of input tax. However, going forwards Amlow (and the group) would be fully taxable so all input tax within the group would be recoverable subject to the usual rules (blocked input tax etc.).

Amlow could consider whether a special partial exemption method would improve input tax recovery. This could, for example, be based on the number of properties, rather than turnover. The process for applying for a partial exemption special method is lengthy and Amlow would need to demonstrate why a special method would produce a fairer result than the standard method.

Fabby could reconsider whether management charges to Amlow are appropriate or not, as there is a VAT cost to these. Fabby may not be supplying services for these, in which case it would be better not to charge them.

----------ANSWER-5-ABOVE----------

----------ANSWER-6-BELOW----------

Answer-to-Question-_6_

Composite Supply
HMRC is treating the supply of the magazine as ancillary to the main supply of television services.

The Card Protection Plan case considered the perspective of the customer when deciding whether a supply was single or mixed.

The customers make a decision whether they wish to recieve the magazine, so from the perspective of the customer, they are subscribing to a television service and a magazine as separate items.

In the Black Cab Services case, insurance was found to be a separate exempt supply where it was offered as an optional extra to customers. Conversely, in the Calingrove case, the supply was a single supply of a caravan pitch with an ancillary supply of electricity. Therefore, if part of a supply is optional, it should be considered a multiple supply, with separate VAT liabilities applied to each component.

The magazine is optional for customers of the television service so should be considered a separate supply which is zero rated.

Where supplies are bundled together, the price must be allocated across the different elements (M&S "free" gift of wine case). The price should be apportioned on a fair and reasonable basis.

The television services and magazine are bundled together when supplied monthly. However, VAT is only charged on 50% of the net price. Given that on their own, the television service is priced at £600 and the magazine is priced at £60, the apportionment of the net price should be more like 1/11th being zero-rated.

Assessment 1
The basis on which the assessment has been raised is reasonable. However, the calculation method is suitable as it is based on the supplies of Nesse Ltd, not Oder Ltd and Oder Ltd is the company being assessed.

The calculation should be based on a fair and reasonable

apportionment of the mixed supplies made by Oder Ltd as detailed above.

Assessment 2

Nesse Ltd (Nesse) has correctly charged VAT on its advertising income. The sales of magazine to non-subscribers are correctly zero-rated. Therefore, there is grounds for HMRC to have issued an assessment on Nesse.

It appears that they may be trying to hold Nesse jointly and severally liable for the assessment on Oder Ltd (Oder).
This would be relevant in circumstances such as missing trader fraud, which do not apply here or if Oder and Nesse were in a VAT group, which is not the case.

Assessment 3

The deficit payments do not amount to consideration for goods or services as it is given voluntarily by Oder. Therefore, there is no supply for VAT purposes so the assessment is not valid.