The Chartered Tax Adviser Examination

May 2017

Suggested solutions

VAT on UK Domestic Transactions, IPT and SDLT

Advisory Paper

QUESTION 1

Ms L Brown
ABZ Developments Ltd
Rio House
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Law Services LLP
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5 May 2017

Dear Linda

SDLT and VAT Costs

I refer to the matters raised in your letter of 2 May. My calculations of the expected SDLT and VAT costs are set out below with related comments.

1) SDLT charge

SDLT is chargeable by reference to residential or non-residential property, with residential property restricted to a dwelling and its grounds.

"Dwelling" includes residential accommodation for students, but excludes a "hall of residence" for students in higher education. Hall of residence is not defined but ordinarily it is a building whose only or main purpose is to accommodate students and comprises multiple rooms with sleeping accommodation, study and dining facilities, leisure/social space, etc. Although the property in this instance accommodates students in higher education, each flat has the attributes of a dwelling and the starting point is therefore that it is a residential property.

The basic position above may be modified if a single transaction comprises 6 or more dwellings, in which case it is classed as non residential property with correspondingly lower SDLT rates. Since there are more than 6 dwellings here, the SDLT chargeable is £114,500 (£2,000 on the consideration in the range £150,000 to £250,000, with the balance chargeable at 5%).

Where a transaction comprises two or more "dwellings", a taxpayer may claim multi-dwelling relief, with SDLT chargeable on the dwellings' average consideration (£312,500), multiplied by the number of dwellings, rather than by reference to £2.5million. Where this relief is claimed, the categorisation of six or more dwellings as non-residential property is disregarded. Were the relief to be claimed, the SDLT charge would be £120,000, represented by SDLT of £15,000 on the deemed consideration of £312,500 per property (as the purchase is effected by a company, the higher rates of SDLT apply).

As the SDLT charge will be lower if the transaction is treated relating to non-residential property, multi-dwelling relief should not be claimed.

2) Irrecoverable VAT.

Both the current and proposed residential accommodation within the building represents "dwellings" in VAT law.

(a) Conversion of flats - VAT status. Although the number of dwellings pre and post completion of the works will be unchanged at 9 units, on the first and second floors we have a changed number of dwellings; accordingly, their conversion will be chargeable to VAT at 5%. The number of dwellings on the third floor is unchanged so these works will be chargeable to VAT at the standard rate.

Since these properties will be the subject of short term leases, the Group's supplies will be VAT exempt, with related input tax non-deductible. I deal with this aspect later.

(b) Construction of the penthouses - VAT status. Exceptionally the enlargement of an existing building is zero rated to the extent that an additional dwelling(s) is created, so the penthouse works will be substantially zero rated (a limited range of goods incorporated therein e.g. carpets and loose furniture, white goods, etc will not qualify for relief and hence are standard rated, with the tax charged non-deductible. I have insufficient information to quantify such irrecoverable VAT).

Since the Group will commission the construction of the penthouses, the grant of leases exceeding 21 years will be zero rated, with related VAT incurred (mainly that on professional fees - see below) substantially deductible. I say "substantially" because in the case of one of the penthouses, the major interest lease will be preceded by a VAT exempt lease on account of its occupation by the Group's managing director. Input tax attributable to this property is not irrecoverable as attributable exclusively to the initial VAT exempt supply but as residual input tax on the basis of the decisions in *Briararch* and *Curtis Henderson* [1992] STC 732.

(c) Lift. Assuming that the lift will be supplied by the contractor, it represents "building materials" incorporated into the building. Accordingly, its supply and installation should be apportioned fairly and reasonably to reflect the VAT status of the dwellings' building works.

(d) Garages. There is no VAT relief on the conversion of the retail units to garages since they are not intended to be occupied along with the dwellings. The short lease of the garages will be standard rated, the presumption being that they are to be used for the parking of vehicles.

(e) Professional fees. Unless the professional services are subsumed in the contractor's construction/conversion services say, under a design and build contract, they are standard rated given that the reliefs in question exclude services supplied by architects, consultants, etc.

(f) Projected irrecoverable input tax. Under the Group's partial exemption method, 33.74% of its residual input tax is irrecoverable. Although I have not reviewed the method's terms, given that partial exemption methods usually set out in clear terms how input tax is to be attributed, applying these principles I regard VAT incurred on the contractor's and professional services falls to be treated as residual input tax, with none of it to be used exclusively in making either taxable or exempt supplies. That being so, I compute the irrecoverable VAT to be £45,127:

	£
VAT on contractor's charges:	
Penthouses - essentially zero rated	Nil
First and second floor flats - reduced rate	20,000
Third floor flats - standard rate	40,000
Lift - VAT chargeable by reference to VAT status of works to the dwellings served:	
(i) First/second floors (£100,000 x [£400,000/£1.6m] @ 5%	1,250
(ii) Third floor (£100,000 x [£200,000/£1.6m] @ 20%	2,500
(iii) Penthouses essentially zero rated	Nil
Professional fees - standard rated	50,000
Garages	20,000
Total VAT incurred	**£133,750**
Projected Irrecoverable VAT (£133,750 @ 33.74%)	**£45,127**

I recommend that you check the wording of the method carefully to satisfy yourself that VAT incurred on the project expenses may be treated as residual input tax.

I hope that this note meets your requirements.

Kind regards

Mary Rose

MARKING GUIDE

TOPIC	MARKS
Computation of SDLT charge on Bristol property:	
(a) Charge to SDLT based on residential and non-residential land, scope of "dwelling" and conclusion	2
(b) 6 or more dwellings classed as non-residential (½ mark) and computation of SDLT if transaction treated as non residential (½ mark)	1
(c) Scope of multiple dwelling relief and computation of SDLT where multiple dwelling relief claimed	1
(d) Conclusion	1
Irrecoverable VAT - London property:	
(a) Flats - VAT status of conversion works :	
(i) scope of reduced rate	1
(ii) conclusion on VAT chargeable on works	1
(b) Penthouses - VAT status of construction services	
(i) scope for zero rating	2
(ii) status of onward supplies and attribution of input tax	2
(c) Lift - VAT status of supply based on underlying supplies to residential accommodation served by the lift	1
(d) Garages - VAT status of construction services and onward supplies	1
(e) Professional fees - VAT status of supplies	1
(f) computation of irrecoverable VAT:	
(i) conclusion that input tax incurred on construction/conversion and professional services to be treated as residual input tax	1
(ii) quantify irrecoverable VAT (marks will be awarded for any reasonable, soundly based estimate)	3
Presentation and higher skills	2
TOTAL	**20**

QUESTION 2

Presentation notes

Given the importance that the legislation attaches to a "motor car", we should be clear on its scope. Motor cars are essentially passenger vehicles having three or more wheels designed for use on public roads, but exclude a vehicle which may accommodate only one passenger or 12 or more seated persons or one constructed to carry a payload of one tonne or more (vans and twin/double cab pick-ups).

1) Although VAT incurred on the purchase or acquisition of a motor car is non-deductible, exceptionally it is recoverable on a motor dealer's "stock in trade" i.e. new or qualifying second hand cars (cars on which the previous owner recovered VAT in full) acquired with the intention of resale within 12 months.

   VAT is chargeable when a car permanently ceases to be trading stock (but is still owned by the dealer), for example, it is made available to staff for private purposes on a permanent basis or for a period exceeding 12 months. This VAT is charged on a “self-supply” basis – i.e. the dealer must account for VAT - the value of the supply being:

   (a) for a new car, its cost (including accessories and delivery charges, with no allowance for a retrospective manufacturer's bonus/discount);

   (b) for a used car, the market price of an identical or similar car.

   In the case of vans, a dealer may deduct in full VAT incurred on vans for resale. There is no deemed supply on vans moved from trading stock to general business use say, for use as a delivery van.

2) A deemed supply arises on trading stock temporarily used for private purpose, but not vehicles loaned to potential customers or as courtesy cars where cars are being repaired.

   The value of the deemed supply is the VAT inclusive payment received in return (if any), or in the absence of payment, cost or the scale charge agreed with motor trade bodies.

   Where the payment received is nominal, in the case of cars (not vans), HM Revenue & Customs (HMRC) can direct that VAT be accounted for on the market value. A direction must be made within 3 years of the relevant supply.

3) Two forms of breakdown cover may be supplied by motor dealers (usually in relation to second hand cars): (a) insurance linked products and (b) an in-house warranty/guarantee under which the dealer agrees to repair the vehicle in the event of breakdown.

   An insurance linked product is regarded by HMRC as a VAT exempt supply distinct from the standard rated supply of the vehicle where the following conditions are met:

   (a) a contract of insurance is concluded between the purchaser and insurer;

   (b) the contract covers solely the purchaser's risks;

   (c) the purchaser may purchase the car without cover;

   (d) the premium payable and commission earned by the dealer is disclosed to the customer.

   Where a "free" warranty is provided by the dealer, it is subsumed in the standard rated supply of the vehicle, even where the invoice refers to the purchase of the warranty. If a separate charge is identified, it is standard rated. Economically the former treatment is more likely to be beneficial in the case of margin scheme cars.

4) VAT incurred on road fuel used exclusively for business motoring is deductible in full. Where it is used both for business and private purposes, the client's options are:

(a) account for output tax on the lower of the payment made by employees, directors and family members or market value;

(b) apply the scale charge referable to vehicles CO_2 emissions;

(c) by concession, dispense with accounting for VAT on the deemed supply by not deducting VAT on all fuel purchased. HMRC must be advised before this option is exercised.

5) Where a dealer accepts a second hand car in part exchange for a replacement new car, and to meet the deposit criteria set by the finance company, it inflates both the market value of the part exchange vehicle and the sale price of the new car, output tax must be accounted for on the sale price of the new car as reflected in the credit agreement (not the sale price of the replacement vehicle net of the inflated price allowed on the part exchange car). This requirement reflects a series of rulings issued by the Court of Justice of the European Communities and the UK Courts.

MARKING GUIDE

TOPIC	**MARKS**
Scope of "motor car"	1
Deduction of input tax on cars and vans acquired by a dealer:	
(a) right of deduction on cars acquired as trading stock.	½
(b) scope of "stock in trade"	1
(c) self supply on cars removed from trading stock and its valuation	2
(d) deduction of VAT on vans.	1
Deemed supply on private use of trading stock:	
(a) scope of supply.	1
(b) loan of vehicles for business purposes outside deemed charge.	½
(c) value of supply	½
(d) direction by HM Revenue & Customs on valuation of supply.	1
Treatment of breakdown cover:	
(a) conditions for separate exempt supply	2
(b) treatment of in-house warranty	1
Fuel supplied for private purposes (½ mark for each of the options identified in the suggested answer)	1½
Value of supply of replacement car where value of part exchange car inflated (no marks will be awarded in the absence of some analysis from a candidate)	2
TOTAL	**15**

QUESTION 3

Based on the facts described Dan has good reason to be concerned.

Food that is heated at a customer's request to be consumed off the premises is subject to VAT at the standard rate. Further, sales of food (whether hot or cold) for consumption on the premises is subject to the standard rate of VAT. Accordingly, from the description provided, the VAT treatment is incorrect as VAT should be charged on food sold for consumption on the premises in both Chattlegate and Wilkesborough.

It is concerning that the incorrect treatment is being applied only in these larger shops. If intentional, this could be with a view to defrauding the Crown.

Taxpayer Notices and HM Revenue & Customs (HMRC) Powers

HMRC are entitled to serve a notice on a taxpayer requiring it to provide information or documents that are reasonably required in order for HMRC to check its tax position.

The information requested must relate to the matter in question; the period covered must be specified and the time given to produce the information must be reasonable. The information asked for appears necessary to check Och Pie Ltd's tax position and therefore Dan should comply fully with the notice. However, if the notice does not specify the period that it covers clarification should be sought on this point – especially given that Dan has only recently joined the business.

HMRC Powers of Inspection

HMRC also have the power to enter and inspect business premises, assets and documents where they are relevant to a person's tax position. These powers do not extend to the entry or inspection of any part of the premises used solely as a dwelling. Business assets include assets believed to be owned, leased or used in connection with the business. For Och Pie Ltd this would mean that HMRC would be entitled to enter and search the shops (but not any residential flats above the shops) as well as business records including digital records and the cash registers.

HMRC are entitled to take copies of business documents and can remove original copies of documents where necessary (e.g. if fraud is suspected) but a receipt must be provided.

HMRC are likely to undertake further checks on the invoices that are suspected to be false – including checking that the supplier and VAT number are genuine and examining the transaction from the other side to ensure that output tax has been accounted for by the supplier

Potential personal implications for Dan Smith

Criminal fraud is where a person knowingly takes steps to evade VAT or to assist another person in evading VAT. On the information that provided it cannot be discounted that HMRC could proceed with a case of criminal fraud. In a Crown Court the maximum imprisonment is 7 years and/or an unlimited fine; this is 6 months and/or a fine of the greater of £5,000 or 3 times the tax evaded in Magistrates Courts.

In practice, a case of civil fraud is more likely as the burden of proof in civil cases is based on the balance of probabilities in contrast to needing to prove a criminal case beyond reasonable doubt. As Dan has only been in post a short time and does not appear to have been involved in the fraudulent activities HMRC are unlikely to pursue a criminal action against him. However, civil penalties can be up to 100% of the tax evaded and assessments can cover a period of up to 20 years.

Where HMRC suspect that a company director is responsible for the wrongdoing then they may require him or her to pay some, or all, of the penalty personally.

Whilst the investigation can be intimidating HMRC are required to comply with Human Rights legislation and therefore Dan should be informed of his rights.

Actions that Dan should consider taking on behalf of the company

At any point Dan can make a disclosure to HMRC. As he is new to the business and has discovered these issues, cooperating with HMRC and providing a full disclosure of the information available to him will serve best to mitigate his own risk in this matter.

HMRC will normally offer a taxpayer (which in this case is Och Pie Ltd) an opportunity to disclose any tax loss brought about by their deliberate action with the possibility that the resulting penalty could be mitigated.

Dan should consider engaging with a specialist in HMRC civil and criminal investigations (or a lawyer) as he is likely to require legal advice in relation to how best to cooperate with HMRC.

MARKING GUIDE

TOPIC	**MARKS**
Identify and explain that the VAT treatment of catering and hot takeaway food applied by Och Pie Ltd has been incorrect and identify that this indicates that fraud has potentially taken place	2
Explain what a tax payer notice is, what detail it must contain and whether it can be issued in respect of the records mentioned by Dan Smith	2
Explain HM Revenue & Customs powers – including power to search and what areas/assets can be searched	2
Explanation of offences regarded as criminal and the potential sentences/penalties that can be applied when a person is found guilty	3
Explain the difference between the burden of proof for criminal versus civil offences. Conclude that Dan Smith is unlikely to face criminal prosecution. Explain that penalties for civil fraud could apply and set out what these are. State that the time limit for assessment is 20 years in cases of fraud	4
Identify that experienced/legal advice is required and that Dan may be able to mitigate his position through full cooperation and that all investigations must comply with the Human Rights Act	2
TOTAL	**15**

QUESTION 4

From: Denise Buckley
To: Derek Baker
Date: 5 May 2017
Subject: Jack Morris - VAT registration.

Dear Derek

Thank you for your email of 2 May - you essentially raise two matters; firstly, is Jack a "taxable person" independently supplying services and, if so, when should he register for VAT.

1) Is Jack independently supplying services?

UK law, unlike the EU VAT Directive, says nothing on services supplied under a contract of employment, instead defining a taxable person as a person registered (or required to be) for VAT. The Directive provides that a taxable person is any person who undertakes an economic activity independent of a contract of employment or under terms akin to an employer/employee relationship in regard to working conditions, remuneration and employer's liability.

In considering whether Jack's services are delivered under a contract of employment, we must have regard to, for example, the level of control exercised by Hampton/Perfect over when and how Jack's services are delivered; the extent to which he is required to provide his services in person; the provision by Jack of tools and equipment; the degree to which he is integrated into his employers' businesses; the provision of holiday and sick pay, etc.

Given the information that you have supplied, I consider that Jack's services are not delivered under a contract of employment: the level of control exercised over how he delivers the service is limited, essentially he is an independent operator; his services are invoiced; he has met personally his tax and NIC obligations; he is required to provide his own van, tools, protective clothing, etc; and finally, he assumes a degree of economic risk.

Alternatively, is Jack bound by ties akin to employment? The Directive (and the rulings of the European Court of Justice in *Kingdom of the Netherlands* Case C-235/85 and *Ayuntamientu de Sevilla* [1993] STC 659) require us to consider Jack's:

(a) working conditions - the degree of his integration in his "employer's" business and the extent to which he is free to organise the activity independently: essentially, the degree of control that his employer exercises over day to day performance of his services,

(b) remuneration - is Jack remunerated directly by his employer and where does the balance of the economic risk lie? and

(c) employer's liability - does it extend beyond Jack's representative activities and commitments?

On balance, I consider that Jack is acting as an independent contractor. There is little evidence of his integration within the organisations which have engaged him; the benefits commonly accruing to employees are substantially absent; the degree of control exercised over him by his employer goes no further than that expected of a contractor/subcontractor relationship; his remuneration is not fixed and he has assumed a degree of economic risk different in degree from that present in an employer/employee relationship; he has freedom to engage staff to deliver the installation services and finally his employers' liability is limited, at best, to his representative activities.

2) VAT registration

Jack must notify HM Revenue & Customs (HMRC) of his liability to register to VAT within 30 days of the value of his taxable supplies in the year then ending exceeding the statutory threshold, with registration taking effect from the end of the following month. The threshold of £73,000 was met on 31 March 2012, with registration effective from 1 May 2012, not 1 April 2012 as asserted by HM Revenue & Customs.

However, Jack would have been exempted from registration if HMRC were satisfied that the value of his taxable supplies in the following year would be less than £75,000 (as indeed was the case). In exempting Jack from registration, officers must, and are limited to taking account of all information available to them at 30 April 2012 - see *Gray* [2000] EWHC Ch 1567. Jack advised HMRC of his projected turnover at this time, and on the face of it he should have been exempted from registration.

That being so, he was required next to notify HMRC of his liability to register for VAT on 30 April 2014, and registered with effect from 1 May 2014 (*Examiners Note - some candidates identified that the registration threshold may have been breached at the end of February 2014, with registration effected from 1 April. Such an analysis was accepted by the examiner*).

Jack could mitigate his liability by:

1) claiming pre-registration input tax;

2) seeking to recover the output tax from Perfect (if Perfect agrees to this, which it may not do); and

3) Potentially claiming VAT bad debt relief on the unpaid fees from Hampton (though as these supplies took place in April, relief will not be available until at least October 2017).

Accordingly, I project his net liability to VAT at present to be £29,959, calculated as follows:

	£
VAT due on income received, inclusive of VAT - 1 May 2014 to 31 March 2017 £(259,000 - 6,916 i.e [1/12 x 83,000]) x 1/6	42,014
Input tax on VAT bearing expenses - 1 May 2014 to 31 March 2017 £(2,340 - 110 i.e.[1/12 x £1,320]) x 1/6	(372)
Pre-registration input tax on the van and tools held at date of registration (investigate possible claim on services supplied in the 6 months preceding registration and whether clothing is still used in the business) £15,600 x 1/6	(2,600)
Output tax possibly recoverable from Perfect £(56,000 - 1,500) x 1/6	(9,083)
Net projected liability	**£29,959**

I hope that this note meets your requirements.

Kind regards

Linda

MARKING GUIDE

TOPIC	MARKS
Taxable person/employee?	
(a) identify issue i.e. is Jack a taxable person independently carrying on an economic activity	1
(b) identifying criteria set out in EU VAT Directive	1
(c) Jack's services supplied independently or as an employee (½ mark to be awarded for any of the following features identified by candidates: degree of control exercised over Jack, level of his integration in employers' businesses; personal service required, level of economic risk assumed by Jack, provision of tools and van, lack of sick and holiday pay, accounting treatment adopted by Jack, employer's liability, subject to maximum of three marks).	3
(d) Quality of arguments supporting conclusion (marks will not be withheld if a candidate's conclusion differs from the suggested answer)	2
Registration	
(a) Registration requirements and exemption from registration	1
(b) Conclusion on date of effective registration taking account of possible exemption from registration (marks will be awarded even if a candidate's conclusion differ from the suggested answer)	3
(c) Computation of net liability (examiner will show flexibility based on candidates' earlier conclusions).	3
Presentation and higher skills	1
TOTAL	**15**

QUESTION 5

Memo

To: Will Moore (Merciless Capital Ltd)
From: Peter Downs (WMorris LLP)
Date: 3 May 2017

Thank you for your email of 28 April 2017. In reply:

1) VAT return for the period ended 31 March 2017

For the period ended 31 March 2017 Merciless Capital Ltd will be entitled to a repayment of £599,194. The detailed calculation of these figures is set out in the appendix to this memo. The return needs to be filed online by 7 May 2017.

2) Further Queries

In response to your further queries:

1) Calculation of input tax recovery

Input tax must be attributed to the supplies that the business makes, or intends to make. Input tax used only to make taxable supplies is recovered in full. Input tax used only to make exempt supplies cannot be recovered. All other input tax is treated as residual and is recoverable on a basis which fairly and reasonably reflects the extent to which it is used to make taxable supplies. The standard method for calculating this is to use the percentage of the value of the taxable supplies as a proportion of the total value of supplies made.

A separate calculation must be performed to compute input tax deductible on sales of securities as they must be excluded from a values based calculation. Input tax directly attributable to share sales to counterparties established outside the EU is recoverable as 'specified supplies'. Input tax relating to the sales of shares is deductible by reference to 'use'. Whilst 'use' is not defined, normally a 'transaction count' method is accepted as a fair approximation of use. This is shown in calculation 2 of the appendix.

Taxable supplies include those outside the scope of UK VAT (under the place of supply rules) which would be taxable if supplied in the UK, for example, the supplies made to Carrozzo SPA (as per calculation 1 of the appendix). However, reverse charge transactions (e.g. Italian lawyers' services) must be excluded.

The loan interest must be included in the calculation as exempt income as it does not accrue from an incidental financial transaction as the loan to Fisher Ltd has been arranged with a commercial purpose in mind and is expected to be an ongoing activity (as established in the case of *Floridienne* and *Berginvest SA* (C-142/99)). This is shown in calculation 1 of the appendix.

The input tax relating to legal fees noted in calculation 3 of the appendix could be regarded as residual as when a decision is taken to sell these investments an exempt financial transaction may arise. However, applying the principles established in *BLP Group PLC* (C-4/1994), where input tax is directly attributable to an actual supply it is therefore not possible to look past this transaction to any further supply or benefit that may arise in the future. Accordingly, it is reasonable to treat the input tax incurred on the legal fees as directly attributable to the taxable supplies of director's fees, as a direct an immediate link exists to this business activity.

Once calculated, the recovery rate must be rounded to 2 decimal places and not to the next whole number as Merciless Capital Ltd has incurred more than £400,000 of residual input tax per month on average.

VAT recovery must be re-calculated annually using annual figures. The VAT recoverable using the annual data is compared to the VAT recovered during the year, with an adjustment to reflect input tax under/over-claimed included in either the last return of the VAT year, e.g. the 12 months ending 31 March, or the following return. This will not apply for the period ended 31 March 2017 as the business registered for VAT in this period.

Under the standard method, the annual recovery rate for a VAT year may be used as a provisional basis for recovering input tax incurred in the following year.

Regulations exist that require the input tax deductible to be adjusted where the standard method does not result in a fair apportionment. The only input tax that HM Revenue & Customs ('HMRC') are likely to take issue relates to the legal fees for the purchase of Fisher Ltd and Carrozzo SPA which HMRC often regard as residual rather than fully recoverable. However, due to the low value of this input tax any difference could not be regarded as 'substantial' (defined as £50,000).

2) Pre-registration Input Tax

Input tax incurred on services received in the six months prior to registration must be included on the first VAT return (the deduction is subject to HMRC's discretion). The input tax incurred on the intellectual property advice and the legal advice invoiced to Merciless Capital Ltd on 7th October is within this period and has therefore been included. The VAT charged on the invoice dated 30 September 2016 is similarly deductible but it cannot be claimed until Michelle has been reimbursed (or received an undertaking to this effect). This is shown in calculation 3 of the appendix.

3) Other recovery methods

If the standard method is not appropriate, you may apply for a Partial Exemption Special Method (a 'PESM'). This is a written agreement with HMRC and a formal declaration that the method proposed produces a fair and reasonable result is required. PESMs are common amongst private equity businesses and can involve different proxies for use, such as number of transactions and use of staff time.

Appendix – Calculation of input tax deductible for the period ended 31 March 2017:

1) Calculation of the recovery rate for input tax on expenses, except those relating to share sales

Summary of income and VAT treatment	Taxable	Exempt
	£	£
Director's fees - Fisher Ltd	6,000	
Director's fees - Carrozzo SPA	6,000	
Loan interest (note (c))		5,000
Total	£12,000	£5,000

Recovery rate (12,000/17,000 x 100) = 70.59%

2) Calculation of the recovery rate for input tax relating to sales of shares

	Taxable	Exempt
Shares sold to Hedgintons LLP	1	
Shares sold to Green Flame SAU		1
Shares sold to Keys GmbH		1
Shares sold to Grace Common Investment Fund		1
Total	1	3

Recovery rate (1/4 x100) = 25%

3) Computation of input tax recoverable (standard method):

	Fully Recoverable	Residual
	£	£
Attribution of input tax:		
Office rent		120,000
Rent of parking spaces		17,600
Furniture, antiques, artworks		484,000
Computers, printers, software		60,000
Legal advice – Carrozzo SPA	18,000	
Legal advice – Fisher Ltd	15,000	
Web design and branding		68,000
Legal advice (office lease, employment contracts)		38,000
Intellectual property advice		5,600
Legal advice 7th October		7,400
Total	33,000	800,600

	Taxable input tax	Exempt input tax
	£	£
Taxable input tax fully recoverable	33,000	
Application of VAT recovery rate to residual input tax: £800,600 x 70.59%	565,144	235,456
VAT incurred of financial market data and installation costs relating to share sales apportioned by reference to usage: £9,000 x 25/75%	2,250	6,750
Total recoverable input tax	£600,394	

VAT Repayment Due	£
Output Tax (on fees to Fisher Ltd)	19,200
Input Tax	600,394
VAT Repayment due	£599,194

MARKING GUIDE

TOPIC	MARKS
Computation of input tax deductible:	
(a) Analysis of income and calculation of recovery rate in relation to general business activities	1
(b) Calculation of recovery rate in respect of share dealing activities (any reasonable basis which differs from the suggested answer will be accepted)	1
(c) Attribution of input tax arising on heads of expenditure other than legal advice sought on investment in Carrozzo SPA and Fisher Ltd and pre-registration input tax (½ mark for each item, subject to a maximum of 3 marks)	3
(d) Attribution of input tax on legal advice sought on investment in Carrozzo SPA and Fisher Ltd (½ mark for each item, subject to a maximum of 1 mark)	1
(e) Treatment of pre-registration input tax (½ mark for each item, subject to a maximum of 1 mark)	1
(f) Calculation of input tax recoverable and conclusion	2
Comment on the calculations, etc:	
(a) Recovery rate on general business activities to be rounded up to 2 decimal places	1
(b) Supplies outside the scope of UK VAT to be brought into account as taxable supplies	1
(c) Treatment of loan interest	1
(d) Treatment of reverse charge transactions	1
(e) Requirement that input tax attributable to financial transactions be the subject of a separate calculation based on use	1
(f) Commentary on attribution of input tax on legal advice sought on investing in Carrozzo SPA and Fisher Ltd	1
(g) Commentary on right to recover pre-registration input tax	1
(h) Commentary on provisional recovery of input tax and annual adjustments, etc	1
(i) Advice on application for a PESM and general advice on the its scope	1
Presentation and higher skills	2
TOTAL	**20**

QUESTION 6

To: AEdmonds@Empress.com
From: Liz.Williams@Helmer.co.uk
Date: 2 May 2017
Subject: Insurance Premium Tax accounting

Dear Alex

Thank you for your email.

I have set out below responses to the points you raise.

Empress PLC's Products

Repair contracts are not a contract of insurance – these are more akin to service agreements. These contracts are outside the scope of IPT.

The extended warranty products sold under Empress PLC's arrangement with the high-street retailer are subject to IPT at the higher rate of 20%.

The extended warranties that Empress PLC sells over the phone or online are subject to the standard rate of IPT.

The proposed rate change will only increase the standard rate of IPT therefore only the online or over the phone extended warranty products will be affected.

IPT Accounting

The basic tax point for IPT is the receipt of a premium - the date that the insurer receives payment of the premium. However, Empress PLC is operating the Special Accounting Scheme. Under the Scheme, premiums are received on the premium written date rather than the date of receipt. The premium written date is the date that the insurer (Empress PLC) makes an entry in its accounts showing the premium as due to it.

Should Empress PLC wish to change its method of accounting for IPT it will need to write to HM Revenue & Customs (HMRC); this letter will need to specify the date from which its use of the Special Accounting Scheme will cease. This will only be approved if all IPT returns and payments are up to date, and you have been in the Scheme for at least 12 months.

Rate Change Measures

The standard rate of IPT will increase from 10% to 12% with effect from 1 June 2017. For cash received accounting, all standard rated premiums received on or after 1 June 2017 will be subject to IPT at 12%. For the Special Accounting Scheme a transitional period is normally available; for premiums impacted by the 1 October 2016 rate increase to 10% this was in place until 1 February 2017. This meant that where cover commenced before 1 October 2016 IPT could be accounted for at 9.5% even if the premium was not written into the insurer's accounts at that point.

Anti-forestalling measures apply when a rate change takes effect and these are as follows:

1) Advance payment (ie in your case, writing the premium before the rate change but where the policy commences afterwards) and this is done between the announcement on 23 November 2016 and 1 June 2017. This will result in the 12% rate applying where this is not the insurer's normal practice.

2) For policies taken out between the 23 November 2016 announcement and 1 June 2017, the length of the cover cannot be extended (e.g. to periods of more than one year) without the 12% rate applying unless this is normal commercial practice.

I have considered the rate change and the IPT accounting arrangements for the Gold Package product below. My conclusions are as follows:

1) As the full value of the Gold Package premium is written as due at the inception of the policy this will be the tax point at which the full amount of IPT becomes due.

2) This will mean that the full value of premiums written into Empress PLC's accounts before the end of the transitional period will be subject to IPT at 10% and not 12%.

Tax Point Options

I recommend that Empress PLC write to HMRC to change to the cash received method. This will provide automatic bad debt relief (helpful if there is a continued increase in customers paying late), as well as the cash flow benefit that would be provided by not having to account for the IPT on premiums before they are received.

Remediation Project

The following points should be noted in relation to the Remediation Project:

1) The IPT rate applied to the refund must be the same as the IPT rate originally charged to the customer – this is irrespective of when the policy commenced or when the refund is processed.

2) HMRC consider that the refund is an adjustment to the premium paid and therefore not an error for IPT purposes. This means that the 4 year statutory cap will not apply and Empress PLC must adjust its IPT irrespective of when the original tax point took place.

3) The compensatory amount paid will fall outside the scope of IPT.

I trust the above is helpful. However, if you have any questions or would like me to review this section of your board paper once drafted I would be happy to do so.

Kind regards

Liz Williams

MARKING GUIDE

TOPIC	MARKS
Confirm the IPT liability of the products and advise that the repair contracts and the extended warranties sold through the retailer should not have been impacted by the rate change	2
Explain how tax points are determined under each of the Special Accounting Scheme and the cash receipts accounting method	2
Explain that to withdraw from the Special Accounting Scheme a business must write to HM Revenue & Customs, specifying a date, and have all returns and payments up to date	1
Explain how the business is obliged to account for IPT around the IPT rate change (including an overview of existing anti forestalling measures) for both Special Accounting Scheme and Cash Accounting	2
Explain that a key benefit of the cash received method is that bad debt relief is automatic	1
Confirm the tax points that apply for the Gold Package product and how these would differ under the Cash Accounting Method. Conclude that under the Special Accounting Scheme the rate of Insurance Premium Tax that applied was lower but that if the business were to now shift to cash received this would improve cash flow in the future	3
Explain that return premiums are subject to IPT at the rate charged and that as the refunds under the remediation project are an adjustment to consideration the four year cap does not apply. Confirm that the compensation paid will be outside the scope of Insurance Premium Tax	3
Presentation and Higher Skills	1
TOTAL	**15**