# The Chartered Institute of Taxation

## Advanced Technical

## Domestic Indirect Taxation

## May 2023

## Suggested solutions

**ANSWER 1**

**Vaccinations**

The traditional administered travel vaccinations offered by Yeldon Ltd ("Yeldon") are likely to qualify for VAT exemption under Item 1(d) Group 7 Schedule 9 VAT Act 1994.

In order to qualify, it has to be a supply of medical services by a registered healthcare professional. A nurse is a registered healthcare professional, and *Dr Peter d'Ambrumenil (C-307/01),* established the 'purpose test' whereby, healthcare professionals can exempt their services where the purpose test is met; i.e. to protect, maintain or restore the health of an individual.

Vaccinations are offered to protect a person from becoming seriously ill, and therefore, the test is met.

The malaria prevention service by contrast is not a service performed by a registered healthcare professional and will not be VAT exempt. The medication is prescribed to an individual for self-administration by an appropriate person (a registered pharmacist), and as such will be zero-rated by virtue of Item 1, Group 12, Schedule 8 VAT Act 1994.

**Vaccination Guarantee**

The vaccination guarantee appears to be an insurance policy for the traveller and is VAT exempt (Item 1, Group 2, Schedule 9 VAT Act 1994). Whilst there is no definition of insurance for VAT purposes, it is generally understood that where an insurer, in return for a premium, undertakes to provide services agreed in the event of the materialisation of the risk covered, it will constitute insurance.

**Covid testing**

As with the vaccination offering, where services are performed by a medical health professional, and the primary purpose test is met, the supply will be VAT exempt.

Yeldon's offering is aimed at travellers, which arguably is not primarily concerned with protecting, maintaining or restoring the health of an individual (the purpose test), but instead, allowing a third party (i.e. an airline) to make a decision. However, HMRC's VAT brief (Brief 11, 2021) confirms that HMRC considers travel tests to meet the purpose test for VAT exemption, so it is reasonable that Yeldon's offerings should qualify for VAT exemption.

Item 1, Group 7 of Schedule 9 allows for medical services to be exempt when provided by a registered healthcare professional. Note 2 of the group allows an unregistered person, to make an exempt supply under item 1, where the services are '*wholly performed or directly supervised'* by a registered person. This would mean that Yeldon could exempt a supply, where the medical services are wholly performed or directly supervised by one of the registered health professionals.

There are two offerings, one in which the sample is collected/overseen by a registered nurse, and those where test kits are posted to individuals who order online. HMRC's brief (11/2021) implies that for exemption to apply to covid testing, the test will need to be administered by a registered healthcare professional, presumably in order to be '*wholly performed or directly supervised*' in accordance with Note 2, Group 7 Schedule 9 VAT Act 1994. Therefore, it is expected that for tests where samples are collected/overseen by registered healthcare professionals in Yeldon's clinic, the supply will be exempt, but for those self-administered and posted to the laboratory, the supply will be standard rated.

It is worth adding that the additional £7.50 charge, although it may appear initially to be a separate postage cost, the customer is likely to consider this to be part of a single supply of testing services. The extra charge for postage is just an ancillary component of the testing service required by the end user, thus making the whole supply liable to VAT at the standard rate.

The service offered by Yeldon is the testing of a sample, which itself is subcontracted to a laboratory. Both laboratories use biomedical scientists to manage and oversee the service offering. Biomedical scientists are accepted by HMRC as a registered health professional, and thus where they are undertaken to protect, maintain and restore the health of an individual patient, can be VAT exempt.

Both laboratories are providing services that are VAT exempt, and Yeldon should contact Laralab Ltd to challenge the VAT charged on testing services.

**Input tax recovery**

As a result of making both taxable and exempt supplies, Yeldon is partially exempt business and will be required to undertake an annual calculation to calculate the proportion of VAT recoverable on overhead costs. It may consider the use of a partial exemption special method (PESM),( e.g. transaction count) to provide it with a more favourable VAT recovery.

Yeldon will not be able to recover any VAT on drugs/ consumables used in the vaccination/ directly administered Covid testing, but it will be able to recover input on drugs/ consumables used in the malaria prevention service and self-administered covid testing. Yeldon should ensure it does not recover VAT that has been incorrectly charged (e.g. by Laralab) and instead, should seek recourse from the supplier.

**Insurance premium tax (IPT) -Vaccination Guarantee**

IPT is an indirect tax levied on supplies of insurance. IPT will only be due on insurance agreements where the risk is located within the UK, and there are two rates applicable in the UK, the standard rate (12%) and the higher rate (20%).

IPT is due on the 'premium'. A premium is the amount that an insurer receives or is entitled to receive under a taxable contract of insurance. IPT doesn't generally apply to guarantees, however, in this case, whilst described as a guarantee, it is more akin to an insurance policy. This is because unlike a guarantee, which usually has 3 parties to the contract (guarantor, creditor and debtor) this is a primary liability for Yeldon and there are only two parties involved.

Travel insurance is liable to IPT at the higher rate, 20%. Where a policy is taken out in the UK for a maximum four-month period covering a travel or holiday risk, it is deemed to be a UK risk. The vaccination guarantee offering appears to be a premium, for a period of less than four months covering a holiday/travel risk; it will therefore be liable to IPT at the higher rate

**ANSWER 1 MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| **Vaccinations** | |
| Vaccinations will be VAT exempt | 1 |
| Must be performed by a registered healthcare professional | 1 |
| Must be medical services that meet the 'purpose' test established in *Dr Peter d'Ambrumenil (C-307/01) [case not required for point]* | 1 |
| Malaria prevention is not performed by a registered healthcare professional, not exempt | 1 |
| Prescribed by an appropriate person (pharmacist) and zero-rated under Item 1 Group 12 Schedule 8 VAT Act 1994 | 1 |
| **Vaccination Guarantee** | |
| Guarantee is a type of insurance policy and VAT exempt | 0.5 |
| **Covid testing** | |
| Testing for the purposes of travel – discussion around purpose test, HMRC's acceptance that VAT exempt | 1 |
| Application of '*wholly performed and directly supervised*' note in group 7, Yeldon can exempt supplies as a result | 2 |
| Should be VAT exempt – recourse is to the supplier for VAT charged in error | 1 |
| Discussion on whether 'wholly performed' note requires the test to be administered by registered health professional; HMRC brief 11/2021 confirms a test should be administered to be classified as exempt for VAT | 2 |
| Self-administered tests should be taxable at the standard rate | 1 |
| Additional postage charge, part of a single supply of testing. Should be standard rated as follows liability of self-administered test | 1 |
| Laboratory testing services – using registered healthcare professionals (biomedical scientists) and meet the purpose test. | 2 |
| **Input Tax recovery** | |
| Partially exempt business, will need to undertake a calculation to attribute VAT on overheads | 0.5 |

| | |
|---|---|
| No recovery on costs related to vaccinations/ administered vaccinations, but recovery on costs related to malaria prevention service and self-administered testing | 1 |
| **Insurance Premium Tax (IPT)** | |
| IPT general explanation – indirect tax levied on insurance, UK risks, standard (12%) and higher rate (20%) in the UK, | 0.5 |
| IPT is due on the premium; explanation of premium | 0.5 |
| Guarantees not usually liable to IPT, but analysis of this supply as being more akin to an insurance contract than a guarantee for IPT purposes | 1 |
| Travel insurance – recognising this is a policy relating to travel, liable to IPT at 20% as a UK risk (because taken out in the UK for less than 4 months) | 1 |
| **TOTAL** | **20** |

**ANSWER 2**

**Shop Income**

Markdeen Ltd ("Markdeen") is receiving income from the shop operation, with the operational support of Markdeen Trading Ltd ("MTL"). The income is used to pay staff and for stock, but is still taxable income for VAT purposes, and counts towards the VAT registration threshold. If MTL's share is 5% and a minimum of £5,000, it is likely Markdeen have unknowingly breached the VAT registration threshold (£85,000) in the first year of trading at those levels.

Markdeen may therefore face penalties for failing to notify HMRC of between 0% and 30% of the VAT due depending on how many months have passed since the requirement to register existed. Penalties can be reduced by telling, helping and giving HMRC access to records. HMRC have the powers to assess tax back as far as 20 years for a failure to notify.

**Lease with Lang4U**

The issue is whether MTL is making supplies as an agent for the charity. Potentially there may be a lease and sub-leasing arrangement, but if HMRC consider this to be an agency arrangement, it may also consider that MTL is making supplies of management services (at the standard VAT rate) to Markdeen.

The starting point for establishing whether an agency arrangement exists is to consider what contractual arrangements exist between the parties *(Airtours Holiday Transport Ltd v HMRC [2016] UKSC 21, [2015] STC 61)*. It is then useful to consider whether the 'economic reality' differs from the contractual position such that it undermines the VAT treatment aligned with the contractual position. *Secret Hotels 2 v HMRC [2014] UKSC 16* highlights this approach, where the Court confirmed it would consider the "*surrounding circumstances in so far as they were known to both parties, and to commercial common sense"* as well as whether the wording of the contract "*can be said to represent the economic reality of the relationship in the light of any relevant facts".*

It is evident that MTL has an agreement with Lang4U Ltd, in its own name, as if it rightfully were able to. This is despite the lack of an accessible formal agreement documenting such a right between MTL and Markdeen. Recharges of costs such as utilities and back-office on a regular basis supports a mutual understanding or agreement, that MTL is legally intended to have a right of occupation of the grounds/buildings.

As a result, the income should be treated with reference to the economic reality. The facts are supportive of MTL acting as principal (rather than as an agent), and the income collected represents VAT exempt rental rather than taxable income for management services to its parent company (equal to the value of rent collected).

**Boot fair**

If MTL operates the boot fair itself, collecting £10 per car, this is generally accepted by HMRC as a passive supply of land and thus VAT exempt (subject to an option to tax). However, if MTL enters into the agreement with a commercial boot fair operator, the VAT liability of the supply will depend what '*associated facilities'* are provided.

These principles were challenged in the FTT case of *Rufforth Park Ltd (2022) UKFTT 43 (TC),* where HMRC unsuccessfully argued the supply of services by the appellant amounted to more than a passive supply of land by virtue of additional services such as parking, toilets, on-site café, covered pitches and capital improvements to the site.

In the case of *Zombory-Moldovan T/A Craft Carnival [2016],* similar supplies of stall rental at a craft fair were deemed to be standard rated. The cases were distinguished based on facts, for example Rufforth Park Ltd did not have a formal contract with customers, an obligation to run the boot fair or security, no chairs, tables or electricity was provided, and the facilities (toilet and café) were basic. In summary, the more basic and passive the supply, the more likely it is that it will be VAT exempt.

It is likely that in this instance, the facilities being provided are going to be basic, as in the case of Rufforth Park Ltd (i.e. toilets and refreshments), and therefore the rental income will be VAT exempt.

Partial Exemption

Following the above analysis, both MTL and Markdeen will be making both taxable and exempt supplies and so should consider partial exemption, especially as Markdeen may have to register for VAT retrospectively and consider charging VAT on its supplies to MTL, either automatically on the supply of utilities and back-office services, or by considering the option to tax on the lease to MTL.

**ANSWER 2 MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| **Café Income** | |
| VAT registration requirement for the charity | 1 |
| Penalties for late notification (0-30%) | 0.5 |
| Mitigating penalties (telling, helping, giving access) | 0.5 |
| HMRC power to assess back as far as 20 years for a failure to notify (s77(4) VATA 1994 *7*) | 1 |
| **Lease with local language school** | |
| Whether an agency arrangement exists as potential VAT consequence | 1 |
| Disclosed vs undisclosed agency | 1 |
| Assess VAT position by looking at contractual position, but consider the impact of economic reality on the VAT - *Airtours Holiday Transport Ltd v HMRC [2016] UKSC 21, [2015] STC 61 & Secret Hotels 2 v HMRC [2014] UKSC 16* | 2 |
| Application to Markdeen Trading – clear that all parties believed subsidiary were acting as principal, exempt rental not taxable management services | 2 |
| **Boot fair** | |
| Running the boot fair itself means income likely to be accepted by HMRC as VAT exempt (para 2.6 VAT Notice 742) | 1 |
| Offering to commercial operator – depends what is being supplied facility wise as to whether it will be VAT exempt land or facilities | 1 |
| Discussion of principles establishing land vs facility Rufforth Park Ltd, Craft Carnivals (Zombory-Moldovan T/A Craft Carnival [2016]) | 2 |
| Conclusion – likely VAT exempt unless significant services provided | 1 |
| Partial Exemption | |
| Recognition of the need to consider partial exemption | 1 |
| **Total** | 15 |

**ANSWER 3**

**Restructuring**

The current offering by HWE Ltd ('HWE') is a single supply for VAT purposes; all elements are included in return for a single price with a single VAT liability (standard rated).

Restructuring requires more than a simple change to VAT accounting; it would require a fundamental change to the nature of its offering to customers. This could be beneficial as some elements may not be liable to VAT if offered separately.

It may be possible to amend the offering to a multiple supply, in which the various elements of the package are made available to customers separately. Customers must be able to select the options they would like to purchase, without obligation to purchase others. This may have undesirable commercial consequences for HWE.

In restructuring the supply, HWE Ltd will still not be able to exempt any of its supplies as education. It is not an eligible body (Item 1, Group 6, Schedule 9 VATA 1994), and as a limited company, it will not be providing 'private tuition' independently of an employer, as outlined in item 2 of the same group. If however the examination fees are being disbursed by HWE Ltd only, and these services are being provided by an eligible body, they could possibly be passed on to the individual customer without VAT being added.

HWE may be able to benefit from the zero-rate introduced with effect from 1 May 2020 on electronic publications, if the training materials were offered separately to customers. The benefit of the zero rate on training materials could be increased by 'value shifting'. This is used by businesses selling a bundle of services, to apportion more value to items which are zero-rated or exempt, than those which might be taxable, reducing the amount of VAT which needs to be accounted for.

**Abusive practice**

Where contractual arrangements are inconsistent with the economic reality, HMRC may consider the situation to be artificial. The abuse principal was established in the case of *Halifax* (C-255/02) and was subsequently applied to a supply splitting scenario in *Part Service* (C-425/06).

The two tests identified in the Halifax case mean that abuse occurs if an arrangement produces a tax advantage that is contrary to the purpose of the legislation, and the essential aim of those arrangements is to gain a tax advantage.

If a transaction is deemed to be abusive, the arrangements will be redefined to deny the tax advantage sought (i.e. with supply splitting, by combining the supplies together).

A challenge is reasonably likely by HMRC in this scenario, as both of the Halifax tests are met. The economic reality would appear to be inconsistent with the revised contractual arrangements, with many customers likely purchasing the same thing before and after the restructure, with only a tax advantage gained.

**Disclosure of Tax Avoidance Schemes:** VAT and other indirect taxes **(DASVOIT)**

If an organisation promotes or uses arrangements which will give or intend to give it a VAT or other indirect tax advantage, there is an obligation to notify the arrangements to HMRC, where the following criteria are met:

1. The arrangements enable or might expect to enable a person to gain an indirect tax advantage,
2. This advantage is, or might be expected to be, the primary or one or the primary reasons for entering the arrangement
3. The arrangements fall within the 'hallmarks' outlined in the Notifiable Arrangement Regulations.

The main duty to disclose a tax avoidance scheme under DASVOIT falls on the promoter of the scheme.

The tax advisers have proposed a restructure of HWE's affairs and have made a firm approach to the customer with the proposal, and so will be considered promotor for the scheme.

The proposal will create a tax advantage by reducing the amount of output tax due, and it appears to be the primary reason for HWE to proceed. From the information provided, it is suggested that value shifting and splitting a single supply to create a VAT advantage will both apply here (one of the hallmarks outlined in the Notifiable Arrangement Regulations).

Certain arrangements which have been made available/ proposed prior to 1 January 2018, or are substantially the same as those previously made available or implemented, are excluded from disclosure under a concept known as 'grandfathering'. Accordingly, unless grandfathering specifically applies, the scheme is notifiable. The obligation to notify will fall on to the promoter (the adviser) rather than HWE Ltd.

Examiners note: HMRC have recently consulted on VAT and value shifting, and it is therefore evident HMRC are aware that this is common practice which the government intends to legislate against.

**ANSWER 3 MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| **Restructuring the offering** | |
| Current supply single supply with single VAT liability. Possible to amend offering to multiple supply. | 1 |
| Must be separate options available for taking up services. More than a change to VAT accounting, requires a change in the nature of supplies | 2 |
| No opportunity for exemption, discussion on criteria for exemption on education in context of HWE Ltd and disbursement of exam fees | 2 |
| Opportunity to use zero-rate introduced on electronic publications | 1 |
| Potential for using value-shifting to maximise opportunity | 1 |
| **Abusive practice** | |
| Explanation of abuse and case law | 1 |
| Halifax tests for abusive practice | 1 |
| Consequence of abuse – redefinition of transactions to deny tax advantage sought | 1 |
| Application of abuse to HWE Ltd scenario | 1 |
| **Disclosure of Tax Avoidance Schemes (DASVOIT)** | |
| Explanation of DASVOIT and criteria for notifying to HMRC | 1 |
| Main duty on promoter to disclose, explanation of what a promoter is | 1 |
| Applying DASVOIT to HWE Ltd and its tax advisers | 1 |
| DASVOIT – grandfathering and scheme notification | 1 |
| **Total** | 15 |

**ANSWER 4**

Unit A

The sale of Unit A may be a Transfer Of A Going Concern (TOGC), in which case it will not be a supply for VAT purposes. The transfer of a single property can be regarded as a business, and the buyer is VAT registered, so two of the relevant conditions are met.

For the purposes of a TOGC, the business must be of the 'same kind', not identical. Whilst Rupert was leasing the unit full time and Arts Helps Hands ("AHH") intends to use the property for its own purposes on occasion, this should not breach this condition. HMRC allow part tenanted properties to be considered TOGCs, however AHH's own activities could be considered a different use of the property and may breach the TOGC condition. Whilst not free from doubt, on balance this should qualify as a TOGC given the majority of the time this property will be leased.

Consideration must also be given to the break in trade, as AHH will be pausing activity to refurbish the unit. HMRC does not give a specific period of time that would break this condition, and such breaks in trade must be considered in the context of the business. In *Harber [1994] 1231* it was found that a break in trade for refurbishments did not breach the condition. As AHH intends to immediately begin with the refurbishment works and make supplies of the property, this condition should be met.

Rupert should obtain confirmation that AHH has, or will by the relevant date, opted to tax the property. He should also obtain written confirmation that this option will not be disapplied. As Unit A is not currently or planned to be a Capital Item, this test should be satisfied. It is recommended however that this is included within the contract.

On this basis, the sale of Unit A should qualify as a TOGC.

Unit B

Unit B will not qualify as a TOGC as AHH will be using its head office, which will not be the same type of business as carried on by Rupert previously.

As Rupert has opted to tax, the default position will be that VAT will be due. The disapplication rules will not apply to this property sale as this will not qualify as a relevant charitable purpose (para 7, Sch 10, VATA 1994) given AHH intends to use this as its office.

AHH has however advised that it will not be willing to pay a full 20% over market price. Therefore, to the extent that Rupert's option to tax applies, Rupert will be obliged to account for 1/6 of the sale price as VAT, or £100,000 at the market price.

As Rupert only opted to tax the property 2 months ago, he may be able to revoke this under the 'cooling off' provision in para 23, Sch 10, VATA 1994. This allows the option to tax to be revoked within 6 months of it being exercised, assuming the conditions in para 23 (1) apply. Less than 6 months have passed since Rupert opted to tax; no tax has yet become due as he has not made supplies of the property, and there is no transfer of a going concern. Rupert would also need to notify on a VAT 1614C form. Four of the relevant conditions are therefore met.

In addition, HMRC's Public Notice 742A also requires that one of a further three conditions is met.

One of these relates to the clawback of input tax where the first use of the property differs from the originally intended use. Should the revocation apply, Rupert would be making an exempt sale of the property rather than the intended taxable supply. Given that no taxable supplies have yet taken place, the exempt sale would be the first use of the property and hence the clawback rules would apply, as this takes place within 6 years of Rupert's original intention. This would follow the decision in *Tremerton Ltd [2000] BVC 3*.

Therefore condition (2) would be met and hence Rupert would be entitled to revoke the option to tax. This requires Rupert to pay back the input tax incurred on the refurbishment works. This would however be less than the output tax he would otherwise need to account for if the option to tax is not revoked and would therefore be the preferred approach.

Rupert should request that AHH contributes to this via an increased purchase price. This would be lower than the VAT Arts Helps Hands would have otherwise incurred and may allow the parties to share this cost.

Rupert must ensure that he revokes the option before this 6-month period has expired.

Unit C

Rupert is not making a supply of Unit C. However, as he has ceased trading, he will have a requirement to de-register from VAT. He will be required to notify HMRC within 30 days of ceasing activity via a VAT 7 form. He will then have to complete a final VAT return.

On the final VAT return, Rupert will need to account for a deemed supply on any assets on hand on which he has previously recovered input tax, except to the extent that such output tax would not exceed £1,000.

Rupert has recovered £30,000 input tax on fixtures within Unit C that he will be retaining for his personal use. As such, he will have an obligation to account for a deemed supply on these goods. Output tax is likely to be due on the value of the goods if they were purchased today (para 6, Sch 6, VATA 1994). Given these are relatively new assets, it is likely that Rupert would be required to account for output tax on the value of £150,000, and effectively be in a position of repaying the input tax previously recovered.

HMRC's Notice 700/11 also requires a deemed supply to be accounted for on any interest in land that would be taxable if sold. However, HMRC has a specific exemption for land or buildings on which no VAT was incurred on the purchase. Therefore, Rupert will not be required to account for output tax on Unit C itself.

**ANSWER 4 MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| **Unit A** | |
| Summarise the conditions that are met for a TOGC | 1 |
| Same kind of business discussion and conclusion that this is the same kind of business and condition is met | 1.5 |
| Break in trade – discussion of whether the refurbishments would break this condition and conclude condition is met. Refer to principles of refurbishments in cases such as Harber or Old Red Lion (Case names not needed for marks) | 1.5 |
| Additional property conditions, and recommendation to Rupert regarding contractual clauses | 1 |
| Consideration of disapplication rules, conclude that these will not apply | 1 |
| Conclude that this would be a TOGC | 0.5 |
| **Unit B** | |
| No TOGC as charity using the unit for its own purposes | 1 |
| No disapplication of the option to tax as the use by the charity is not a relevant charitable purpose | 1 |
| Revocation of the option to tax under the 6-month rule, confirm that initial 4 conditions are met | 1.5 |
| Revocation form and time limit | 0.5 |
| Consider additional 3 conditions from HMRC guidance, conclude that conditions (1) and (3) wouldn't be met | 1 |
| Discussion of condition (2), conclude that this would require a clawback adjustment and hence condition is met, Tremerton decision (case not required for mark) | 1.5 |
| Conclude revocation conditions are met | 0.5 |
| Calculate VAT due on sale compared to VAT due under clawback, determine revocation is better for Rupert | 1 |
| Possibility for Rupert to negotiate and request Arts Helps Hands contributes to input tax cost via a higher purchase price | 0.5 |
| **Unit C** | |

| | |
|---|---|
| Requirement for Rupert to de-register from VAT due to no further business activities | 1 |
| Identify requirements to notify, relevant form, time limits, and final VAT return | 1 |
| Deemed supply on assets on hand at de-registration rules | 0.5 |
| No deemed supply on the property itself as no input tax recovered on the purchase, but would be due on additional fixtures and fittings | 1 |
| Value on which output tax will be due, reference to Schedule 6 | 1 |
| Calculation of likely output tax charge | 0.5 |
| **TOTAL** | **20** |

**ANSWER 5**

Termination Payments

Following EU various cases, HMRC revisited their policy on termination payments and sought to bring these within the scope of VAT where they are consideration for a supply; specifically if there is a direct link between the amount received and that supply. This position was supported in *MEO [2018] Bus LR 1155* which held that specific contractual clauses requiring payment upon early termination are additional consideration, even where the customer was no longer receiving the supply.

HMRC recognise the existence of damages payments as still being outside the scope of VAT, though merely referring to a payment as "damages" is not sufficient. Payments are likely to still fall within the scope of VAT where a customer does not use all of a supply to which they are entitled, or breach other contractual terms, and are required to pay a penalty fee.

An exception to this is in the case of 'punitive' damages, whereby the amount paid is seen as intended to prevent a breach of contract, rather than provide compensation for lost income. In these instances, HMRC consider the link between the payment and the underlying supply to be broken, such that this is not further consideration for the underlying supply and is outside the scope of VAT. Such amount is not defined by HMRC and must be considered in the context of the contract.

For CellMan, it appears therefore that the 25% compensation clause in its contract will be subject to VAT as further consideration for the supply of energy. Whilst this is less than the amount CellMan would have received if the contract had run its course, *Vodafone Portugal [2020] STC 1975* found this not to be determinative.

In respect of the larger payments for earlier terminations, CellMan may contend that these could be 'punitive' and hence outside the scope of VAT if set at an appropriately high level compared to the length of time remaining on the contract.

However, HMRC's guidance on this is that it sees punitive damages as amounts intended to prevent the contract termination rather than compensate the supplier. The additional 20% charge is fixed regardless of the time remaining on the contract. Even where this is only 6 months, the total fee payable by the customer is unlikely to prevent them from cancelling.

Consequently, it may be difficult for CellMan to argue that these are punitive damages and HMRC are likely to impose that VAT is due on the higher termination fees also.

Debt book

CellMan will need to consider its obligation to account for VAT upon receipt of amounts recovered from customers on the acquired debts.

The tax point for energy supplies is the earlier of the receipt of payment or issue of an invoice (Reg SI 1995/2518). CellMan may therefore have an obligation to account for output tax on amounts received if the original supplier had not already raised a VAT invoice for the supply in question. CellMan should therefore ensure that it obtains the relevant information from the sellers to allow it to account for VAT.

Mixed Supplies

Energy can be provided at a reduced rate of VAT where this is for a 'qualifying use' within para 3, Group 1, Sch 7A, VATA 1994. This includes domestic use or use by a charity otherwise than for business purposes.

Use by student accommodation blocks will be qualifying use as this will be deemed as a 'relevant residential purpose' within para 6 of this Group. However, the remaining lease of the building for use as a restaurant, etc will not be 'qualifying use'.

Given this customer will be using less than 60% of the property for relevant residential purposes, CellMan will need to apportion its supply and charge VAT at 5% on the supply to the accommodation, and 20% on the supply to the commercial part (Para 4, Group 5, Sch 7A, VATA 1994).

CellMan should obtain a certificate from Studhome stating the relevant apportionment and CellMan will have an obligation to carry out due diligence checks to ensure that this is reasonable. CellMan should request updated certificates on a regular basis, to confirm that the property is still being used in the same way.

CellMan should also consider the de minimis rules going forward for business customers who signed up to smaller contracts. It is possible that supplies may fall within the deemed domestic provisions in para 5, Group 1, Sch 7A, VATA 1994, wherein supplies under these thresholds, are charged at the reduced rate, regardless of the status of the customer.

**ANSWER 5 MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| **Termination Payments** | |
| Recognise change in HMRC policy | 0.5 |
| Direct link between the amounts due and the underlying supply, include reference and comparison to MEO case | 1.5 |
| Damages payments are still outside the scope of VAT | 0.5 |
| Considerations for whether a payment is damages – entitlement to the supply and breach of contract | 1 |
| Punitive damages are outside the scope, they are designed to prevent a breach and not compensate for lost income | 1 |
| Consider 25% early exit fee - the amount does not have to match the amount that would be received under the contract, reference to Vodafone case | 1.5 |
| Conclude 25% exit fee will be subject to VAT | 0.5 |
| Consider larger fee, reference HMRC guidance that this is not seen as preventative and would not prevent a customer from cancelling | 1.5 |
| Conclude that larger fees are likely to be subject to VAT | 0.5 |
| **Debt Books** | |
| Regulation 86 reference and rules | 0.5 |
| Impact on CellMan Ltd and potential requirement to account for VAT on amounts received from new customers | 1 |
| **Ongoing Supplies** | |
| Supplies for a qualifying use are subject to VAT at the reduced rate | 0.5 |
| Student accommodation qualifies as a relevant residential purpose and hence a domestic supply, restaurant, grocers, barber do not | 1 |
| Apportionment required as less than 60% is qualifying use | 1 |
| Certification from customer, CellMan Ltd's obligations to review and recommendations to renew regularly | 1.5 |
| De-minimis rules for new customers on small contracts, may be subject to VAT at 5% | 1 |
| **TOTAL** | **15** |

**ANSWER 6**

Purchase of Main Home

For SDLT, Sally would be considered non-resident in the UK in line with para 4, Sch 9A, FA 2003, as she has not spent 183 days in the UK within the last 12 months. Her 6-month visit in 2020 would now be out of time for these purposes and she has only spent 3 months within the last 12 months.

Therefore, Sally will be required to pay a surcharge rate of 2% on top of the SDLT rates applicable to residential property.

As this is Sally's first property in the UK , the additional 3% surcharge applicable to second homes will not apply, however.

Based on the current offer Sally has placed on the property, she will be liable for SDLT as follows:

| Price (£) | Non-Resident SDLT Rate | Non-Resident SDLT Charge (£) |
|---|---|---|
| 125,000 | 2% | 2,500 |
| 125,000 – 250,000 | 4% | 5,000 |
| 250,000 – 900,000 | 7% | 45,500 |
| **Total** | | **53,000** |

The residency test for SDLT purposes runs from the year prior to the transaction, through to the year following the transaction completion date (para 4(2), Sch 9, FA 2003). Consequently, it is likely that Sally would be considered a resident on the basis that this will be her main home following the transaction. If this were the case, Sally must still account for SDLT based on her status at the time of the transaction but would be entitled to a refund of the additional surcharge should she satisfy the 183-day threshold within the following year. Such a reclaim would need to be made within 2 years of the completion of the transaction.

Sally would be able to make a reclaim for £18,000 based on the difference between the non-resident and resident rates:

| Price (£) | Resident SDLT Rate | Resident SDLT Charge (£) |
|---|---|---|
| 125,000 | 0% | 0 |
| 125,000 – 250,000 | 2% | 2,500 |
| 250,000 – 900,000 | 5% | 32,500 |
| **Total** | | **35,000** |

Corner Shop

The corner shop will be considered a 'mixed property' under s55, FA 2003 given it is not entirely residential and hence the non-residential SDLT rates will apply. Sch 4, FA 2003 sets out the elements that can constitute chargeable consideration.

Sally is paying £350,000 in cash at or before completion which will form part of the chargeable consideration.

Para 3, Sch 4, FA 2003 deals with postponed consideration such as the amount Sally will be liable to pay once the tenant has been identified. This is included within the SDLT calculation at the date of the transaction as though the amount were due at that time. There is no possibility to discount this amount on the basis that it will be paid in the future and hence this will also form part of the chargeable consideration.

Sally is also agreeing to carry out works for the seller, that may otherwise be the seller's obligation. Para 10 Sch 4 sets out when such works are included in the chargeable consideration.

Sally is carrying on works on the land to be acquired, and it does not appear that as a condition of the contract these fall to be the vendor's obligations, in which case the works would be excluded as part of the consideration.

However, Sally will be carrying out the works before practical completion and hence there is a risk that condition (a) of para 10(2), Sch 4 regarding works being undertaken after completion would not be met, meaning the value of the works is considered to be chargeable consideration.

In response to this risk, Sally proposed, and has been granted, full and exclusive rights of access in order to carry out the works. The completion date for a land transaction can be overridden as the 'effective date' for SDLT purposes if the transaction is 'substantially performed' in which case the contract date is said to be the effective date. This is defined in s44, para 5, FA 2003 as either the purchaser taking possession of the whole property or paying a substantial amount of consideration. Sally effectively will have control of the property upon paying the deposit and hence the contract will be substantially performed at that date.

Accordingly, Sally is carrying out the works after the 'effective date' of the transaction, meeting all of the conditions in para 10(2), Sch 4, and so the value of the works carried out would not constitute part of the chargeable consideration for the property.

Therefore, the SDLT due on the property will be:

| **Price (£)** | **SDLT Rate** | **SDLT Charge (£)** |
|---|---|---|
| 150,000 | 0% | 0 |
| 150,000 – 250,000 | 2% | 2,000 |
| 250,000 – 400,000 | 5% | 7,500 |
| **Total** | | **9,500** |

**Examiner's Note**

Use of current rates will still gain full marks

**ANSWER 6 MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| **Main Home** | |
| Sally would be deemed as a non-resident, including application of the rules | 1 |
| Therefore 2% surcharge on the SDLT that she will be required to pay | 0.5 |
| Sally is selling home in France, so no 3% surcharge applicable for 2nd property | 0.5 |
| Calculation of SDLT | 1 |
| Reconsideration of non-resident rules, runs up to year following purchase. Conclude that Sally may meet these rules if she lives in the UK for the next 6 months | 1.5 |
| Ability to recalculate SDLT if Sally meets the resident rules, must account for 2% surcharge at time of purchase, but ability to make a reclaim | 1.5 |
| Calculation of reclaim | 1 |
| **Corner Shop** | |
| Mixed use property so non-residential rates will apply | 0.5 |
| Analysis of chargeable consideration required, cash will always form part of this | 0.5 |
| Postponed consideration will be included, no ability to discount this to present value | 1 |
| Works on land may be chargeable consideration, conclude that conditions 2(b) and (c) are met | 1.5 |
| Work carried out before conclusion of the contract, analysis on the 'effective date' for SDLT purposes | 1 |
| Conclude effective date is date Sally is granted full and exclusive access | 1 |
| Conclude Sally is carrying out works after the effective date and so this is not part of chargeable consideration | 1 |
| Calculate SDLT due | 1.5 |
| **TOTAL** | **15** |