THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Domestic Indirect Taxation

November 2023

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.

- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.

- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.

- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

- Additional marks may be awarded for presentation.

- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. The Northern Lakes Foundation is a VAT registered, non-profit making body and registered charity whose principal objective is the promotion of physical recreation in the local community. Its main activity is to maintain and develop Hardrada Lake and its surrounds; its subsidiary activities being the provision of sporting and physical recreational programmes to schools and young persons' groups, along with advice to the public on matters relating to water sports. Its main sources of income are grants, donations and fund raising, with smaller amounts (including £8,500 per annum, plus VAT from the Hardrada Sailing and Kiteboarding Club) accruing from the letting of property, the hire of facilities, fishing and boat permit charges and educational/training fees.

Following a change in Treasurer, the Club has asked why the Foundation charges VAT on the rent and boat supplement charges payable under the lease originally granted to the club in September 2003. Under its terms, the club occupies 1.5 acres of land adjacent to the lake for a term of 21 years in return for an annual rent (currently £4,000, excluding VAT). The lease permits persons authorised by the Club to sail on the Hardrada Lake in return for payment by the club of a boat supplement, based on the total number of members' boats and boards registered with it. In the year to 31 March 2023, the supplement totalled £4,500, excluding VAT. The club must take reasonable steps to ensure that users of the waters comply with regulations issued by national water sports associations. The Northern Lakes Foundation has not opted to tax the land.

The club is a non-profit making, unincorporated body whose principal objective is to promote participation in sailing and kiteboarding. In return for an annual subscription, among other benefits received, a member may sail on the lake. Also, for an annual fee of £25, a member may store on the club's premises a yacht, board and kite, etc. The club is not VAT registered since its services are mainly VAT exempt.

Since fishermen and independent boat users on payment of the Foundation's permit charge have access to the lake's waters in conjunction with club members, the Foundation concluded that VAT exemption did not apply; accordingly, VAT has been charged both on the rent and the boat supplement, with the Foundation's VAT invoices separately identifying these charges. In the past four years, total VAT charged on rent and sailing permits amounted to £6,000.

The Northern Lakes Foundation is currently preparing a new 21-year lease in favour of the club.

Requirement:

Advise on the nature of Northern Lakes Foundation's supplies made under the lease, together with any recommended action the parties should take. (20)

2. Hermitage Hall, a student residence, was constructed by Andrew Johnson University in 1970. It has always been leased to its students on annual tenancies. It is no longer fit for purpose and accordingly, its upgrading is imperative.

At a projected cost of £8.4 million (including £1.4 million VAT), the University will refurbish the building to create ensuite study-bedrooms, along with self-catering facilities and social space to allow students to meet and interact. The upgraded accommodation will not constitute self-contained living accommodation. On completion of the works, the University will grant a 25-year lease with break clauses in years 15 and 20 to AJU Enterprises Ltd, a subsidiary company outside the University's VAT Group. The rent payable by AJU Enterprises Ltd will reflect market value. It will certify that the building will be used exclusively to accommodate University students, with rents payable by them reflecting that due on equivalent University accommodation. AJU Enterprises Ltd will insure and maintain the property.

AJU Enterprises Ltd has existing cash reserves but, to the extent, that it requires further funds to meet its cash flow requirements, the University will provide financial support at a rate of interest based on market value.

Requirement:

Discuss, by reference to relevant caselaw, the University's entitlement to VAT recovery under the proposal, and how HMRC may view the arrangement. (15)

3. Sabi Investments Ltd is resident in Jersey. In May 2021 it acquired "Foggy End", a manor house in the UK with renowned gardens and grounds and 12 acres of parkland, for £3 million. Previously the property had been occupied as a family home. It is registered under a single land registry title. Eight acres of the parkland were and continue to be used as grazing by a neighbouring farmer for his herd of rare White Park cattle under an annual licence on payment of £1,000 per annum.

The company paid SDLT of £139,500 in June 2021. When completing the SDLT return, its lawyers had advised:

1) The property had been characterised as “mixed use” given the commercial use of the parkland.

2) Since the house was to be used for trading purposes, the transaction was exempt from the higher rate of 15%.

Excluding the parkland, the value attributed to the house, gardens and grounds was £2.7 million. Sabi Investments Ltd converted the property into a high-end restaurant, spa and wedding venue, including a self-contained flat for the chef. In April 2022 a talented chef was recruited and she occupied the flat immediately. Her remuneration package was performance related, with an emphasis on establishing a leading restaurant. The converted property was fully operational by June 2022. In May 2023, the restaurant was awarded one Michelin star and in recognition, the chef was awarded a 20% interest in the company.

HMRC have issued:

1) An assessment for underpaid SDLT of £269,250, on account of:

    (a) The incorrect classification of the property as residential.

    (b) Relief from the higher rate did not apply because it was reasonably foreseeable that, at the effective date, part of the house would be occupied by an employee whose remuneration would equal or exceed 10% of the company’s net profits.

2) A penalty notice for £40,387, representing 15% of tax underpaid on account of the company’s careless behaviour, the discovery of the error by HMRC with an allowance made for the company’s co-operation.

In response to the company’s notice of appeal, HMRC have affirmed their decision but offered to review the matter.

Requirement:

Discuss the merits of HMRC’s assessment and penalty notice. (15)

4. Lahn Developments Ltd is a commercial property developer. It has exercised a real estate election in respect of its properties. Lahn Developments Ltd is constructing a new data centre (Erton House) to be used by several insurance companies. The cost of the project is £30 million.

Two potential tenants so far have been identified:

1) Alpha Insurance Ltd, which is a tenant under an existing lease with Lahn Developments Ltd at a different site (Edbridge House). This lease is not opted for VAT and was entered into before the real estate election was made. Lahn Developments Ltd will pay £300,000 to Alpha Insurance Ltd to surrender this lease and grant a lease for 30% of Erton House. Alpha Insurance Ltd will pay a dilapidation charge of £100,000 to Lahn Developments Ltd to reflect the cost of restoring Edbridge House to its former condition.

2) Beta Insurance Ltd, which plans to occupy 20% of the new data centre primarily for its UK motor insurance business. Lahn Developments Ltd has borrowed £20 million from Beta Insurance Ltd to finance the development.

Lahn Developments Ltd will grant separate leases to each insurance company under which each tenant will pay an annual charge covering:

1) Exclusive occupation of a defined part of the building for a term of five years, together with access to the common parts for its employees and suppliers.

2) The right for the tenant to install its own servers and other computing facilities in its unit.

3) Electricity and other electronic services to ensure that tenants have uninterrupted access to the internet and for the processing and storage of electronic data.

4) Use of meeting rooms on the ground floor via a common booking system.

5) Use by employees of a subsidised on-site restaurant.

6) Membership of a local health club for up to 10 staff.

7) 10 parking spaces.

All leases are exclusive of VAT.

Requirement:

Explain the VAT treatment of the surrender and dilapidation payments in relation to Edbridge House, and the lease payments for Erton House. (20)

5. Ms Ahmed owns 60% of the issued share capital of Fabby Food Ltd, which sells food wholesale to the catering industry. The remaining 40% of shares are owned by Mr Turner, though under a shareholders agreement, he is entitled to 55% of any distributions of profits.

Ms Ahmed also owns 100% of Fhosst Catering Ltd, which operates catering contracts for local authorities across the country.

In June 2023 Ms Ahmed formed a 60/40 partnership with Mr Brownlow known as Amlow Investments LLP which acquired a property investment business that leases mainly residential property but also some commercial units, all of which have been opted to tax. Following the acquisition, to fund future investments, Ms Ahmed transferred her shares in Fabby Food Ltd and Fhosst Catering Ltd to Amlow Investments LLP, with Mr Brownlow making a cash injection of £20 million into the partnership.

Both companies and the partnership are resident in the UK and are currently registered separately for VAT, though Ms Ahmed is considering the benefits of a VAT Group registration effective from 1 December 2023. She is planning to make management charges from Fabby Food Ltd to the other entities and wishes to reduce irrecoverable VAT in Amlow Investments LLP.

Fhosst Catering Ltd and Amlow Investments LLP makes quarterly VAT returns, whereas Fabby Food Ltd makes monthly returns.

The forecast VAT position for the year to 30 November 2024 based upon the standard method is:

Outputs (VAT exclusive where applicable)	Fabby Food Ltd	Fhosst Catering Ltd	Amlow Investments LLP
	£	£	£
Standard rated turnover	200,000	12,500,000	1,800,000
Zero rated turnover	4,000,000	-	-
Residential rents	-	-	16,200,000
Proposed management charges	500,000	-	-
	£4,700,000	£12,500,000	£18,000,000
Inputs (all bearing 20% VAT)			
Directly attributable to taxable supplies	600,000	750,000	350,000
Proposed management charges (allocated on turnover basis)	-	204,918	295,082
Other residual overheads	250,000	600,000	400,000
	£850,000	£1,554,918	£1,045,082
VAT recovery rate	100.00%	100.00%	10.00%
Value of standard rated supplies less standard rated deductible inputs	£(150,000)	£10,945,082	£1,380,492*
VAT (Recoverable)/Payable (based on 20% of above net standard rated outputs/(inputs)	£(30,000)	£2,189,016	£276,098

* working: £1,380,492 = £1,800,000 – £350,000 – (295,082 + 400,000) x 10%

Requirement:

1) **Explain which entities could be included in any VAT grouping election and whether, based on the above projections, such an election would be beneficial?** (11)

2) **Discuss ways other than a VAT grouping election which might allow VAT costs to be mitigated.** (4)

Total (15)

6. Oder Ltd is a VAT registered telecommunications company which has been supplying services to private consumers for an annual subscription since 1 August 2019. The subscription comprises Oder Ltd's television service and a monthly television magazine which is produced and distributed by a separately VAT registered subsidiary company; Neisse Ltd.

The magazine contains details of television programmes, articles and advertisements. It can be purchased separately by non-subscribers. Annually, Neisse Ltd receives £100,000 plus VAT of advertising income and £20,000 from sales of the magazine to non-subscribers. Subscribers to the television service do not have to receive the magazine if they do not wish to and some make use of this opt-out facility.

Under the subscription service, a tri-partite contract governs the arrangements whereby:

1) Oder Ltd provides the consumer with a television service for an annual subscription of £600, plus VAT.

2) Neisse Ltd undertakes to provide to each subscriber a monthly magazine, at an annual cost of £60 (no VAT).

3) Monthly, a subscriber must pay Oder Ltd £65 for the TV services and magazine (being (£720 plus £60)/12).

4) Oder Ltd transfers the magazine payments received to Neisse Ltd.

Neisse Ltd's magazine sales in the four years to 31 July 2023 totalled £2,850,000.

In a separate agreement also effective from 1 August 2019, Oder Ltd agreed at its discretion to make additional payments to Neisse Ltd in any financial year in which Neisse Ltd's costs exceeded its income from the supply of magazines ('deficit payments'). Oder Ltd has made deficit payments totalling £480,000 in the four years to 31 July 2023 and has not added VAT to the payments.

HMRC have recently issued the following alternative assessments for underpaid output tax in the four VAT years from 1 August 2019:

1) On Oder Ltd for £461,667 (being (£2,850,000 - (£20,000 x 4)) /6) on the grounds that it is making a composite supply of the television services and the magazine to the subscribers.

2) On Neisse Ltd for £461,667 on the grounds that the magazine does not qualify for zero rating, as being part of a composite supply.

3) On Neisse Ltd for £80,000 on the grounds that the deficit payments are standard rated supplies.

Assessments 2 and 3 are in the alternative to Assessment 1.

Requirement:

Discuss, with reference to caselaw, whether HMRC's grounds of assessment are correct.
(15)

You are NOT required to discuss the appeals process.