

Institution **CIOT - CTA**
Course **APS VAT and Other Indirect Tax**

Event **NA**

Exam Mode **OPEN LAPTOP**

Answer-to-Question-_1_

To: Amari Adoyo
From: Same Turner
Subject:
Date: May 2023

1 - Introduction

1.1 The purpose of this report is to provide Amari with advice in relation to the sale of the 'Simba' statue.

1.2 We discuss below the tax implications of when Amari sells Simba through the Auction and gift the net proceeds to Caloseni Foundation ('CF') and also the implication of gifting Simba to CF which will then sell the auction. We have also proposed an alternative structure.

1.3 This report is based on the information provided in your letter dated 3 May 2023 and the notes enclosed with that letter and the letter from Billings LLP to you dated 27 April 2023.

1.4 Please note that this report is for the sole use of Amari Adoyo and cannot be relied upon by any third party without the permission of Widford Westmill LLP. We do acknowledge that it may be relevant for Billings and CF but would need to have a hold harmless letter in place if you are to share it with them.

2 - Executive Summary

2.1 The sale of Simba will be considered a trading activity as it is similar to your other trading activities. You would therefore pay tax at 45% on the sale of Simba via auction.

2.2 It won't be necessary to make any adjustments regarding the VAT incurred and recovered on the cleaning of the statues and installation of the security system.

2.3 Simba statue will be in fixed assets for accounting and tax purposes currently as it was not for sale. You should elect to transfer it to trading stock at cost (which would be £2,400 plus the cost of the plinth and any other costs directly relating to it). This means that there will not be a tax charge as a result of the movement from fixed assets to trading stock.

2.4 The net proceeds before income tax under option one will be £100,000 and so the cost to you would be £50,000. You would be required to pay tax at 45% on the net proceeds (ie £45,000) and class 4 NICs of £3,250.

2.5 If eligible for Gift relief, the donation to CF would allow you to obtain income tax relief of approximately £31,250 (see appendix 2) and would allow CF to claim an additional £25,000 on the donation which means the total amount for the appeal would be approximately £125,000.

2.6 Under option 2, the total cost to you would be £40,000 (see appendix three) but you would not be required to pay income tax or corporation tax on the gift to CF.

2.7 The total amount that CF would likely receive (based on a hammer price of £150,000) would be approximately £110,000 (see appendix two). However, CF would be required to register for UK VAT (if it is not already) under this option which would increase administrative costs for it.

2.8 Therefore option 2 would result in a lower cost to you but less proceeds and more administration for CF. Option 1 would be a higher cost to you but more proceeds would be received by CF

(assuming that it can claim gift relief). Of the two options you have suggested and on the assumption that gift aid will be available, I would therefore recommend option 1 and that you sell Simba to the auction and gift the proceeds to CF.

2.9 I recommend that you structure the arrangements so that Billing act on behalf of you or CF and you are selling the goods via the auction.

2.10 Under option 1, the amount available to donate would be £125,000 and if eligible, CF would be able to claim £156,250.

2.11 Under option 2, the cost to you would be £10,000 and the proceeds available to CF would be £135,000.

2.12 If gift relief is available, I recommend that you choose option 1 and sell the goods directly to the winning bidder and Billings does not operate either of the Margin Schemes.

2.13 If gift relief is not available, I recommend that you choose option 2 and donate the goods to CF who will then make a zero rated sale to the winning bidder.

3 - Tax treatment of Simba Statue

3.1 In determining the tax treatment of the sale of the Simba statue, it must be determined whether Simba should be considered a capital assets or trading stock.

3.2 If Simba is considered to be a capital asset, when it is sold via auction, this will be a capital disposal which would be subject to capital gains tax at 20%.

3.3 However, if Simba is considered to be trading stock, this sale via auction would be considered to be a trading activity and

so the proceeds would be subject to income tax at 45%.

3.4 You have stated that the construction of Simba was more of a Hobby and that you previously rejected an offer as you consider the statue to be part of your own personal collection. This might suggest that the sale of Simba would not be a trading activity and would be a capital disposal.

3.5 However, you have also stated that Simba is displayed in the Sculpture Park at Hadbridge farm in which you also display other sculpture which were for sale and have been sold. The sale of these sculptures has correctly been treated as a trading activity.

3.6 When considering whether an activity constitutes a trading activity, HMRC will look at, among other factors, the degree of integration with an existing trading activity. As Simba was displayed in the same gardens where other statues were for sale and your main business is the sale of sculptures, this would appear to create a link between the activities.

3.7 The fact that the other sculptures and Simba were insured together under a single policy rather than separate policies also suggests that their disposal should be treated in the same manner.

3.8 If Simba was treated as your own private asset, this potentially might mean that the cost relating to the cleaning of the sculptures was not for entirely business purposes and so the cost should not have been deducted in full for income tax purposes and the VAT should not have been fully recoverable.

3.9 However, as the VAT was incurred more than 4 years ago, this is outside the time limits for correcting errors and so won't be necessary to correct. It also would not be necessary to correct the full deduction for income tax purposes as the costs were

incurred more than 6 years ago. HMRC would also be unlikely to treat the asset privately given that it is situated in a garden to which you charge admission. The admission to the garden would be a taxable business activity and Simba would not appear to be different to the other statues from a tax perspective. Therefore it appears to be correct to have fully recovered VAT at deducted the costs on the cleaning and security system.

3.10 If more than £250,000 plus VAT was incurred on creating the Sculpture Park and there was private use of the Sculpture Park, this might lead to a restriction of the input VAT originally incurred when you created the sculpture park. However, as you charge admission to the park and have attracted sales of your sculptures and from the gift shop and cafe, I do not believe there will be any restrictions under the capital goods scheme (CGS) as the cost appear to relate wholly to your taxable business activities.

3.11 On balance, the sale of Simba should be treated as a trading activity of your business.

3.12 The Statue would move from fixed assets to trading assets. Normally this movement for accounting and tax purposes takes place at market value. This would create a tax liability for you when it is moved and would likely be based on the £150,000 estimated sale price at auction rather than the £10,000 offer in 2016.

3.13 However, you can elect to move the asset at cost. This would mean that there would be no tax to pay as a result of the movement to trading stock. I recommend that you make this election. The cost would be the price paid when the original bronze was imported (£2,400, see Appendix one) plus the cost of the sandstone for the plinth and any cost relating to cleaning that directly related to Simba.

4 Option one - Amari sells Simba and gifts the proceeds to CF

4.1 As discussed in section 3 above, the sale of Simba via auction would be a trading activity and would be taxed at 45%.

4.2 Billings LLP has stated that they are able to sell either using the VAT Margin Scheme or the Auctioneer's scheme.

4.3 Whichever scheme is used, it will not impact the VAT treatment of your supplies under option one. This is because it impacts the VAT treatment of the auctioneer's supplies and not yours. It will also not impact the amount that can be gifted to CF.

4.4 Under both schemes, you would be treated as selling Simba to the auctioneer at the hammer price (ie the price paid by the winning bidder) as the auctioneer is treated as selling the goods to the winning bidder.

4.5 Your sale to Billings LLP would be subject to VAT at 20%. However, you would have to treat the Hammer price as being inclusive of VAT at 20%. The VAT treatment would not change if the buyer was based in America or not as the sale is to Billings.

4.6 Therefore, the net proceeds (before deducting costs) would be £125,000 ($150,000 * 5/6$) assuming that Simba does sell for the expected price. The VAT that would need to be paid to HMRC would be £25,000. The tax point of your supply would be the date you receive the funds from Billings LLP.

4.7 The seller's commission you would be required to pay would be £15,000 plus £3,000 of VAT. This cost should be deductible for income tax purposes and the VAT should be fully recoverable through your VAT return as well as the VAT on the removal fees.

4.8 Therefore the net proceeds would be approximately £100,000 (see appendix two) after deducting the selling commission, VAT element and removal costs. The cost of the plinth would also be deductible. The cost of when the bronze was originally imported would not be deductible as although this was incurred less than 7 years before you starting trading as a sole trader, it was not incurred wholly and exclusively for the purposes of the trade at the time.

4.9 You would therefore pay income tax of approximately £45,000 (see appendix two). You would pay class 4 NICs of £3,250 (100,000 * 3.25%).

4.10 Assuming that you gift the net proceeds from the auction rather than after tax, the charity would receive £100,000.

4.11 There are no VAT implications of the gift of the net proceeds.

4.12 However, you may be able to claim gift aid on the donation and should do so. Gift aid increases the basic rate and higher rate band by the 20% on the amount of the donation.

4.13 This would provide you an income tax saving of approximately £31,250.

4.14 The gift aid claim would also mean that, if eligible, the charity would be entitled to claim an additional £25,000 on the donation through gift aid.

4.15 I would need to get one of my colleagues involved as I am not sure whether donations to non UK charities are eligible for Gift relief.

5 Option two - Amari gifts Simba to CF who sell the sculpture

through the auction

5.1 The place of supply of the gift of goods to CF for VAT purposes will be the UK. Although CF is based in Belgium, the supply of goods takes place in the UK as you will not be exporting the goods to Belgium and CF will be selling the goods in the UK.

5.2 Normally when gifts are gifted for a non business where VAT was originally recovered on them (ie on the purchase of the sandstone for the plinth), there is a deemed output VAT charge (if the place of supply is in the UK). This means that you would be required to account for VAT at 20% on top of the market value (ie £150,000 and £30,000 of VAT). CF would not have to pay this additional £30,000 but you would have to include it on your VAT returns.

5.3 CF would not be able to recover this VAT charged, unless you issue a certificate (which is not a VAT invoice) that shows VAT was accounted for on the gift by way of deemed supply. CF would also need to either be VAT registered in the UK or submit a refund claim.

5.4 It can take a while for overseas entities to register or make refund claims so this could delay the time it takes for the funds to reach Patribea.

5.5 There is however a zero rating for the donation of goods to a charity. Zero rating means that you would not charge VAT on top of the £150,000 but that you would be able to recover any VAT incurred on the removal costs etc.

5.6 In order for the donation to be zero rated, the goods must be donated to the charity so that the charity can sell them to either two or more specified persons or the general public. HMRC accept that if goods are donated to the charity for sale at auction, this can qualify for zero rating.

5.7 The zero rating will not apply if before you donate the goods to CF there is an agreement between you and CF and or the buyer (ie there is a known buyer) or if CF has an agreement with a known buyer.

5.8 The zero rating would not appear to apply as for VAT purposes, regardless of whether Billings LLP uses the VAT Margin Scheme or the Auctioneer's scheme, CF sale would be to the Auction and not the public.

5.9 Therefore, you would have to account for output VAT of £30,000 on the gift to CF.

5.10 Simba's sale to Billings would give it a VAT registration obligation in the UK as it would be treated as making a standard rated sale at hammer price to the auction house. Simba would not benefit from the £85,000 VAT registration threshold as I have assumed that it has no establishment in the UK.

5.11 It would therefore be required to register for VAT with effect from the date it first knew that it would make a SR sale within 30 days (ie the date when the auction is fixed and the structure is known).

5.11 Registering for VAT would increase the administrative costs for CF as it would need to submit a VAT 1 to HMRC before the date of the auction. As in section 4, it would have to account for VAT at 1/6 th of the Hammer Price (ie £25,000). CF may be able to recover the VAT accounted for on the deemed supply as per 5.3 above.

5.12 Billings would not charge UK VAT on the seller's commission to CF as it is established in Belgium. This is because the seller's commission would be a Business 2 Business supply as it relates to a sale of goods, even though CF is a charity.

5.13 CF would account for the reverse charge on the commission through its Belgian VAT return.

5.14 Under this proposal, as you are not selling Simba to CF, there will be no movement from fixed assets to trading stock.

5.15 Instead, you will be treated as making a capital disposal which will be treated as being made at cost as it is being gifted to a charity. Therefore, there would be no income tax or capital gains on the gift to CF for you. The base cost of the asset for CF would be the same as your base cost.

5.16 CF is unlikely required to pay corporation tax on the sale via auction as the proceeds are to be used for a charitable purposes and so they may be exempt. However, this would need to be confirmed with one of my colleagues who specialises in charities.

5.17 Therefore the total cost to you under this option would be £40,000 (see appendix three). You would still be entitled to recover input VAT relating to the removal costs as you will be accounting for VAT on the gift of the goods.

5.18 For income tax, you won't obtain a deduction from trading profits as the donation is not made wholly and exclusively for the purposes of your sculpture selling trade. It is for humanitarian reasons instead. It is unlikely that you would be able to claim gift aid either.

5.19 The total money obtained by CF under this option would therefore be £110,000 (see appendix 4).

6 Alternative structures

6.1 As Billing's have suggested either selling under the VAT Margin Scheme or the Auctioneer's Scheme, they will be treated as selling Simba to the end buyer.

6.2 However, if Billing acted as an agent on your behalf (or CF's) to see the goods at auction. This would change the VAT implications.

6.3 In order for Billing to be treated as acting as agent, you would need to have a contract in place with Billings that states that they will act as your (or CF's) agent at the auction and Billing's will not be selling the goods as principle.

6.4 Ideally any publicity and advertising should clearly state that you are the creator or seller (or CF is the seller). You as the seller would need to issue a VAT invoice to the end customer and not Billings.

6.5 The impact it has on option 1 is that if the goods are sold and remain in the UK, you would charge VAT in the same way as under 4 above.

6.6 If the goods are sold to an American customer and are exported outside of the UK, the sale to them would be zero rated. You can't zero rate goods if Billings operates the VAT margin scheme or acutioneer scheme as they will be selling the goods to the overseas customer.

6.7 In order to export goods, you would need to apply for a GB EORI number. This can easily be done online. You might also need to appoint a freight agent to arrange the transport of the goods.

6.8 In order to zero rate the goods for VAT, you would need to obtain evidence that the goods have left the UK within 3 months of the sale at auction. Evidence can include commercial evidence such as authenticated sea and air waybills or bills of lading. It

can also include official evidence such as a good departure message. If the export is arranged by Billings on your behalf, you would need to obtain a certificate of export from Billings for your records (which can be obtained from VAT notice 703) and Billings would need to obtain evidence that the goods were exported.

6.9 If the proper evidence isn't obtained to show the goods left within 3 months, HMRC will raise an assessment for the under-declared VAT.

6.10 The amount available to you to donate would therefore be £125,000 and CF (assuming they are eligible), would be entitled to claim gift aid meaning they would have total net proceeds of £156,250.

6.11 Under option 2, as CF will be selling to the general public and there are no arrangements with an agreed prior to the gift, you will not be required to account for VAT on the £150,000 as the deemed supply will be zero-rated.

6.12 CF should be entitled to zero-rate its supply to the end customers at the auction as it will be selling goods that were donated to it for sale. This is regardless of whether the goods remain in the UK or are exported.

6.13 Therefore, the only cost to you under this option would be the £10,000 of removal cost (the VAT on which would be fully recoverable).

6.14 The net proceeds for CF would be £135,000. However, it would also not be required to register for VAT in the UK as it will only be making a zero-rated supply and so can apply for an exception from HMRC.

6.15 This would reduce administrative costs.

We trust that the above is clear but please do not hesitate to contact me should you have any queries.

Sam Turner

Widford Westmill LLP

Appendix one - Base cost of Simba

Metal	0.5 tonnes	£1,000 per tonne	£500	
Freight and import charges			1,500	
Total value for import VAT			2,000	
import VAT			£400	
Total cost of import - note 1			2,400	
removal costs - note 2			10,000	
total cost			£12,400	
Seller's commission	150,000 * 10%		15,000	£3,000 VAT

1 - VAT is a cost to Amari as he was not registered for VAT in 2004 and he was not registered until 2011

2 - VAT will be recoverable on the removal costs so only the £10,000 is an actual cost

Appendix two - net proceeds under option 1

Hammer price		150,000		
Less VAT element		(25,000)		
Less seller's commission		(15,000)		
Less removal costs				
Net proceeds		(10,000)		
		£100,000		
Tax at 45%		£45,000		
Gift relief				
37,700 + (100,000 * 100/80)		162,700		
150,000 + (100,000 * 100/80)		275,000		
Basic rate tax saving	(162,700-37,700)*(0.4-0.2)	£25,000		
Higher rate tax saving	(275,000 - 150,000)*(0.45-0.4)	£6,250		
Total tax saving		£31,250		

Appendix 3 - Cost for Amari under option 2

VAT on deemed supply	150,000	20%	£30,000	
removal costs			£10,000	

Total cost			£40,000	

Appendix 4 - amount retained by CF

Hammer proceeds		150,000		
Less VAT element		(25,000)		
Less selling commission		(15,000)		CF should be entitled to full VAT recovery on the reverse charge through its Belgian VAT return
		110,000		

Appendix 5 - net proceeds under option 1 if zero rated

Hammer price		150,000		
Less sellers commission		(15,000)		
Less removal cost		(10,000)		
net proceeds		125,000		
Plus gift aid	125,000 * 100/80	156,250		

Appendix 6 - Net proceeds under option 2 if CF sell goods as principle

Hammer price		150,000		
Less sellers commission		(15,000)		
Total		£135,000		