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# Application and Interaction

0 4 0 5 2 0 1 7 Date of Examination

Tick box if you have answered in accordance with Scots Law

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## Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your paper not being marked. You must:

- Complete the details on this page and on the answer pages using BLACK or BLUE ballpoint pen only.
- Write on one side of the page.
- Not write in the margin areas indicated.
- If you have used additional pages, please add your candidate number and the question number to these pages.
- Do not put blank pages into the envelope at the end of the exam.

**Please do all of the above before the end of the examination.**

|   | Tick question attempted | For use by examiner only |
|---|-------------------------|--------------------------|
| 1 |                         |                          |
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| 3 |                         |                          |
| 4 |                         |                          |
| 5 | ✓                       |                          |
|   |                         |                          |

| FORMAT & STYLE OF ANSWER  | MAXIMUM MARKS | MARKS AWARDED |
|---|---------------|---------------|
| <p>The answer is set out in the format demanded. Thus, if it is a letter, it will be properly set out as a letter with addresses, date, "Dear X" and conclude "Yours sincerely" etc. If it is a report, it will give some indication as to what it is about and who it is for.</p>  | 1             |               |
| <p>The report or letter should contain an introduction setting out the terms of reference, information being relied on etc. It should also contain a summary of the key findings and recommendations.</p>   | 2             |               |
| <p>The body of the letter or report should be laid out in a clear way with appropriate headings so that the reader can navigate around it easily and spot the key areas without reading the entire document to try to find a discussion of, for example, income tax on some employment related shares.</p>  | 1             |               |
| <p>The answer "flows" so that a logical chain of thought presented to the reader rather than a series of random comments (which may nevertheless be technically correct).</p>   | 1             |               |
| <p>The style of writing should be appropriate to what is being produced. For example, a report to a client or lay person (which will always be the main element of a question) should not contain large numbers of legislative references whereas a technical note to the tax partner should. Technical advice should be conveyed in style appropriate to the reader.</p> | 2             |               |
| <p><b>RELEVANCE OF ANSWER</b></p>   |               |               |
| <p>The answer does not contain large amounts of irrelevant material which would only serve to confuse a client.</p>   | 2             |               |
| <p>Technical knowledge (which will be rewarded through the technical marks and should not affect the awarding of these marks) has been directly applied to the specific circumstances of the reader and has this resulted in an answer tailored to their circumstances.</p>   | 3             |               |
| <p>The question(s) posed has/have been answered.</p>  | 2             |               |
| <p><b>PROVISION OF ADVICE</b></p>   |               |               |
| <p>The report gives advice. This means that where possible it should come off the fence and suggest the best option rather than simply giving a list of unweighted possibilities which fail to give the client an answer to their real problem: what should I do?</p>   | 4             |               |
| <p>Advice should include relevant and appropriate planning for the future.</p>  | 2             |               |
| <p>Advice should be commercial. This means that candidates should consider the bigger picture rather than narrowly focussing on saving tax.</p>   | 2             |               |
| <p><b>TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS</b></p>  | 22            |               |

To : Jennyfer Daley  
From : Ashley Bell.  
Subject : Hays Head Farm  
Date : 4 May 2017.

Dear Jennyfer

As per your request, ~~below~~<sup>attached</sup> I have prepared a report to be sent to Linda Morris at Hays Head Farm for your review.

The report is attached alyside and I await ~~your~~ your comments.

Regards.

Ashley Bell.

# REPORT

~~To~~  
~~From~~  
~~Subject~~ To : Linda Mann  
~~From~~ from : Jennifer Daley  
Subject: Hays Head Farm  
Date : 4 May 2017.

## Terms of Reference

Our report and advice set out is based on your email dated 26 April 2017, the correspondence from HMRC dated 21 April 2017 and the information we have on Hays Head Farm from our client files.

Should any of these contain information which is not up to date, our advice may change.

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- 2 Direct Taxes
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## 1 Introduction.

Thank you for providing us with the information for the purpose of this report. In this report we will consider the VAT, other indirect taxes, direct taxes and legal matters in relation to the operations of Hays Head Farm ('HHF')

## 2 Executive Summary

- The farm shop is making a mixture of zero-rated standard rated supplies.
- Similar treatment applies for the grazing and stabling.
- HMRC should be informed and assisted in their findings for underpaid VAT.
- The overhead costs should be apportioned for recovery between business and private use.
- Field rate expenses may be allowed.
- The insurance payout will be outside the scope of VAT.
- The transfer to a new partnership should be a Transfer of Going Concern.
- SDLT will be payable on the option.

transferred to Becky.

- You should seek to attain gyt rely on the transfer of assets.
- The Riding school shall be exempt education if via the partnership.
- The ~~pro's~~ cons of a LLP although the pro's.
- The conversion of the Alley Partner shall be subject to 5% VMT.
- The sale is disputed, but we suggest should be zero rated.
- A belated OTT shall be sought for the field.
- You should notify assets of your registration for CC within 30 days of your supplies.
- The FFRS ~~is~~ is not appropriate.

### 3 Diversification of the business

Following the fall in milk prices, we understand that you have diversified your business and now have a farm shop and have horse grazing and stabling. We assume that prior to this, you would have only been selling milk which would have been zero rated for VAT.

#### (i) Farm Shop

As you will be selling meat and vegetables, similar to the sale of milk, this will be zero rated for VAT. Therefore you would be correct to not charge VAT on these sales.

As for fruit juices and colas however, these are beverages and VAT should have been accounted for on these at the standard rate of 20%. Given that HMRC have picked upon this matter, we will address this in detail later in the report.



(ii) Grazing & stabling.

We assume that grazing would be merely feeding stuff for the horses, This would therefore be zero rated for VAT and no VAT should be chargeable. However, depending on what exactly stabling entails may mean that VAT is charged.

If stabling is just a charge to the horse owner for keeping the horses, this may be seen as a service and subject to VAT at 20%. However, it may be argued that this is an exempt supply of land.

Having considered this, we would advise that this would be considered storage for the purposes of VAT which is specifically carved out from the land exemption. Hence, VAT should be accounted for at 20%.

(iii) Costs

Although costs weren't recorded for the above, there may be an opportunity to recover VAT which we can discuss in more detail if required.

#### 4 VAT Returns

As mentioned above, it appears that your business contains an element of standard rated supplies alongside the zero rated supplies. Therefore, some output VAT <sup>(on sales)</sup> should have been accounted for.

As for the recovery of VAT, you are currently recovering all the VAT on the ~~total~~ ~~and~~ ~~excluded~~ cost. However, in reality, this should be restricted to that which relates to the business only. Where the lighting and heating relates to the business, you are correct in recovering this.

As for the office in the farmhouse, there appears to be a private use element which cannot be recovered. Therefore, VAT should only be recovered on the element that relates to the farming business, either by keeping detailed records of the apportionment, or making a charge for the private element.

Again, this matter appears to be on the roster of HMRC which we will discuss later.

Additionally, you may be able to claim flat rate expenses for the business use of the farmhouse. Depending on the level of use, this could be between £10 and £26 per month.

### 5 Tuberculosis issue

We are sorry to hear of this unfortunate incident. As for the compensation, the amount of £20,000 is not for a supply and therefore will be outside the scope for VAT purposes and no VAT will be due.

The sale of the herd will be zero-rated for VAT and you will not be required to account for VAT. From a direct tax perspective, the sale of the herd will be a disposal of your stock and your account should also reflect this.

~~The~~

As for any costs incurred in arranging these, VAT should be recoverable as an overhead cost.

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Transfer of business

We would need to consider a variety of tax implications in this matter. Firstly, from a VAT perspective, there is a strong possibility that this transfer will be treated as a Transfer of Going Concern ('TOGC'). This essentially means that the business will continue to undergo similar operations, and no VAT will be chargeable on the transfer.

The rules stipulate that a similar business is to be run, that there is no significant break in trading and no series of successive transfers amongst others. Given that the firm ships and groceries will still be part of the new partnership activities, it appears that the TOGC conditions will be met.

(i) Stamp taxes

Stamp duty Land tax ('SDLT') is usually payable when there is a ~~tax~~ purchase of land or property. Although there will not be a purchase as such, you will be transferring the property/business and will trigger SDLT via this.

There is however a relief that is available for partnerships. Where the partners of a partnership transfer the chargeable interest to a partnership, which will be the case in a new partnership, then the chargeable amount will be based on the 'sum of lower proportions', i.e. the amount owned by the partners afterwards.

Appendix 1 sets out this calculation. This shows that given that  $\frac{1}{5}$  will be transferred to Bechy, the remaining 80% will still be owned as per before. Therefore SDLT will be payable on the £240,000 (i.e. 20% of the market value).

The first £170,000 will not attract SDLT and the next £90,000 will be subject to 2% SDLT. This £1,800 charge will be payable by the new partnership with the payment and return to be submitted within 30 days to Customs.

lii) Direct Taxes

There will be a gain arising for the purposes of direct tax. This gain is calculated at Appendix 2.

You will essentially be disposing the land and buildings at market value (£1.2 million), with a cost of £500,000, resulting a gain of £700,000. This gain can be reduced by the £10,000 capital losses brought forward and also by the allowance of £1,100. Therefore you will have a net chargeable gain of £678,900.

When you are basic rate taxpayer, this gain will be taxed at 10%, so tax of £67,890.

However, you may be able to set off the £678,900 gain against the base cost of the new partnership assets.

If you choose to gift the assets to the new partnership, you shall be eligible for gift

relief, in which case the base cost of the asset in <sup>the</sup> new partnership will be reduced by the gain. The gain will then only be realised on disposal by the new partnership.

Appendix 3 shows that the base cost will be reduced to £521,100 and no tax will be payable. This relief has to be claimed within 4 years of the transfer.

We would therefore highly advise that gift relief is sought in this matter.

From a VAT perspective although the TOAC conditions ~~are~~ <sup>seem to be</sup> met, for completeness they are:

- Should be the same kind of business
- No successive transfers of business
- No significant gap in trading
- If the transferor is a taxable person, so should be the transferee. On this point, the new partnership should register for VAT.
- If any option to buy is in place, this should be matched.
- Sufficient funds and assets are transferred

Although we haven't addressed each in detail, so long as they are met, TOAC treatment shall be compulsory and automatic.



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Riding School

The conversion costs you incur are expected to incur VAT at 20%. Unfortunately, it does not appear that a riding school is for a charitable or residential purpose and therefore VAT shall be <sup>charged</sup> ~~recoverable~~ on the conversion. Having said that, the <sup>VAT</sup> costs incurred shall be recoverable by the business.

Understanding the nature of the riding school, there is a possibility that you may be able to treat this as <sup>an</sup> exempt supply of education.

Since a partnership is not a company for VAT purposes, you are still therefore treated as an individual for legal purposes.

Therefore the supply of ~~education~~ private tuition by an individual, ~~of~~ a subject taught ordinarily in school shall qualify for the education exemption.

Whether or not these riding is ordinarily taught in school is <sup>crucially</sup> debatable. It is arguable that this is

not a cannaly taught skill/topic in school however, there are examples of schools that do in fact have these notes within their curricula or prospectus's. Therefore, you can argue that this is with the education exemption.

On the balance of probabilities, we would advise that the exemption is satisfied. Especially given the fact that charging VAT would give you a commercial character.

### Liability

This needs to be considered from both a VAT and legal angle. From a VAT perspective, if you were to set up ~~as~~ a LLP, you would be seen as a corporate body. This would mean that you will not fulfill the education exemption and VAT shall be chargeable on the here ridy school.

From a legal perspective, a partnership and LLP are two different entities completely.

A LLP is a separate legal entity and separate to that of the partners. In the occurrence of liabilities, the liability of the ~~LLP~~<sup>partners</sup> is limited to their ~~share~~ contribution, with the rest being attributed to the corporate body itself.

However, it is a requirement for there to be at least one unlimited partner, which given the small number partners, may not be desirable.

A partnership is instead seen as a group of contributors or sole traders. It is not a legal entity in its own right and therefore the partners have unlimited liability over the affairs of the business. They are all jointly and severally liable for the liabilities of the business.

However, from a direct tax perspective, they are still seen as sole traders. They are therefore taxed as sole traders and individually on their partnership profits, and subject to class 2 and Class 4 NIC's.

Therefore, given the fact that being an LLP will scupper the exemption on the ndij school, we advise that this route is not sought.

However, please do be aware that by being exempt education, the costs on the commercial will be unrecouable as linked to an exempt supply. Hence, the costs of both shall be compared to see the net effect.

### 8 Milking parlour

The milking parlour is a commercial element to the business and looking at the current layout, it is clear that you have a mixed use building, with part being residential.

#### (i) Conversion

The conversion ~~from~~ the current to the intended layout will ~~be~~ result in ~~the~~ a change in the number of dwellings. The number of dwellings will change from 1 to 3.

Therefore for VAT purposes, you will be able to ~~secure~~ get the conversion services with a VAT rate of 5% (reduced rate). Please note that this will be for the services only and where the goods are supplied with the services. If the goods are supplied separately, these will be subject to VAT at 20%.

We would therefore advise that these costs are routed through a single supplier, who will provide services at 5%.

### (ii) Subsequent sale

This is a highly contentious issue with HMRC and one which is still unclear. The taxpayers argument, and one which we would support is that the sale of the houses will be zero rated as being the first grant of the major interest of a residential property.

There have been two cases in the courts, namely Alexander Cartyside and Langford that have successfully argued this point. This is based

on the argument that the houses are conversions from non-residential properties (i.e. the multi partur) so the zero rating condition is met.

However, HMRC fail to support this argument. They argue that this is an exempt sale of residential property, since there was already ~~as residential~~ a residential element to the existing property, so not a non-residential property to begin with. HMRC were successful in the cases of Cabon Vale and McPherson.

Having said that, on the balance of the law and facts, given that 3 houses are being formed from 1 partially residential partur, we would advise that the sales are zero-rated.

This would allow the input VAT recovery on the conversion. As usual, no VAT shall be recoverable of goods such as cars and furniture. ~~as well~~

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Disposy of the field

For an option to tax to be valid, you must make an option intently and notify HMRC within 30 days via a 1614A form. If not, then there is a danger of it not being valid.

However, HMRC may allow you to have a belated option in place if you can evidence that you have been charging VAT. Given that you have been charging VAT on a lease for 4 years, you may be able to argue a belated notification. Harj said that, the fact that you have no evidence of intent constitutes of option, this is unhelpful.

If you would on the balance of probability, advise that VAT is charged on the sale of land. You should inform HMRC that you wish to apply for a belated notification, and that you have accounted for VAT for 4 years ending this, assuming this was paid to HMRC. Failure to do so may trigger HMRC to question the method.

Q10 Anaerobic digester unit

Climate Change Levy (CCL) is a tax on the supply of specified energy products ~~by business~~ ~~consumers~~ for use as fuels by business consumers.

The amount and rates of CCL depend on the type of energy and the amount. For example natural gas would be taxed at £0.00195/kWh and electricity at £0.00559/kWh.

Since there is no registration threshold, you will be required to <sup>register for</sup> CCL on your sales, including those to <sup>the</sup> National Grid and self-supplies. The only supplies allowing exemption will be domestic and <sup>non-business</sup> use. Unlike VAT, ~~these~~ CCL is a sticky tax and will not be recoverable.

Based on your information, you will be required to register for CCL. The portion relating to domestic use may be excluded, but the remainder will be chargeable.



A&amp;I

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You will therefore be required to ~~reappear~~ notify your regulator within 30 days of your effective supply. Since you are a partnership, this will be via a CCL2 form rather than a CCL1. This sent to the CCL Unit in Southend on Sea and you will receive your certificate shortly after.

As far returns, these will be submitted periodically, usually in 3 month intervals.

### HMRC Letter

As discussed in earlier parts of the letter, HMRC have challenged the method of the business. It is evident that some food sales should have been subject to VAT. In relation to these, HMRC are correct to raise this.

Similarly, VAT should have been accounted for on the ~~gross~~ trading for these.

FOR EXAMINER  
USE ONLY

Given these are instances where you have under declared VAT, HMRC will seek to go back 4 years and recover this amount. There is a high chance of penalties and interest too.

Since HMRC have found these errors, they have prompted you to make a disclosure. Therefore, assuming the errors are not deliberate and merely careless, penalties of upto 30% of the ~~tax~~ potential tax loss can be levied.

In order to mitigate these, we would highly advise that you comply with their investigations. By telling, giving and allowing HMRC access to the required information, you should be able to mitigate any potential penalty to 15%. Since the disclosure is prompted to HMRC, it will not be possible to mitigate the penalties if they occur.

As for interest, this is applied on a daily basis ~~based on the~~ up till the time of payment.

We would advise therefore that you do not delay unduly in your response to HMRC.

## 12 Farmers flat rate scheme. (FFRS)

HMRC alluded to the FFRS scheme which is an option for farmers to charge VAT of 4% on all supplies made by them. The intention being that the farmer will be allowed to recover this 4% in full. These rules will recover the VAT as per their normal rules.

However, these rules only apply to farmers who carry out designated activities. Given the diversification of your business, this will ~~most likely~~ be within the breach of a farmer and hence not appropriate in your example.

Plus, given you are fully taxable, you still be able to recover the VAT in full so there is no benefit in you using the FFRS.

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Conclusion

You will see from our report that there are a number of action points. However, we would like to stress the importance of ensuring that any reorganisation is considered to be headload or a TOCC and care is taken over the VAT headcount.

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Next steps

- Respond to HMRC promptly regarding their letter.
- Consider registry for CCL.
- Ensure you attain a headload option to tax.

If you have any further queries or need clarification, please feel free to get in touch.

Jennifer Daley (Tax Partner)

cc. Ashley Bell.

Appendix 1 - SDLT charge. to transfer into a new partnership.

formula  $\Rightarrow$  Market value  $\times (100 - SLP) \%$ .

$$\Rightarrow \pounds 1,200,000 \times (100 - 80)\%$$

$\uparrow$  as 20% will be transferred to Becky

$$\Rightarrow \pounds 1,200,000 \times 20\%$$

$$\Rightarrow \pounds 240,000$$

SDLT @ 0% first  $\pounds 100,000$

@ 2% remainder

( $90,000 \times 2\%$ )

$\pounds 1,800$

$\pounds 1,800$

Appendix 2 - Direct taxes

|                 |                 |
|-----------------|-----------------|
| <del>Cost</del> |                 |
| Capital gains   | £               |
| Proceeds (MV)   | 1,200,000.      |
| Cost            | <u>500,000</u>  |
| Gain            | <u>£700,000</u> |

|                    |                 |
|--------------------|-----------------|
| Capital losses b/f | (10,000).       |
| CGT allowance      | <u>(11,100)</u> |
| Chargeable gain    | <u>678,900</u>  |

|           |               |
|-----------|---------------|
| Tax @ 10% | <u>67,890</u> |
|-----------|---------------|



basic rate taxpayer.

Appendix 3 - CGT relief

|                                 |                |
|---------------------------------|----------------|
| Base cost (for new partnership) | £1,200,000     |
| <u>CGT relief</u>               | <u>678,900</u> |
| New base cost                   | <u>521,100</u> |

no tax payable.