The Chartered Institute of Taxation

Advanced Technical

Domestic Indirect Taxation

May 2021

Suggested answers

ANSWER 1

ABC LLP

Compliance

ABC LLP must notify HMRC of its appointment as liquidator within 21 days, by sending a copy of the Insolvency Practitioners Certificate of Appointment, together with form VAT 769.

The current VAT return period will end on the day before the appointment (i.e. 30 April) and a new VAT return period will start from the date of appointment (i.e. 1 May). The due date for the return for period ending 30 April will be 30 June 2021. This return may be submitted by ABC LLP unsigned and marked "completed from the books and records of the company".

The late payment for quarter ending 28 February 2021 will have triggered the default surcharge regime. However, HMRC does not apply the default surcharge for the period up to the date of appointment (i.e. the period to 30 April 2021) or to the post appointment returns, so a financial penalty should not apply (as the initial default surcharge is 0%).

For insolvency procedures starting after 1 December 2020, VAT due to HMRC but held by businesses when they enter formal insolvency rank as secondary preferential debts in the order of priority. This means they are paid ahead of secured creditors holding a floating charge (for example banks) and ahead of non-preferential creditors (for example suppliers).

When the assets of the business are sold by the liquidator, the sale is treated as a supply by the registered business and should be reported in the VAT returns that are filed.

Once the business ceases to make taxable supplies it must deregister by notifying HMRC within 30 days. Deregistration will be effective from the date the trade ceased. HMRC will issue a final VAT return (VAT 193), and a final annual adjustment should be made for the period from the start of the current partial exemption year up to the date of deregistration. There may be a deregistration charge for assets on hand, unless the VAT on the current replacement cost of the assets is below £1,000.

If there is an intention to make taxable supplies in the future then the deregistration can be deferred, allowing continuing recovery of input tax.

Bad Debt Relief (BDR)

If an invoice has been outstanding for over 6 months, BDR can be claimed in Box 4 of the next VAT return. The claim must be made within 4 years and 6 months of the later of:

- the date on which the consideration became due and payable; and
- the date of supply.

If a payment is received by the liquidator after BDR has been claimed, this is treated as payment for the supply by the business and the BDR is clawed back.

It is also possible to claim BDR once the business has deregistered and this must be notified to HMRC along with full details of the claim.

The payment by the debt factor is not treated as payment for the original supply, rather this is for the purchase of the debt (which is an exempt supply of finance by the business). Typically, the business cannot claim BDR once the debt has been assigned.

With regards to the debts which are over 4 years and 6 months old, it is not possible to issue credit notes for these as credit notes can only be issued where there is a genuine mistake, overcharge or agreed reduction in consideration. So these bad debts will be out of time for VAT relief.

BDR claims for supplies made by Stanley Wilks Ltd when it was part of the VAT group are proper to Stanley Wilks Ltd and not to the representative member of the group.

VAT recovery

I understand that Stanley Wilks Ltd is due a refund of output tax over declared during the time when it was part of the SW Holdings Ltd VAT group. Following the decision in *Lloyds Banking Group plc & Ors* it is the representative member who is entitled to any claim, therefore this refund cannot be claimed by the liquidator on behalf of Stanley Wilks Ltd now that it has left the VAT group. I would advise contacting SW Holdings Ltd to agree a way forward in this respect.

With regards VAT incurred after deregistration, this can be recovered (subject to the usual partial exemption restrictions) using form VAT427, which should be submitted to HMRC with the original invoices.

MARKING GUIDE

TOPIC	**MARKS**
Compliance obligations on liquidation including notifying HMRC and VAT return periods/due dates	2
Deregistration and final VAT return including partial exemption adjustment and application of default surcharge regime	3
Preferential creditors / HMRC and future sales	1
BDR provisions	1
BDR when payment received by liquidator	1
BDR on transfer of debts to debt factor, including VAT liability of payment for debts	2
Debts over 4 years old	1
Member leaving VAT group - who entitled to make historical claims - consider case law	2
VAT incurred after deregistration - how to recover	1
Presentation and higher skills	1
TOTAL	**15**

ANSWER 2

Three Counties College

VAT

There is a barter transaction consisting of the College's grant of the lease in return for Riverdale Development Ltd's (RDL) sublease. The VAT liability and value of each supply is considered in isolation.

For a barter transaction the value of each supply is based on how much each would have been willing to pay in money for the lease. Often, the value of each supply is considered the same, but it is important that the values are a true reflection of worth, evidenced for example by an independent valuation. This is especially the case given the need to evidence that RDL has not obtained the carpark for less than open market value, i.e. is the value of the lease of the facilities management services at least £1 million in this case.

1) The College's supply to RDL is exempt from VAT. The College will therefore be unable to recover any VAT incurred in relation to the grant of the lease to RDL (e.g. valuation costs). If the College opt to tax (OTT) to support VAT recovery, this would be disapplied by virtue of anti-avoidance legislation, which applies to certain transactions where the grantor (i.e. the College) will be in ultimate occupation of the land (through the sublease) for less than 80% taxable business purposes (which I assume will be the case based on the proposed use for mainly educational purposes).

2) RDL is likely to seek to OTT in order to recover the VAT incurred on construction. VAT charged on the sublease will be largely irrecoverable by the College, depending on the specific nature of activities carried out in the facilities and on the College's partial exemption method. Under the anti-avoidance provisions, the provision of finance is not restricted to monetary payments but can also be the transfer of goods or assets. Therefore if the land is provided for less than open market value, the developer, overall, will be paying less for the development than it otherwise would and the College will be seen as a 'development financier'. RDL's OTT will then be disapplied due to the College's occupation of the Facilities for less than 80% taxable business purposes.

Provided that RDL does not obtain the carpark from the College for less than open market value, any OTT submitted by RDL would not be disapplied. RDL will therefore charge VAT to the College on the value of its supply, but, importantly will be able to recover fully the VAT it incurs on construction of the Facilities (and so this irrecoverable VAT cost will not exist within the development, which would likely be passed on to the College).

If the facilities management services are compulsory and included within the sublease agreement, the charge made by RDL to the College is an ancillary element of the sublease, and the VAT liability follows the liability of the sublease itself (i.e. subject to VAT on the assumption that RDL opts to tax and it is not disapplied; otherwise exempt). Alternatively, if non-compulsory, the services will be standard rated.

VAT will also be incurred on the fit-out costs incurred by the College.

As the building will be used partly for taxable purposes, the VAT on all of the costs incurred will be partially recoverable and it may be worth reviewing the College's partial exemption method to potentially ring-fence this building based on its use. In addition, the fit out and the sublease will be Capital Goods Scheme items for the College so use should be monitored over 10 years and adjustments made as necessary.

SDLT

A transaction whereby two parties enter into land transactions of major interests in land in consideration for each other should fall within the special exchange rules in Schedule 4 FA 2003. As such the transactions must be considered separately in order to determine the amount of chargeable consideration.
The chargeable consideration for each transfer is the greater of:
(i) the market value of the subject-matter of the acquisition; or
(ii) the amount or value of the consideration actually given.

The sublease can achieve exemption provided you can meet the following conditions:
- The lease from the College is entered into wholly or partly in consideration of the leaseback;
- The only other consideration provided by RDL (if any) is the payment of money or release from/assumption of debt;
- The interest leased back must be an interest out of the original lease from the College (and not comprise land not subject to that original lease);
- The College and RDL must not be members of the same 75% group; and
- The transaction does not involve a sub sale arrangement.

The chargeable consideration for the lease to RDL is the higher of the value of the encumbered lease from the College and any consideration given (including any VAT payable to the College but not including the value of the leaseback to the College). As the value of the lease from the College is £1 million, the SDLT payable by RDL will be £39,500.

Please note that it is assumed that the fit-out works on the Facilities are carried out by the College after the grant of sublease by RDL and that any management services provided by RDL are paid for separately such that there are no services or works provided in consideration for either lease.

Recommendations

1) VAT on fees relating to the granting of the initial lease to RDL will be irrecoverable.

2) The budget should also include irrecoverable VAT (in line with the College's partial exemption method) on the lease back from RDL, in addition to VAT on the fit-out costs and facilities management. It may be possible to reduce this cost by reviewing the College's partial exemption method and considering whether the VAT recovery is fair and reasonable given the intended use of the new facilities.

3) The SDLT charge payable by RDL may also impact the pricing agreed with the College for the development and so your budget overall.

MARKING GUIDE

TOPIC	MARKS
Barter of land for sublease, consider VAT liability of each supply	1
Exempt supply of land subject to option to tax, impact on VAT recovery	2
Disapplication of option to tax due to College's occupation	2
Assume developer will seek to opt, any VAT charged will be partly irrecoverable due to exempt status of College (subject to some taxable use for ticketed performances, therefore residual)	2
Disapplication of developer's option to tax if land supplied for less than OMV	3
Developer's supply of facilities management - follow liability of sublease	1
VAT on fit out costs, also partly irrecoverable (residual for College). Possible scope for changing partial exemption method	2
CGS item, inc fit out costs	1
SDLT: Special exchange rules apply to determine chargeable consideration. As leases in relation to same plots of land, sublease exempt from SDLT subject to conditions	2
SDLT: Chargeable consideration for land to developer is higher of value of encumbered lease from College and any consideration given (inc VAT payable). Calculation of SDLT payable	3
Presentation and higher skills	1
TOTAL	**20**

ANSWER 3

Full credit will be given to candidates answering on the basis of LBTT as opposed to SDLT

Frank Private Equity LLP

Sale of shares and management charges

Frank Private Equity LLP (FPEL) will be making a sale of shares which is exempt for VAT purposes.

VAT recovery by Fashion Holdings Ltd (FHL)

FHL would need to be VAT registered in order to recover the VAT it incurs. FHL is only eligible to register for VAT if it makes, or intends to make, taxable supplies. This is discussed below in relation to whether FHL makes supplies.

If VAT registered, there are two key questions when considering if FHL can recover the VAT incurred on transaction costs (established following *Larentia + Minerva* C-108/14).

1. Are the supplies being made to FHL?

A party is considered a recipient of the supply if it has:

a) Contracted for the supply;
b) Made use of the supply; and
c) Been invoiced and paid for the supply.

Although FHL has contracted, been invoiced, and paid for the supply, it does not appear that it has made use of it. This is because the work does not appear to have benefited FHL. Consequently, it appears that FHL is not the recipient of the supply for VAT purposes, as it is FPEL which is making the share sale and so requires the advice under the due diligence exercise. It may be possible to argue that FHL also derived a benefit from the advice, as it is required to assist in finding a buyer for the shares in order to continue its business, however it is not guaranteed that HMRC would accept this position.

2. Is FHL participating in any economic activity?

VAT is only recoverable by an entity if it is incurred in the course of an economic activity. If the entity (as here) is passively holding shares, this is not considered an economic activity. As FHL does not make any supplies (even within the corporate group) such as loans or management charges, the criteria are not met for the VAT to be recoverable. It would not be possible for FHL to register for VAT as things stand at present.

Accordingly, the VAT incurred on the sale costs by FHL is not recoverable because both of the above tests are not met.

VAT recovery by Bargain Bags Ltd (BBL)

With regards the costs incurred by the trading company, this VAT will only be recoverable if there is a direct and immediate link with its taxable business activity (as established in *BAA Limited* [2013] Court of Appeal Civ 112). It will also be necessary for BBL to hold a valid VAT invoice in its name. As above, this would rely on an argument that BBL derived a benefit from the advice.

Options to maximise VAT recovery

If it is possible for FHL to recharge the costs incurred in respect of the transaction (either to FPEL, BBL or Bid Co), this should be a taxable supply for VAT purposes, provided it meets the economic activity test (per *Wakefield College* [2018] BVC 22*)*. This would allow FHL to register for VAT and recover the VAT incurred on the transaction costs. This will depend on the commercial arrangements with FPEL (i.e. whether it would accept the costs). Taxable supplies by FHL would allow it to join the existing VAT

group; consequently, any charges between the group would be disregarded for VAT purposes. As stated, the receiving entity still has to make use of the supply.

Alternatively, if FHL was to make management charges to its subsidiaries, this would be an economic activity (based on current case law) which would allow it to join the existing VAT group and so achieve the same outcome as above. FHL would however need to be actively managing its subsidiaries and have economic substance to do so (per the Larentia + Minerva case). At present the directors are employed by Bid Co and it makes the management charges. Consequently, it would be necessary to either:

1) Transfer the staff to FHL;
2) Have joint contracts of employment; or
3) Recharge from Bid Co to FHL, which would then supply the management charges.

The third option would seem messy so either of the first 2 options should be explored.

Going forwards, where possible the transaction costs should be supplied to BBL (including contracts and invoices being in the name of this entity) as it is able to recover VAT in full. Again, this is dependent on the costs being used for the purpose of its business activity.

MARKING GUIDE

TOPIC	**MARKS**
Exempt sale of shares by FPEL	1
FHL - whether can register for VAT	2
Consideration of economic activity and L&M case law	2
Conclusion on VAT recovery on costs incurred by FHL	2
Consideration of VAT grouping	1
VAT recovery on costs incurred by trading sub	2
Options to optimise VAT recovery e.g. can they recharge to FPEL or Bid Co? So FHL would VAT register (either on own or in VAT group)	2
Issues in relation to staff being in the wrong entity	2
Presentation and higher skills	1
TOTAL	**15**

ANSWER 4

Petstuff Online Ltd

Assessments

Whilst the previous advice was that all items were standard rated, some 'animal food' may in fact be zero-rated, such as hay for horses. A full catalogue of products needs to be used to assess the correct treatment.

On the current assumption that all items are standard rated, the figures indicate there was an understatement for the period 3/21, as £20,000 VAT should be due, not £17,000. The £3,000 underpayment is 15% of what was actually due, hence HMRC's calculation.

Based on sales figures, the £3,000 is attributable to the medications/flea treatments, which must still be being accounted for as an exempt supply, rather than standard rated as was advised previously.

HMRC would be wrong to use this, and the 15% figure, as a sample period due to fluctuations in sales of products throughout the year. Period 3/21 was partially in the peak period of higher sales of medicines and flea treatments. There would therefore be a higher percentage of VAT not accounted for in this period compared to say the September and December quarters.

Penalties

HMRC can impose penalties where they consider errors to be careless or deliberate. The penalty will be a percentage of the 'potential lost revenue', dependant on the level of behaviour and mitigating factors such as cooperation and whether the disclosure was prompted.

If careless, the maximum penalty is 30%, if it is deliberate but not concealed it is 70% and if deliberate and concealed then 100%. However, these can be reduced to a minimum of 0%, 20% and 30% respectively.

It is highly likely that HMRC will argue the errors were deliberate, contending that Petstuff Online Ltd either knew the classifications were wrong, or deliberately failed to take action necessary to ensure returns were accurate.

Returns were routinely submitted using the wrong rate. Further, Petstuff Line Ltd were advised 7 years ago that this was the wrong rate. It seems that no further action was taken to verify the changes had been made. However, some changes were made (for cages/huts), which could indicate it was merely an oversight.

Most likely, the behaviour would be at least careless. Not incorporating the change after being told to do so, lacks reasonable care. The fact that other changes were made supports a carelessness, rather than deliberate, argument. The fact a tax manager submits the returns may also be taken into account. HMRC may argue, if the manager knew all the categories should be standard rated, it must have been obvious on reviewing the returns that something was wrong, and nothing was done to rectify this.

No further steps appear to have been taken to conceal the inaccuracies however, to be 'deliberate and concealed'.

Where HMRC consider the understatement was deliberate they can assess back 20 years. It may be that they take the view this behaviour only started once the advice was received 7 years ago. This may depend on the basis for the previous categorisation, and whether this was in reliance on other, incorrect, advice, and the reasonableness of relying on this. Even if previous advice was sought, and relied upon, this may not be enough, as the responsibility for correct returns ultimately lies with the taxpayer.

Interest will also be due on the amount of VAT outstanding.

Input Tax

As Petstuff Online Ltd was treating the supplies of medicines and flea treatments as exempt, it is possible that no input tax was claimed in relation to this. If so, these amounts can be set off against the output tax due to HMRC.

Recommendations

HMRC should be responded to as soon as possible, setting out the error and the cause. The exact differences for each period for the last 4 years should be included, so that HMRC do not apply their 15% across all periods. The response should indicate when this treatment started, to help with mitigation. It will be worth calculating the differences for every period affected, together with the attributable input tax not previously recovered.

There should be full co-operation with HMRC for mitigation against penalties. There would be no, or minimal discount for an unprompted disclosure, as the error was discovered following a HMRC investigation. Credit may be given for bringing earlier periods to HMRC's attention however, and so providing disclosure could be beneficial. Petstuff Online Ltd should also set out the steps which the business will take to ensure such errors do not recur in the future, which may enable HMRC to decide to suspend a careless error penalty.

MARKING GUIDE

TOPIC	**MARKS**
Identification that blanket rate for 'animal food' might not be correct	1
Identify that there was an understatement of VAT	1
Identify source of understatement	1
Discussion of sample period /seasonal fluctuations	2
Explanation of penalty regime	1
View taken on level of behaviour	1
Justification and reasoning for view of level of behaviour	2
Discussion of mitigating factors	2
Identification that can now claim input tax	1
Recommendation of contacting HMRC	1
Recommendation to go back further to other periods	1
Identification of possibility of suspended penalties	0.5
PHS	0.5
TOTAL	**15**

ANSWER 5

Housebuilds Ltd

SDLT

SDLT is charged on land transactions, being the acquisition of a chargeable interest. Relevantly here, the sale of the freehold and the grant of the rights of way/easements are chargeable interests in land and so subject to SDLT, payable on the chargeable consideration.

Chargeable Consideration

Chargeable consideration is anything given in money or money's worth, which here is:

1) The £1.2m land value
2) The construction of the road
3) 5% of house sale proceeds

Land Value

As the land is opted to tax, the total price will be £1.44 million, as VAT is included for SDLT purposes.

Construction of road

Costs of construction work can be chargeable consideration. This is determined by para 10, Sch 4, FA 2003. If certain conditions are met, the costs are not chargeable consideration. The conditions are:

1) the works are carried out after the effective date;
2) the works are carried out on land acquired or to be acquired under the transaction or on other land held by the purchaser; and
3) it is not a condition of the transaction that the works are carried out by the vendor.

As to the effective date, see below. It is not known on the information provided when the works will take place. This should be ascertained from the client.

Part of the works are on Blackacre, part are not. The level of work required on each part is not clear. This is also something to be ascertained from the client.

It is, however, a condition of the contract that Farmer McGhee carries out the works and therefore paragraph 10 does not apply, and the market value of the works is chargeable consideration. The analysis proceeds on the basis that £40,000 represents market value, but this should be confirmed.

The cost of these works will also be subject to VAT so the total consideration would be £48,000.

5% of house sale proceeds

At completion it is not known when these payments will commence, or how much they will be. This is therefore uncertain consideration. SDLT can be paid at completion on a reasonable estimate of the uncertain consideration. However, Housebuilds Ltd can also apply to defer payment of the tax until the consideration becomes certain as it will be paid more than 6 months after the effective date of the transaction. This would be beneficial, and the calculation below is on the basis it will be.

Calculation

The grant of easements/rights of way is only for nominal consideration and so the SDLT payable is £0.

The land is non-residential.

Total chargeable consideration:

	£
Blackacre price	1,440,000
Road construction costs	48,000
TOTAL	**£1,488,000**

Rates

		£
0%	£0-£150,000	£0
2%	£150,001 - £250,000	£2,000
5%	£250,001+	£61,900
Total SDLT due		**£63,900**

Return

A return and payment will be required within 14 days of the effective date of the transaction, otherwise penalties and interest will be charged. The effective date is typically completion, unless the contract is substantially performed prior to completion, (e.g. Housebuilds Ltd taking possession of the land or paying a substantial amount of the purchase price); in which case there will need to be two returns, one at this stage and one on completion.

VAT

When Housebuilds Ltd sells the houses, these will be zero-rated supplies as the first grant of a major interest by a person constructing buildings designed as dwellings. Therefore, Housebuilds Ltd can deduct input tax incurred in constructing the properties, including the VAT incurred on the purchase of the land, as costs incurred in the preparation for making taxable supplies. Construction works should be zero rated.

Housebuilds Ltd is 'blocked' from claiming input tax on the included features unless they are "building materials ordinarily incorporated" for the purposes of Note 22, Group 5 Schedule 8 VATA 1994. Housebuilds Ltd can reclaim the VAT incurred on the fitted kitchen units, the light fittings and electric fireplaces. VAT cannot be reclaimed on the free-standing white goods, or the carpets as they are not building materials ordinarily incorporated.

The works on the access road would be a supply from Farmer McGhee to Housebuilds Ltd. The road is covered by the option to tax so this would be standard rated. There may be a question of recoverability of this input tax, as it will not be directly linked to the taxable supplies of dwellings. However, it could be seen as a general cost in the preparation of making taxable supplies, as there needs to be access to the houses. Therefore, this also would be deductible.

MARKING GUIDE

TOPIC	MARKS
Identify chargeable interests	1
Inclusion of VAT for SDLT	1
Conditions of para 10, Sch 4. Work through their application	2
Request relevant information from clients	1.5
Treatment of uncertain consideration	1
Advice on applying to defer SDLT payment for uncertain consideration	1
Calculation of SDLT due	2
Advice on return	0.5
Advice on effective date	0.5
Identify sale of dwelling will be zero-rated	0.5
Identify construction works will be zero-rated	0.5
Discussion of Builders Blocked Items, identify which items input tax can be claimed for and which cannot	1
Discussion of VAT treatment of access road	1
Deduction of input tax incurred – purchase of land and on access road construction costs	1
PHS	0.5
TOTAL	**15**

ANSWER 6

White Goods and Beyond Ltd

VAT

The supply of white goods is standard rated, and the supply of insurance is exempt, so this is a partially exempt business, meaning the recovery of input tax needs to be considered. Input tax relating exclusively to taxable supplies will be recoverable, and anything relating exclusively to the exempt supplies will not be recoverable. The issue arises in relation to anything that cannot be attributed to either directly, the residual input tax.

The test for determining direct attribution is whether there is a "direct and immediate link" (see *BLP Group v Customs & Excise Commissioners* [1995] STC 424). The items of input tax incurred in the VAT quarter 12/20 can be categorised as follows:

Item	£	*Classification*
Purchase of stock	125,000	Taxable
Rent of opted property	100,000	Residual
Other overheads	38,000	Residual
Marketing leaflets	7,500	Taxable
Website costs	1,000	Residual
Legal services retainer	13,000	Residual
Call centre costs	4,000	Exempt

Which gives totals of:

Classification	£
Taxable	132,500
Exempt	4,000
Residual	152,000

At present WGBL uses the standard method of apportionment based on a values-based calculation. For example, for quarter 12/20 the input tax claimed was £234,340. Deducting that relating to taxable supplies gives £101,840, which is 67% of the residual input tax. The taxable income for that period is 67% of the total income. HMRC have however questioned this recovery, claiming too much may be attributed as taxable.

As the residual input tax exceeds £50,000 p.a., there is a question of whether the standard method differs substantially from a deduction based on use or intended use, in which case the "standard method override" may need to be applied which requires an annual adjustment of the difference from the claimed amount to recovery based on "use". The onus is on the business to undertake these calculations and where they do not, HMRC may assess.

One item that may impact the treatment is the legal services retainer. As this is a set amount, not divided between the taxable and exempt businesses, and part of the general overheads this is correctly treated as residual input tax. However, this does not fairly represent the use by the business, as the majority of the legal services are supplied to the exempt insurance business, but 67% of the cost has been attributed to the taxable business in period 12/20.

The website costs also likely impact the treatment. Again, whilst correct to treat this as residual, as an overhead cost, any income derived directly from the website is for the insurance side of the business, as customers cannot purchase goods on the site. Although, the site also generates interest in the goods on offer and allows customers to see what is in stock and so does contribute to generating these sales, it is unlikely to be to the extent of 67%.

It is also likely that the property costs could require different attribution as the stores will mainly be for taxable supplies and the insurance office for exempt purposes.

Therefore, an override adjustment may have been needed if the difference is substantial. It will be substantial if the difference exceeds £50,000 or 50% of the residual input tax incurred per longer period but is not less than £25,000. In the periods under review by HMRC, the latest longer period would be the tax year to 31 March 2020, with any override adjustment having been required to have been made in the period 06/20.

On average, in the 2019-20 tax year, 70% of residual input tax was attributed as taxable (Taxable (= 980+1175+1025+830) / Total (=1400+1700+1525+1110) = 70%) meaning:

Item	Annual Input Tax	70%
	£	£
Legal services	52,000	36,400
Website	4,000	2,800
Property	400,000	280,000
Total	**456,000**	**319,200**

Recovery based on standard method = £319,200

Figures on the basis of use:

Item	% of exempt use	£
Legal services	85%	44,200
Website	90% (high estimate)	3,600
Property	11%	44,000
Total		**91,800**

Recovery based on use = £456,000 - £91,800 = £364,200

Difference between input tax claimed and usage= £**45,000**

As annual residual input tax is circa £608,000, the difference is clearly less than 50% of this. In respect of the other threshold, whilst very close to the limit of £50,000, this is not 'substantial' and no override correction is required, though a method based on usage would actually be more beneficial.

Recommendations

The response to HMRC's letter should set out clear calculations showing no override adjustment is required for these periods.

Going forward, as the costs will likely remain very similar, it would be worth trying to agree a special method with HMRC. These are used when the standard method does not provide a fair and reasonable

result, which, given the difference in use of some of the residual items, is arguably the case here. Further, as the 2019-20 figures came very close to requiring the application of the standard method override, agreeing a special method will negate having to do this calculation every year (and as stated is more beneficial). A detailed proposal must be sent to HMRC, and written approval is required before a special method can be used.

IPT

The insurance provided is for a premium under a separate contract with the characteristics of insurance, as developed in *Medical Defence Union Ltd v Department of Trade* [1979] 2 WLR 686, and none of the specific exemptions apply, so Insurance Premium Tax ("IPT") will be payable. The liability for this falls on White Goods and Beyond Ltd. There are two main rates of IPT, anything within Schedule 6A to Finance Act 1994 is charged at the higher rate. The charge will apply to the full premium as the contracts only cover risks in the UK.

The goods supplied by **WGBL** are electrical or mechanical appliances ordinarily used in or about the home. Therefore, they fall within the "electrical or mechanical domestic appliances" provisions. As the insurance is not provided free of charge, and the insurer is the supplier of domestic appliances (**WGBL**) the premiums are taxable at the higher rate of 20%.

MARKING GUIDE

TOPIC	**MARKS**
Identify white goods standard rated and insurance exempt. So partial exemption	1
Relevant authority for principle of 'direct and immediate link'	1
Allocate different costs as taxable, exempt, and residual	2
Determine/calculate that using standard method	2
Test for override	2
Identify areas where attribution might be different to use, and why	3
Calculate difference (using any reasonable proportion for website costs)	2
Advise that no override required, suggest write to HMRC explaining this	1.5
Suggest using special method going forward, suggestion of basis for this	1.5
Identify IPT payable on insurance premiums – with reference to conditions	2
Higher rate conditions met here	1
PHS	1
TOTAL	**20**