The Chartered Tax Adviser Examination

May 2018

VAT on UK Domestic Transactions, IPT & SDLT

Advisory Paper

TIME ALLOWED – 3 ¼ HOURS

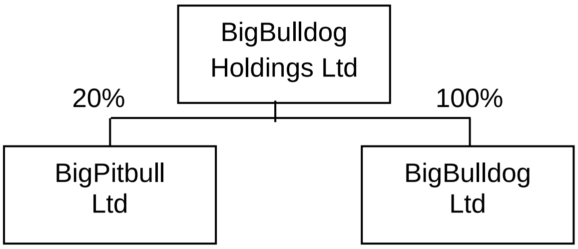
- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer booklet.
- Unless otherwise indicated by the provision of additional table information, you may assume that 2017/18 rates and allowances continue to apply for 2018/19 and future years. Candidates referring to actual or pending rates and allowances for 2018/19 and future years will not be penalised.

1. You are a VAT Manager at a firm of Chartered Tax Advisers and have received the following email from Tommy Barnes, the Tax Manager of an existing client, Animal Investments Group Ltd, a private equity house specialising in holding investments in the pet industry.

From: Tommy Barnes<tbarnes@animalinvestmentgroup.co.uk>
To: Barnaby Jack<bjack@taxadv.co.uk>
Date: 30 April 2018
Subject: Confidential – Project BigBulldog

Dear Barnaby

I need some advice in relation to an on-going transaction involving a new investment in a group that specialises in providing pet insurance. I have set out the current group structure of the target.



Next month, the shares in BigBulldog Holdings Ltd, currently owned by Jimmy Bulldog, will be acquired. Since Animal Investments Group Ltd primarily makes exempt supplies we have incorporated a new 100% subsidiary company, Bidco456 Ltd, to incur the bid costs and acquire 100% of the share capital from Jimmy.

This is a significant deal so both BigBulldog Holdings Ltd and Bidco456 Ltd have been receiving advice from third party advisors. BigBulldog Holdings Ltd has procured a commercial due diligence report in addition to finance and legal fees. Bidco456 Ltd has procured an independent due diligence report on the BigBulldog Group and also will incur finance and legal fees.

Neither side will receive any invoices until after the deal completes but the total fees incurred by Bidco456 Ltd will be £300,000 plus VAT and by BigBulldog Holdings Ltd will be £200,000 plus VAT including £30,000 relating to personal tax advice provided to Jimmy.

I am thinking about putting Bidco456 Ltd and all the target companies in a VAT group post completion. Currently BigBulldog Holdings Ltd, BigBulldog Ltd and BigPitbull Ltd all have individual VAT registrations. BigBulldog Holdings Ltd is the only fully taxable entity in the group as it only provides management services to BigBulldog Ltd which are usually £400,000 per annum.

As Bidco456 Ltd will be in the VAT group I presume it can recover the VAT it has incurred on the advisor costs in line with the recovery position for the group? From my time in practice I realise there is a lot of caselaw in this area so it would be useful to understand some more in relation to their impact.

The due diligence report identified that BigBulldog Ltd has recently agreed a very favourable partial exemption special method. This followed a formal ruling in relation to the liability of its supplies which resulted in a net repayment from HM Revenue & Customs covering the last four years.

Continued

1. Continuation

If you could let me know your thoughts in relation to my queries that would be most appreciated.

Kind regards

Tommy

You are required to prepare an email in response to the email from Tommy Barnes. (15)

2. You work at a firm of Chartered Tax Advisers and have been provided with the following notes from a meeting between your tax partner and Imraan Aldersley, the Finance Director of HelpHousing Ltd, a charity engaged in activities associated with tackling homelessness.

Notes of a Meeting held at HelpHousing Ltd on 25 April 2018

Present: Tax Partner, Imraan Aldersley (Finance Director)

Change of use

SafeHousing Ltd acquired a 25-year lease, for a premium of £1 million, on a brand new five floor property in Manchester exactly four years ago for fully charitable use. It certified its intended use of the building was for qualifying charitable purposes. Two of the five floors are no longer needed so the charity will let those floors to either a taxable business or another charity that will use it for charitable purposes. It is expected that a higher rental income could be achieved by leasing to a taxable business but Imraan needs some advice on the VAT position.

Project Phoenix

SafeHousing Ltd also owns 100% of the shares in DevCon Ltd, a trading company engaged in property development and construction. DevCon Ltd is considering buying a large plot of bare land in Bury and then building four dwellings on it. The purchase price is £1.3 million. If the dwellings built on the land achieve a total sales price over £5.0 million then a further £600,000 is payable to the vendor and if the dwellings built on the land achieve a total sales price over £7.0 million then a further £300,000 is payable to the vendor.

DevCon Ltd will use its own employees to construct the properties. If instead the company outsourced the labour, this would cost £120,000 per property. At Board level, there is some uncertainty about whether to lease the properties for two to three years and then sell them or sell them all immediately. Imraan would like advice on the VAT implications of these two options as that may affect the Board's decision.

Imraan also needs certainty on the Stamp Duty Land Tax payable on the purchase.

Property Sunrise

DevCon Ltd will construct a property in Chorley containing five separate self-contained dwellings and then sell the entire property to a third party investment company. There are two options for the quality of finish of the dwellings, which will affect the price being asked for the property: it will be £1 million for a basic finish or £1.5 million for a luxury finish. Imraan has been asked to calculate the Stamp Duty Land Tax that the prospective purchaser would have to pay under the two options.

You are required to prepare a letter addressed to Imraan advising on the VAT and Stamp Duty Land Tax issues raised. (20)

3. You work for a firm of Chartered Accountants and have received the following email from a manager in the insolvency department:

From: Alfred Barlow <abarlow@abllp.com
To: Jude Duxbury <jduxbury@abllp.com
Date: 30 April 2018
Subject: Mellor Brook Mobiles

We are about to be appointed as receivers to Mellor Brook Mobiles Ltd, a company supplying mobile handsets and handset insurance to consumers through six high street shops of which one is owned by the company and the other five are leased. Our forensic department were previously appointed to undertake an investigation for the company prior to a likely-receivership appointment. Their findings, which are just being finalised, provided us with the following information relevant to VAT:

1) The company entered into an agreement in August 2017 with Mobile Protection Insurance plc under which it is entitled to commission of £30 on each insurance contract sold. It also receives a fee of £10 for administrative services in relation to inputting the customer details on to an online portal. This is the first time Mellor Brook Mobiles have sold insurance contracts.

   In the October 2017 return period, £30,000 of income was received in relation to commission and £10,000 in relation to administrative services. In the January 2018 return period, only £10,000 of income was received in relation to commission and £6,850 in relation to administrative services. No VAT was charged on this income in the above periods nor in the April 2018 period and from looking at the agreement with Mobile Protection Insurance plc there is no mention of VAT. I know very little about insurance as it affects VAT so would be grateful for your insight in terms of whether what the company has been doing is correct.

2) A third party is interested in buying a shop building (14 Turf Moor) owned by the company which would satisfy some of the company's debts. The building was only purchased 24 months ago for £500,000 plus VAT. The floor above the shop has been leased to another company for the past six months and VAT is charged by Mellor Brook Mobiles Ltd following the exercise of the option to tax just prior to granting the lease. The shop has underperformed and is trading very poorly due to a competitor moving into a nearby shop shortly after the purchase.

   The company has leased a shop at 1 Central Drive since 1995 and has always been charged VAT by its landlord. This is the company’s most profitable shop.

   The remaining four shops are leased from a landlord that is not registered for VAT.

Continued

3. Continuation

3) The cash book shows the following gross (where applicable) receipts and gross payments for the quarter ended April 2018 which match to the sales and purchase invoices dated in the period:

Receipts	Amount £
Takings from sale of handsets	6,696
Rebate from main supplier (credit note)	2,454
Quarterly administrative charges	1,400
Quarterly commission income	4,200
Quarterly rental income	3,000
Compensation payment	1,000

Payments	Amount £
Refunds to customers returning handsets	1,266
Purchase of handsets from main supplier	12,888
Rent of 1 Central Drive	36,000
Quarterly rent on four leased shops	126,000
Staff wages	36,400
Sundry expenses – VATable	12,924
Sundry expenses – non VATable	4,400

4) VAT returns for the quarters ended October 2017 and January 2018 have not been submitted to HM Revenue & Customs. The October 2017 workings show a payment of £12,000 due to HM Revenue & Customs and the January 2018 workings show a repayment of £22,000 due from HM Revenue & Customs, as a result of falling sales.

The Financial Accountant has recently left the company and so we have been asked to prepare the return for the quarter ended April 2018: can you let me know the payable balance due to HM Revenue & Customs please? I understand that there is no partial exemption special method agreed with HM Revenue & Customs and that all staff assist equally in the sale of handsets and the sale of insurance contracts and all premises are used equally in the sale of handsets and the sale of insurance contracts.

Any additional comments regarding the returns, deregistration and VAT recovery, should there be a severe slump in trade and the company needs to be wound up, would also be welcome.

You are required to prepare an email in response to the email from Alfred Barlow. You are NOT required to consider Insurance Premium Tax. (15)

4. You are Andy Weir, an indirect tax senior manager in Farns-Barns LLP, a firm of Chartered Tax Advisers. You have received the following letter from Brian Hare, the recently appointed Finance Director of Sobaki and Kuski Ltd, a longstanding client that operates a couple of department stores and some furniture stores.

Mr A Weir	Sobaki and Kuski Ltd
Farns-Barns LLP	Sobaki and Kuski House
Any Road	A Street
Somewhere	Somewhere
AA3 9LL	AA1 0BB

27 April 2018

Dear Andy

Possible Store Acquisition

As I mentioned when we met recently, we are considering the purchase of the department store currently run by Randals and Smithson Ltd. I have been asked to prepare a board paper about the possible purchase of the business and the premises that it operates from (we have already concluded that we will not buy the company) and would be grateful if you could provide some guidance on the VAT issues that it might pose.

We are still at an early stage in investigating the potential purchase and I have set out below some basic information about the business that the seller has provided and some initial thoughts on what we might do with it if we decide to buy it. If we decide to take this further, we will need to carry out further due diligence so if there is anything in particular that we should look into on the VAT front, please let me know.

We were informed that Randals and Smithson Ltd owns the freehold of its store and that it undertook a refurbishment of the retail space about five years ago. We estimate that the freehold has a value of £1.5 million and have been informed that the refurbishment cost approximately £300,000.

The store will require updating if we decide to buy it. We are likely to close the store during refurbishment as this would be more cost effective than keeping the store open during the work. Whilst we are likely to continue to operate the business as a department store, we are considering using the premises for one of our furniture stores. If we decide to do that, we would almost certainly continue to operate the business as a department store for a short period before closing it down to allow for the necessary work to take place to make the building more suitable for use as a furniture store.

If we decide to continue to operate the business as a department store, we would expect to continue selling a broad range of goods there; adults and children's clothing, some furnishings, electrical equipment and so forth.

Randals and Smithson Ltd also operates a website and certain goods from the range it offers in the store can be purchased on-line via either a free "click and collect" arrangement allowing customers to pick up pre-ordered goods in store or a delivery service (there is a separate charge for delivery). As you know, we have previously considered such an option for our stores and concluded that such an offering would not be cost effective. If we buy the business, we will need to look at the website offering in more detail but at present, our thinking is that the website offering will be closed down.

We were told that the perfumery and costume jewellery departments in the store are operated by concessionaires at present. We do not have details of the concession agreements. We will need to look carefully at these, especially if we discontinue the department store format or close the store to refurbish it.

Continued

4. Continuation

Randals and Smithson Ltd offers a finance package on large purchases such as furniture and white goods. I understand that the actual finance is provided by a third-party lender and that Randals and Smithson Ltd generates commission income from financed sales. As you know, we also arrange finance for significant purchases, in much the same way, and we would expect this to continue in the former Randals and Smithson store, whether or not it continues to operate as a department store. I think that our recently agreed partial exemption method will cope with the addition of another store.

I shall look forward to hearing from you.

Yours sincerely

Brian Hare
Finance Director
Sobaki and Kuski Ltd

You are required to draft a letter to Brian Hare advising on the VAT issues arising from the possible store acquisition. (20)

5. You are a VAT specialist in a firm of Chartered Accountants. One of the audit partners in the firm has contacted you about a new client of the firm, Widget Manufacturing Ltd, where she is working on the first audit of the year ending 31 December 2017. The company manufactures widgets, which it sells to UK based customers. It believes that most of its customers are VAT registered and it issues VAT invoices when it delivers goods to them. It now has a turnover of approximately £25 million a year. The business accounts for VAT on the basis of the invoices it raises to each of its customers.

The audit partner has discovered that the client has been making regular provisions for doubtful debts, but has not reclaimed the VAT on unpaid invoices issued in 2017. She has been told that this has been going on for many years, perhaps as far back as when the company was formed in 1976.

Her contact at the client has extracted the following information about unpaid invoices currently outstanding for the year ended 31 December 2017 and for earlier years where the information was readily available:

Period	Note	VAT Amount
		£
December 2017		12,350
November 2017		7,000
October 2017	1)	4,400
January – September 2017		17,800
Year to December 2016		29,925
Year to December 2015		34,750
Year to December 2014		36,250
Year to December 2013	2)	31,350

Notes

1) This comprises:

		£
	Invoice issued 1 October	1,650
	Invoice issued 17 October	2,750

2) This comprises:

		£
	December 2013	1,900
	November 2013	5,000
	October 2013	4,250
	January – September 2013	24,450

She has been told by a longstanding member of Widget Manufacturing's finance team, who is about to compile the company's April 2018 VAT return, that unpaid debts have always run at about 1% of turnover and that there may be records in archive that could be accessed to establish figures for the period up to 31 December 2008. She has also been told that the company's turnover has grown steadily since it was formed in 1976 and that it was running at about £5 million a year by the early 1980s.

The partner understands that the company allows customers up to 21 days after the date of the invoice to make payment, and that this is written into its terms and conditions. It also offers credit terms on higher value widgets. Typically, customers buying on credit terms pay 50% of the price up front and the balance plus interest over 12 months. To date, none of the customers who have taken advantage of credit terms have defaulted, but obviously this position could easily change in the future, and so requires consideration.

The partner has asked what might be done to recover VAT charged to customers who do not pay, so that the matter can be discussed with the client; and also for some guidance on whether there might be scope to reclaim any of the VAT on past supplies.

You are required to draft a briefing note for the partner to use at her forthcoming meeting with the client. (15)

6. You are Arthur Clark, an indirect tax specialist in XOTax LLP a firm of Chartered Tax Advisers that has an international network of affiliated member firms. You have received the email below from Charlotte Grant, a colleague in an overseas affiliate firm, under the normal inter-firm referral arrangements.

To:	aclark@xotax.co.uk
From:	cgrant@xotax.com
Date:	27 April 2018
Subject:	Anycover Insurance Inc – UK Insurance Premium Tax

Hi Arthur

My client, Anycover Insurance Inc, is considering entering the UK insurance market. Its legal advisers are dealing with the regulatory aspect of the proposal so I don't need advice on that, but I need your help to provide it with information about UK Insurance Premium Tax.

If the proposal goes ahead, Anycover Insurance Inc hopes to sell a range of products, primarily travel insurance (for visitors to the UK and for travellers from the UK visiting other countries), car breakdown cover, both for people taking their cars abroad (covering breakdowns outside the UK) and mechanical breakdown insurance cover. The policies will be sold directly or by brokers, and in the case of the mechanical breakdown product, by dealers selling used cars. It is possible that if Anycover Insurance Inc's expansion into the UK is successful, its associated company, Anycover Life Inc, will market its life insurance products in the UK.

As well as personal travel insurance, Anycover Insurance Inc intends to write policies for UK employers, to cover employees travelling abroad on business.

Anycover Insurance Inc will offer short term policies as an alternative to an annual policy, and will offer instalment payments over the term of annual policies, charging an administration fee of £7.50 plus 2% a month where this option is taken up, as well as straightforward annual premiums. The policies will be marketed via brokers as well as directly (on-line, by phone and by post). Brokers will be paid 3% commission on travel policies (which is not disclosed to policyholders) and a 5% commission (which will be disclosed) will be paid on breakdown cover.

The insurer is also considering a scenario where no commission will be paid to brokers arranging travel insurance, who will charge a separate fee to policy holders.

You are required to draft an email to Charlotte commenting on the various Insurance Premium Tax issues posed by Anycover Insurance Inc's plans. (15)