The Chartered Institute of Taxation

Advanced Technical

Domestic Indirect Taxation

May 2022

Suggested solutions

ANSWER 1

New Builds

Supplies to TZR

The Domestic Reverse Charge ("DRC") is an anti-fraud measure which requires a VAT and CIS registered main contractor to account for VAT on its sub-contractor's supplies in Box 1 of the VAT return and recover in accordance with the normal rules in Box 4.

Where the recipient is an "end user", and informs the supplier of this in writing, the DRC will not apply. An end user is a VAT/ CIS registered business that does not make onward supplies of construction services which have been supplied to them.

TZR Renovation Ltd ("TZR") is an end user, in respect of the housing development, but it should not be treated as one presently because it has not made a written notification to its subcontractors. HMRC's guidance is unclear whether a retrospective or late notification is acceptable. Without any further clarity on this, TZR should not be treated as an end user and should apply the DRC to supplies with a tax point on or after 1 March 2021.

The services of the plumber, electrician and 5P Construction Ltd ("5P") in the course of constructing new dwellings qualify for zero rating (Grp 5 Sch 8 VATA 1994). The DRC does not apply to zero-rated services and will, therefore, not apply to these supplies.

Where the scaffolding company makes separate charges, the labour element will be zero-rated (therefore no DRC) but the hire charges are subject to standard-rate VAT (DRC will apply). Where a single charge for scaffolding is made, TZR will be responsible for the DRC at the standard rate – *HMRC v R & M Scaffolding Ltd EDN/04/89*.

Supplies by TZR

A major interest (freehold or lease exceeding 21 years) grant in the houses will be zero rated; otherwise it will be VAT exempt.

Refurbishment

Supplies to TZR

TZR is making onward supplies of reduced rated construction services in the course of a changed number of dwellings conversion (Grp 6 Sch 7A VATA 1994). As it is not an end user, it will be responsible for accounting for the DRC on supplies from the electrical and plumbing sub-contractors at the reduced rate, and scaffolding sub-contractors at the standard rate.

Supplies by TZR

Intermediary suppliers are suppliers which:

- share with an end user a relevant interest in land, where the construction works are taking place or
- are part of the same corporate group as an end user

Provided the intermediary supplier makes no material alteration to or further processing of the supplies it buys in and re-sells, it is treated in the same way as the end user.

Woulham Interiors Ltd ("WI") is connected to Woulham Estates Ltd (s.1161 CA 2006) and is selling on the refurbishment work supplied by TZR.

To be an intermediary supplier, it should not be making any material alteration to the sub-contractor's supply. HMRC's guidance does not define 'material alteration' but it could be inferred from its approach to design and build contract suppliers (i.e. not treated as DRC supplies) that HMRC would not consider TZR as materially altering the supply, allowing for it to be treated as an intermediary supplier.

In relation to WI's dispute, TZR is in a difficult position. The legislation, whilst requiring a written notification to be made for end user/ intermediary status, does not specify a prescribed form. It is reasonable to have therefore taken an e-mail confirming that it will be recharging the works supplied as a notification, but the customer's dispute could lead to non-payment of its invoice. Alternatively, if TZR

offers to credit the invoice and raise without VAT, it risks non-compliance with HMRC, who may deem the e-mail to constitute notification.

It would therefore be sensible before progressing with this route to ask WI to confirm in writing that its previous e-mail was not intended to constitute formal notification for the purposes of the DRC and that WI accepts full responsibility for accounting for the DRC on the works.

Staffing Supplies

The DRC applies to the supply of labour only construction services but will not apply to a supply of staff.

Labour only construction services can be distinguished from a supply of staff because the business supplying the labour will take responsibility for overseeing the work. The customer may request a specifically skilled labourer or agree to pay a price measured per square metre. The supplying business will usually take responsibility for correcting defects following completion. 5P Construct Ltd's supplies will therefore be subject to the DRC where the works are not zero rated and TZR will need to account for VAT at the reduced rate on supplies relating to the refurbishment.

By contrast, a supply of staff is usually directed and controlled by the customer's foreman or manager and is often charged based upon timesheet hours. The supplies made by Keypen Ltd will not be subject to the DRC and the supplier should charge VAT in accordance with the normal rules.

MARKING GUIDE

TOPIC	MARKS
New Builds	
Overview of the Domestic Reverse Charge (DRC) for Construction – purpose, who it affects, how it operates and what is required if it applies	1
Accounting and time of supply - in particular around the project spanning the date of introduction	0.5
No application of DRC on works where zero-rated	1
Scaffolding discussion– if separate charges, labour element will be zero rated for new build and hire of scaffolding itself subject to the reverse charge. Full amount subject to DRC where single charge	2
Supply of houses by TZR will be zero rated if major interest, or exempt otherwise	0.5
Refurbishment Project	
Conversion will qualify for reduced rate (Grp 6 Sch 7A VATA94)	1
DRC will apply to electrical, plumbing and scaffolding sub-contractors on refurbishment	1
Explanation of intermediary supplier status	1
Discussion on whether Woulham Interiors Ltd can be classified as an intermediary supplier, particularly in relation to material alterations	2
Discussion on notification, no prescribed form, risk to TZR Renovation Ltd of credit note if HMRC challenge	2
Staffing Supplies	
Applying the labour only rules to 5P Construct Ltd with discussion of indicators/how conclusion reached – DRC applies	2
Applying the supply of staff rules to Keypen Ltd with discussion of indicators/how conclusion reached – DRC does not apply	1
TOTAL	**15**

ANSWER 2

Ski Lessons

Skiwithus Ltd is a commercial operator and will not qualify as an eligible body for the purpose of exemption in Note 1 Grp 6 Sch 9 VATA 1994. Further, its supplies will not amount to the supply of 'private tuition' under Item 2 Grp 6 Sch 9 VATA 1994, because they are not provided independently of an employer. The ski lessons will be standard rated.

Use of Ski lift / Admission

Where a single charge is made for accessing the slope and using the ski lift, the principal supply will be one of admission (standard rated) rather than transport, as the transport is a means of better enjoying the principal supply of ski slope access (in accordance with the principles of *Card Protection Plan, C-349/96* and *Purple Parking [2012] STC 1680).*

In *Snow Factor Limited [2020] UKUT 0025,* the appellant successfully argued that the supply of a ski lift pass was reduced rated. This was on the basis customers were allowed to use the slopes free of charge if they accessed the slope by walking, but very few users actually opted for this. The payment was deemed to be for the provision of a cable-suspended passenger transport system and reduced rated. As it appears that Skiwithus provides a similar offering, it could reduce rate the supply.

Hire of Ski Equipment

The separate hire of children's ski boots will be liable to the zero rate of VAT (*The Ice Rink Company Ltd Planet Ice (Milton Keynes) Ltd v HMRC [2020] TC07829).*

The charge made for hiring all other children's and adult's equipment, will be liable to the standard rate of VAT.

Tubing parties

The tubing parties provide access to the facility, equipment and catering services in return for a single charge and will be a single standard-rated supply – *HMRC v D Bryce (t/a The Barn) [2010] UKUT 26 (TCC)*.

Use of Slope by Local Club

Ordinarily a 'licence to occupy' a piece of land or building is VAT exempt. The supply will not be covered by the exception to the exemption for the grant of sporting facilities (item 1(m) Grp 1 Sch 9 VATA 1994), as it is provided to a club with exclusive use of the facilities, for a series of more than 10 periods.

This supply is more than the passive right of occupation. The recipient (a ski club) is hiring this venue specifically because it requires a ski slope and equipment. Further, Skiwithus Ltd is providing more than a basic licence to occupy as the supply includes supervision for equipment hire, going beyond merely providing the key to the door (*Best Images Ltd [2010] UKFTT TC00480* and *Blue Chip Hotels v HMRC [2017] UKUT 204*).

Whilst there is an argument that this is an exempt supply, it is more likely to be considered a standard rated supply of facilities.

Ski Holidays & Tour Operator Margin Scheme (TOMS)

TOMS is a simplification measure that treats a bundle of travel, accommodation and other associated supplies made to the same person as a single supply in the UK, when supplied by a principal or undisclosed agent.

Skiwithus Ltd is packaging together the supply of accommodation, ski lessons and lift passes in its own name and as such will be supplying 'margin scheme packages'. This is because the lift passes will constitute passenger transport, which is a margin scheme supply. Input VAT cannot be recovered on any costs of bought in margin scheme supplies but it should account for output tax on the difference between the amount received and the amount it was charged (the margin).

As the package includes in-house supplies (accommodation in its own hotel and ski lessons), the value of the accommodation and lessons will need to be established and used to calculate the value of the margin scheme supplies. This should be undertaken using the market value method if it is able to do

so. If the mark up on all elements of the package is the same, Skiwithus Ltd can opt for the cost-based method.

As the package is enjoyed within the UK, the VAT liability of the margin (and the ski holiday package) will be standard rated.

HMRC's Assessment

The VAT liability of the dry ski slope pass will not be zero rated, but depending on the specific offering, could be reduced rated. HMRC may have correctly assessed for standard rate VAT on the ski lessons and on the margin element of the ski holiday packages, but not necessarily on the full value of the ski holiday packages, depending on the TOMS calculations. The period to which the assessment should apply however, should be considered in light of the timings discussed below.

Time limits

The normal time limits for HMRC assessing are the later of "2 years after the end of the prescribed accounting period; or one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge" (s.73(6) VATA 1994).

As HMRC visited in January 2020, more than two years have passed since the end of some prescribed accounting periods (31 March 20 and earlier), but the information which led to HMRC's assessment was provided less than a year before the assessment date (January 2022).

The period for which the assessment has been applied however extends back further than the allowable 4 years, and is therefore in part, incorrect.

Action to Be Taken

It is recommended that first, a request for a statutory review under s.83B VATA 1994 is made to allow HMRC the opportunity to reduce the value of their assessment. This must be requested within 30 days of the date of the assessment. Skiwithus Ltd has a statutory right of appeal which must be made within 30 days of the date of the assessment or the conclusion of the review (if requested), directly to the Tribunal. Using Alternative Dispute Resolution ("ADR" - see below) does not affect this right or deadline.

ADR is used as a cheaper, more time efficient and effective way of resolving issues and disagreements than formal litigation. It is commonly used where parties cannot agree on the facts or are not clear about one another's position. Settling the position out of court is often cheaper and therefore more cost effective than formally appealing a decision and could be a viable option for Skiwithus Ltd in challenging the assessment timings and liability.

MARKING GUIDE

TOPIC	MARKS
Ski Lessons	
VAT liability is standard rate	1
Ski Lift/ Admission	
Discussion on single vs multiple supplies in context of Skiwithus Ltd- *Card Protection Plan, C-349/96, Purple Parking [2012] STC 1680* Standard rated if admission including ski-lift	2
Reduced rate for ski lift if separate supply, *Snow Factor Limited [2020] UKUT 0025*	1.5
Ski Equipment Hire	
Children's ski boots – zero rated (case not required) *The Ice Rink Company Ltd Planet Ice (Milton Keynes) Ltd v HMRC [2020] TC07829*	1
Adult and other children's equipment hire – standard rated	1
Tubing parties	
VAT liability and single/multiple supplies application	1
Use of Slope by Ski Club	
Supply will be standard rated, not covered by item 1(m) Grp 1 Sch 9 VATA 1994	1
Licence to occupy vs facility hire, with discussion on impact of staff member opening and closing *Best Images Ltd [2010] UKFTT TC0048, Blue Chip Hotels v HMRC [2017] UKUT 204*).	1.5
TOMS	
Explanation of TOMS and when it applies	1
Application to Skiwithus Ltd – making margin supplies, no input tax, output on margin	2
Apportionment for in-house supplies required using appropriate method	1
Standard rate applies to margin	1
HMRC Powers and Appeals	
HMRC correctly assessed on ski lessons and margin, but potential that ski lift passes are reduced rated	1
Time limits for correcting errors and assessing. Assessment covers a period of more than 4 years from the date it was made	2
Option to request reconsideration, statutory right of appeal and ADR	2
TOTAL	**20**

ANSWER 3

OPTION 1

Insright Ltd ("Insright")

Insright will be liable to account for IPT on premiums for the insurance contracts it provides, unless they are exempt as insurance of risks outside the UK.

Supplies of travel insurance for UK risks are liable to the higher rate of IPT.

Travel insurance that covers a maximum four months, taken out by students that are physically present in the UK at the time of entering into the contract, is a UK risk. For the 'four month' period, it is the period of the policy not the length of the travel that is considered. Single trip policies could fall within this category, or the one below, depending on the duration of the policy.

Where travel insurance covers a period exceeding four months, it is the 'habitual residence' of the person that governs whether it is a UK risk. If the person habitually resides in the UK when the contract is taken out, it is a UK risk. The physical location of the person when they take out the contract is irrelevant. Accordingly, if the student has been in the UK for a year, they are likely to be treated as habitually resident here and it will be a taxable contract, regardless of where they are physically located when the contract is purchased. For example, a UK student (always lived in the UK) flies to Thailand for a one-month holiday and books an annual policy whilst in Thailand. They are habitually resident in the UK and it will be a UK risk.

For the overseas students yet to come to the UK, who book the insurance before their arrival, these contracts will be exempt. However, where a student renews a policy after they have been in the UK for a year, the renewal is unlikely to be exempt as it is likely to cover a UK risk at that point.

'Habitual residence' is not defined. If a student has been in the UK for 10 months and has accepted a lease on a house to continue living here, HMRC might argue they are habitually resident.

Newplace Insurance Ltd ("NI Ltd")

Where NI Ltd satisfies the definition of a 'taxable intermediary', it will need to account for IPT on the fee it charges to the students.

Three conditions must be met for NI Ltd to be a taxable intermediary:

1) The insurance is taxable;
2) The insurance is liable to the higher rate; and
3) NI Ltd charges the fee 'separately'

If the insurance is exempt under 1) above (for example if it relates to an overseas risk), then NI Ltd does not need to register.

Travel insurance satisfies condition 2) above.

Once all taxable contracts have been ascertained from the above, condition 3) needs to be met.

Where NI Ltd does charge a separate fee, it will be a taxable intermediary. The fee is treated as though it were a premium on a higher rate contract and NI Ltd will have to notify HMRC as soon as it forms the intention to receive the fee.

NI Ltd should notify within 30 days from when the intention to receive premiums arises and not when it commences selling the policies. If it fails to register on time, penalties are based on the potential lost revenue. For a failure which is not deliberate, the maximum penalty is 30%. There would be no penalty provided it is registered before the first payment is received. There is no registration threshold and all fees received will be liable to the tax

OPTION 2

If NI Ltd does not charge a separate fee, it will not have a liability to register, and the commission received will be included as part of the premium for Insright. The commission, therefore, would not escape IPT, but NI Ltd will not be responsible for accounting for IPT on it. Under this option, Insright would account for IPT on the full £125.

Interest

Where interest is charged, it will be treated as part of the premium for Insright - s.72(1)(d) FA 1994.

Medical Insurance

The extra free of charge cover that includes medical insurance will not change the rate, as cover for personal illness is a travel risk (para 4 Sch 6A FA 1994) and even if it was not, the travel elements are more than 10% of the total premium, so the contract is still liable to the higher rate.

Recommendation

NI Ltd should accept option 2. The IPT is the same under each option, but under option 1, NI Ltd would have to register and account for IPT. Under option 2, Insright will account for the IPT on the entire £125. Although NI Ltd will not receive its fee as quickly as under option 1, the extra costs of administering the IPT is likely to outweigh this.

MARKING GUIDE

TOPIC	**MARKS**
Liability to IPT under option 1 – Insright Ltd	
Insurance contracts taxable for Insright Ltd unless exempt	½
All travel insurance (if taxable) is higher rate	½
Taxable contract	
Must be a UK risk	½
Travel insurance 4 month rule – taken out in UK	½
Travel insurance 4 month rule – period of policy not holiday	½
Application to scenario – not all short trips will come within this rule	1
Travel insurance – more than 4 month rule – habitual residence	1
Travel insurance – more than 4 month rule – application to overseas student for first booking (for example) and then renewal will be a UK risk	1½
Taxable Intermediary – Newplace Insurance Ltd	
Fees of taxable intermediaries are liable to IPT	½
Needs to be three things, taxable contract, higher rate, separate fee	1½
Notification	
Intention to receive, 30 days, suggest latest date, potential penalty	2
Option 2 - No separate fee	
No separate fee = no liability to register, included for Insright Ltd	1
Interest	
Included in premium for Insright Ltd – does not affect NI Ltd Cash receipt method = tax point when received	1
Medical Cover	
FOC medical cover still is a travel risk, even if not, 10% rule	1
Recommendation	
Separate fee = liability to register	1
Choose option 2 – no need to register and IPT is the same, cashflow better under option 1 but IPT accounting costs would outweigh this	1
TOTAL	**15**

ANSWER 4

VAT Treatment of Amabal Ltd's Services

Exemption will apply where the services:

a) Concern an investment fund falling within items 9 or 10 Grp 5 Sch 9 VATA 1994; and

b) Constitute 'management'.

Calidot Pension Scheme

The services are not within the exemption. As a defined benefit scheme, members do not bear the investment risk - *HMRC v Wheels Common Investment Fund Trustees Ltd and others (C-424/11)*. As a result, the scheme is not a qualifying pension fund under item 9(k) and note 6 and are taxable.

Sonaday Pension Scheme

This is a qualifying pension fund under item 9(k) as defined under note 6. Employer contributions are indirect funding by the pension member under (a) of the definition –*Skatteministeriet v ATP Pension Services A/S (C-464/12).* (b) to (e) are also satisfied.

'Management' includes investment management and services of administering the fund which, viewed broadly, form a distinct whole and are specific to and essential for the management of the qualifying pension fund – *HMRC v Abbey National plc (C-169/04).*

The services are VAT exempt.

Bitic plc

Bitic plc is a closed-ended investment fund. Item 10 includes closed-ended funds which invest directly in real estate –*Staatssecretaris van Financien v Fiscal Eenheid X NV cs (C-595/13)*. A fund investing in a range of real estate across different locations is likely to satisfy the risk spreading requirement under (b). Therefore, conditions (a) to (d) of the definition at note 6 are satisfied.

Management of a real estate fund includes investment management and fund administration, but not actual management of the properties. Amabal Ltd's services of selection, purchase and sale of real estate qualify as management – *Fiscal Eenheid*.

The services are VAT exempt.

Amabal Ltd's Entitlement to Reclaim Input Tax

Amabal Ltd is partially exempt, as it intends to make taxable and exempt supplies. Its tax year will be the 12 months ending 31 May. As the first VAT return will cover a five month period, no annual adjustment is required for the 05/22 period.

Only taxable supplies will be made in the 05/22 period. The standard method would allow full recovery of non-attributable input tax, including fit out costs. As non-attributable input tax will be more than £50,000 and cost are incurred in one year which will be used to make supplies in the following year, the standard method override (SMO) must be considered – Reg 107A VAT Regulations 1995. Input tax directly attributable to intended exempt supplies will be irrecoverable, unless within the de minimis limits.

An SMO adjustment must be made, where the input tax deductible under the standard method differs substantially from the use or intended use of the costs. Substantial means exceeding:

- £50,000; or
- 50% of the non-attributable input tax and £25,000

There is no prescribed form of use-based calculation. For example, suitable calculations could include:

Description	Taxable	Exempt	Recovery Rate
Forecast income	£120,000	£280,000	30.00%
Head count	6	12	33.34%
Assets under management	£10 million	£90 million	10.00%

All of the above would result is an SMO adjustment, based on the data provided. Floor space could also be a suitable basis.

As the majority of the costs relate to the office premises, head count is likely to be the most appropriate method based on the available data (though floor space should also be ascertained). An SMO adjustment should be included in the 08/22 return, which will be £66,660 for fit out costs.

A use-based calculation could be adopted for the 05/22 period, under Reg 101(2)(e) VAT Regulations 1995. This would avoid a large amount of input tax being reclaimed in one period, followed by a significant SMO adjustment in the next.

Amabal Ltd could seek HMRC's written approval to use a partial exemption special method. HMRC normally only backdate approval to the start of the current tax year. If a PESM is to be adopted from the effective date of registration, the proposal should be submitted no later than 31 May 2022.

The standard method use-based calculation for the 05/22 period and a PESM based on head count for subsequent periods is likely to be the best approach.

As the office fit out cost more than £250,000 plus VAT, capital goods scheme (CGS) adjustments are required, even if the SMO applies – *HMRC v Turbine Motor Works Ltd [2011] UKFTT 706 (TC).* Normally, taxable use for CGS purposes reflects the partial exemption annual adjustment recovery rate. HMRC's approval to use a different method could be sought, if it would achieve a more fair and reasonable result. The first CGS adjustment, if any, will be due in the 11/23 period.

Employer's entitlement to reclaim input tax on Amabal Ltd's fees

Only the fees in connection with the Calidot Pension Scheme need to be considered, as Amabal Ltd's services concerning Sonaday are exempt.

Amabal Ltd is contracted to supply services to the trustee of the Calidot Pension Scheme. In principle, this means that Calidot Ltd has no entitlement to reclaim any of the associated VAT. However, following the CJEU's judgment in *Inspecteur van de Belastingdienst/Noord/kantoor Groningen v Fiscale Eenhied PPG Holdings BVcs te Hoogezand (C-26/12),* HMRC's policy provides three possibilities:

1) If Amabal Ltd issues a VAT invoice to Calidot Ltd for the whole of its fee, Calidot Ltd will be entitled to reclaim 30% of the VAT, which HMRC accept as being the proportion relating to management services. Alternatively, Amabal Ltd could apportion its fee and issue a separate VAT invoice for the administration services, allowing Calidot Ltd to reclaim the VAT. Any apportionment would have to be on a fair and reasonable basis.

2) Amabal Ltd could invoice the full value of its services to the trustee. The trustee could register for VAT and issue a VAT invoice to Calidot Ltd for the administration service. Calidot Ltd would be entitled to reclaim the VAT. The trustee would be entitled to partial VAT recovery under the partial exemption rules.

3) Amabal Ltd, Calidot Ltd and the trustee could explore entering into a tri-partite agreement which, provided certain conditions are satisfied as detailed in RCB 08/15, may allow Calidot Ltd to reclaim the VAT in full.

MARKING GUIDE

TOPIC	MARKS
VAT treatment of Amabal Ltd's services and its entitlement to reclaim input tax	
VAT treatment of services supplied to the defined benefit pension scheme:	
Whether management of a special investment fund	2
VAT treatment of services supplied to the defined contribution pension scheme:	
Whether 'management' of a 'qualifying pension fund'	3
VAT treatment of services supplied to the investment trust company:	
Whether 'management' of a 'closed-ended investment undertaking'	3
Recovery of VAT by Amabal Ltd:	
Use of the standard method and standard method override implications	3
Standard method use-based calculation or partial exemption special method	2
Capital goods scheme implications	1
Discuss the extent to which Calidot Ltd is entitled to reclaim the VAT on Amabal Ltd's fees	
Use of the 70:30 split concession, entitlement to adopt a different apportionment and invoicing arrangements	3
Recharge of management services by trustee to Calidot Ltd	2
Possible restructuring as a tri-partite arrangement	1
TOTAL	**20**

ANSWER 5

Margin Scheme

The supply of bikes is subject to the standard rate of VAT. VAT on sales will be a cost, as purchasers are private individuals. The margin scheme for second-hand goods will be beneficial, as output VAT is only due on the margin.

Brian is eligible to use the margin scheme, as he purchases bikes without VAT. Record keeping requirements must be met, including preparing an invoice for purchases from private sellers, keeping a stock record and issuing a sales invoice, including all of the information specified in s.5 HMRC Notice 718/1, which has the force of law. Sales invoices must not show VAT.

The margin is the selling price less the purchase price. Part payment in cash and part exchange does not alter the selling price. The cost of spare parts, MOT test fees and other costs of bringing the bike to sale are not part of the purchase price.

Margin = £9,500 - £3,500 = £6,000

Output VAT = £6,000 x $1/6^{th}$ = £1,000

Mechanical Breakdown Insurance (MBI)

As MBI is optional, the customer's risks are insured and the exact amount of the premium is collected, Brian should treat MBI payments as a disbursement and exclude them from his VAT return.

The commission received is consideration for a supply of insurance intermediary services under item 4 Grp 2 Sch 9 VATA 1994, as Brian is an agent bringing together customer and insurer with a view to the insurance of risks.

The commission will be VAT exempt, provided Brian complies with the disclosure requirements in notes 3 to 6. He must issue a sales invoice to the customer, including a statement setting out the amount of the insurance premium. His commission does not need to be disclosed. The invoice must be issued no later than the time at which the MBI contract is entered into. Otherwise, Brian must account for standard rate VAT on the commission.

The premium collected and the commission received should be dealt with outside the margin scheme.

Input Tax Recovery

Input tax on spare parts is directly attributable to taxable supplies and reclaimable in full.

If exempt commissions are received, Brian will be partially exempt. As the commission per sale is £50 and the average selling price is £8,000, the standard method is likely to allow full recovery of non-attributable input tax. This is because the recovery rate should be rounded up to the nearest one percent (£8,000/(£8,000 + £50) = 99.38%). If Brian has input tax that is directly attributable to exempt supplies or if non-attributable input tax partly relates to exempt supplies, recovery may be restricted. Given the amounts involved, it is likely that the partial exemption de minimis limits would apply.

Entitlement to reclaim the VAT on the purchase of the sports bike depends on whether it was purchased for the purposes of the business. The key test is what Brian had in mind when purchasing the bike *HMRC v Ian Flockton Developments Ltd QB [1987] STC 394.* This is a question of fact.

As Brian purchased it with the intention to use it to promote his business he is, in principle, entitled to recover VAT on the purchase and running costs. The onus is on Brian to be able to evidence his intention. This could include evidence of any legal impediment to private use, such as whether it can legally be used on public roads or whether insured for private use – *HMRC v Upton (t/a Fagomatic) [2002] EWCA Civ 520.*

It is irrelevant whether HMRC believe the business purpose was misconceived or whether, in hindsight, the business achieved its objectives. They are entitled to evaluate the evidence and draw inferences. If HMRC believe such an intention did not exist, they can assess for over claimed input tax, interest and penalties. Brian could appeal, but a Tribunal may only allow such an appeal if HMRC's decision was unreasonable or would have been unreasonable if information brought to the attention of the Tribunal

had been available to HMRC when they made their decision - s.84(4) VATA 1994. This limits the Tribunal's ability to overturn such decisions.

The fact that Brian may gain some personal enjoyment from racing the bike is not relevant, as the right to deduct input tax is based on purpose, not benefit. However, he has previously raced bikes as a hobby, which suggests that continuation of his hobby may also have been an intention. If so, apportionment between business and private use would be necessary, with only the business element reclaimable.

MARKING GUIDE

TOPIC	**MARKS**
VAT treatment of sales:	
Margin scheme will be beneficial	1
Margin scheme conditions	1
Calculation of the margin on first sale, including spare parts, MOT costs and part exchange	2
VAT treatment of mechanical breakdown cover:	
Separate supply of intermediary services and disbursement of premium	1
Disclosure requirements and liability implications	2
Input tax recovery	
Spare parts	0.5
Partial exemption– standard method, rounding up to nearest 1%, de minimis limits	1.5
Whether sports bike purchased for business use. Object in the mind of the purchaser at the time	3
Supporting evidence and risk of challenge by HMRC	1.5
Whether purchased for a dual purpose and apportionment	1.5
TOTAL	**15**

ANSWER 6

Cruises

As the boats are designed or adapted to carry 10 or more passengers, including crew, the city cruise is a zero-rated supply under item 4(a) Grp 8 Sch 8 VATA 1994.

The country cruise could be standard-rated under note 4A(a*).* It takes place on a private waterway to and from Orchard House, which is a place of historical interest.

The transport is supplied by a person connected to the person supplying admission. Floatboat Ltd is connected with Kevin Yan, as he controls it. He is connected with Yu Yan, his mother, who charges admission to Orchard House – s.1122 CTA 2021.

Where passengers choose to remain on the boat, there is no supply of admission. This does not alter the need to apply standard rate VAT to the supplies of passenger transport, based on the wording of Note 4(a). However, HMRC accept that transport supplied 'independently' of admission is zero-rated. Independence is not clearly defined. It is not clear whether Floatboat Ltd and Yu Yan being connected parties is fatal to the question of independence or, for example, whether it may depend on how the transport is held out for sale or the nature of any agreement between Floatboat Ltd and Yu Yan.

The Floatcards, which can be used to gain admission to Orchard House, mean that the transport paid for using the card is unlikely to be independent, meaning standard rate VAT applies. Zero rate VAT may apply where a Floatcard is not used, but a written clearance from HMRC would be needed to gain greater certainty.

Dinner cruises comprise passenger transport and in-house catering. If supplied separately, the transport would be zero-rated and the catering standard-rated. The single price is not determinative of a single or multiple supply. A customer is likely to view the transport and catering as distinct elements which complement each other. Neither element can be said to be a means of better enjoying the other and ancillary to a principal supply – *HMRC v Card Protection Plan Ltd (C-349/96)*. The two elements should be treated as separate supplies - *HMRC v Sea Containers Ltd QB [2000] STC 82* and *HMRC v Durham River Trips Limited (17328).*

The consideration should be apportioned on a fair and reasonable basis s.19(4) VATA 1994*.* There is no prescribed method, but a cost-based apportionment could be suitable.

Floatcard

The Floatcard could be regarded as a voucher under para 1 s.51C Sch 10B VATA 1994 or a ticket.

Multi-Purpose Voucher (MPV)

If a voucher, it would be an MPV, as it can be used to purchase zero-rated and standard-rated supplies.

Payment for the MPV would be disregarded for VAT purposes. Floatboat Ltd would account for output VAT if the card is redeemed for a country cruise. The attractions would account for output VAT on redemption for admission, if applicable. The reimbursement payments to the attractions would be outside the scope of VAT. Standard rate VAT would apply to the administration fee.

A number of specific attractions, as notified to customers on the leaflet, are obliged to accept the card as consideration for admission*.* The card is transferable by gift. The card meets the definition of a voucher under para 1(2) to 1(3). However, para 1(5) excludes instruments functioning as a ticket.

Functions as a Ticket?

Floatcard allows admission once to each attraction. This is similar to a ticket, which would normally be used once. A voucher is normally used until its value has been used up.

The card has a face value of £500. Floatcard is used at four attractions on average, with an average admission price of £20. The face value is arbitrary, as a cardholder is unlikely to use the full value. Its function is similar to a ticket.

As a ticket, the purchase price would be consideration for supplies with different VAT liabilities and should be apportioned on a fair and reasonable basis. A suitable basis could be the actual use of cards over a representative period.

The attractions would make standard-rated supplies of admission to Floatboat Ltd. The VAT incurred would be reclaimable. The administration fee would be standard-rated, as consideration for a supply of administration or marketing.

Arguably, the card does not function as a ticket, as the holder chooses how and when to use it. Floatcard does not allow admission to the attraction but allows the holder to acquire a ticket.

A request for a preliminary ruling on similar facts has been lodged with the CJEU - *DSAB Destination Stockholm AB (C-637/20)*. The judgment is awaited.

Conclusion

The correct interpretation is not clear. On balance, Floatcard appears to function as a ticket and, therefore, falls outside the definition of a voucher.

Floatboat Ltd should consider applying to HMRC for a written clearance, as there is a genuine point of uncertainty concerning the correct interpretation of the law. However, obtaining a definitive clearance may be difficult. Alternatively, Floatboat Ltd could consider amending the terms and conditions, to address the above issues. For example, allowing multiple admissions to the same attraction or cruise and having a more meaningful face value.

MARKING GUIDE

TOPIC	**MARKS**
Canal cruise:	
City cruise – Zero-rated supply of passenger transport	1
Country cruise – standard rate VAT under Note 4A. Connected party rules	3
Dinner cruise. Single v multiple supply. Apportionment – No need to mention specific case names for marks	2
Visitor cards:	
VAT treatment if a multi-purpose voucher on issue, redemption by Floatboat Ltd and redemption by other attractions	3
Whether it functions as a ticket. How to gain more certainty. *DSAB Destination Stockholm (C-637/20)*- No need to mention specific case names for marks	3
VAT treatment if not a multi-purpose voucher and the need to apportion	2
VAT treatment of service fee	1
TOTAL	**15**