

The Chartered Institute of Taxation

Application and Professional Skills

VAT and Other Indirect Taxes

May 2023

Suggested solution

REPORT FOR MR AMARI ADOYO ON THE TAX IMPLICATIONS OF A PROPOSED GIFT FOR THE BENEFIT OF THE PATRIBEAN RELIEF APPEAL (“THE APPEAL”)

Introduction

1. This Report is prepared on the instructions of Mr Amari Adoyo (“Amari”) who proposes making a gift for the benefit of the Appeal, using a valuable bronze sculpture (“Simba”) of which he is the creator and owner.
2. This Report is based on information provided by Amari in a letter to Widford Westmill LLP dated 3 May 2023 and information held in our client file.
3. Amari wishes to understand the tax implications of his proposal prior to meeting with Caloseni Foundation, the lead charity in the Appeal (“Caloseni”), and Billings LLP, the auction house which handles sales of his work (“Billings”). The advice and recommendations provided in this Report are for the sole benefit of Amari and may not be relied on by any third party who should, where appropriate, seek independent advice.

Executive summary

4. Our findings may be summarised as follows:
 - (1) There are two proposed options, (a) and (b), each giving rise to different tax implications. Under Option (a), Amari would auction Simba through Billings and gift the net proceeds to Caloseni. Under Option (b), Amari would gift Simba to Caloseni, who would auction the sculpture through Billings, retaining the net proceeds.
 - (2) In either case, the tax treatment will be affected by whether Simba is a business asset or a private asset of Amari (“the business/private issue”).
 - (3) The business/private issue is uncertain. It may be arguable that Simba has been, and remains, a private asset. We consider the better view, however, is that Simba was appropriated to stock in 2016 and therefore became a business asset. This treatment is less likely to be challenged by HM Revenue & Customs (“HMRC”).
 - (4) Option (a) will trigger VAT, income tax liabilities and national insurance contributions (“NICs”). Expenditure, however, will be tax deductible. A significant advantage, in the form of Gift Aid relief, will also arise.
 - (5) Option (b) will also trigger a VAT liability for Amari. No income tax or NICs, however, would be chargeable, but Gift Aid relief will not apply. There could be UK tax implications for Caloseni when auctioning Simba.
 - (6) For completeness, we have considered the tax position if Simba is a private asset. Under either Option (a) or (b), Amari will not be chargeable to VAT, income tax or NICs. However, in principle capital gains tax (“CGT”) is chargeable, although under Option (b) exemption may be claimed. In neither case, however, will Gift Aid relief apply.
 - (7) The precise calculation of tax liability will depend not only on which option is chosen, but also on Simba’s value for tax purposes at the time of disposal and any other allowances to which Amari may be entitled.
 - (8) Amari is an additional rate taxpayer; therefore, Gift Aid relief is very beneficial to him. It also benefits Caloseni. Both these advantages arise where Option (a) is adopted and Simba is a business asset.
 - (9) Illustrative figures, based on certain stated assumptions, suggest that Option (a) may produce a marginally better result.
 - (10) A further option Amari may like to consider is making a cash donation to Caloseni out of income (and not dispose of Simba). This would be most tax-efficient. Not only would this benefit from Gift Aid relief, but there would also be no liability to taxes or NICs. It might, however, raise a number of commercial issues.

Our more detailed analysis and recommendations are set out below.

The business/private issue

5. This is a pivotal issue whichever of Options (a) or (b) is chosen.
6. Whether an asset is business or private for tax purposes is a question of fact. The evidence here is unclear as, sadly, Mr Kanzi (who acted before we were instructed) has died. We do not know whether at any point Simba was included in the Accounts as stock in trade or whether it has been excluded on the grounds it was a private asset. If, for example, the historic costs (such as purchase, importation, costs of creating the work) were treated as business expenses, this would provide a strong indication that Simba is a business asset for tax purposes. Amari informs us that, initially, he regarded Simba as a private asset. Of itself, such an intention is unlikely to be sufficient and, in order to be accepted by HMRC, would require supporting evidence. We know, however, that in 2016 Simba was installed on a plinth which was fixed into the Sculpture Park, thus forming part of the land. The Sculpture Park, for tax purposes, is premises to which the public are admitted for payment. We know also that, from 2016 onwards, Simba was displayed along with other artworks for sale to interested buyers. An offer to purchase it for £10,000 was indeed received in 2016. Subsequently also, the costs of insuring, protecting and repairing Simba have all been included as business expenses and VAT reclaimed.
7. In considering the business/private issue, HMRC look for certain hallmarks (badges of trade). The fact that Amari's business is primarily concerned with creating and selling artworks is a compelling factor. Also of relevance is the inclusion of Simba in the Sculpture Park (where artworks are displayed to the paying public and to potential buyers). A similar issue, as to whether an artwork is a business or private asset, arises in the case of stately homes. HMRC may consider that there is a presumption that an artwork displayed to the paying public is a business asset. They could potentially accept it could be "ring-fenced" as private, but would expect to see cogent evidence. The lack of this is likely to lead to challenge. Our conclusion is that Simba was appropriated to trading stock in 2016. For tax purposes, this is deemed to be a sale and purchase of the asset at the then market value. In principle, Amari would have incurred liability to CGT (with the possibility of an election to roll any gain into the computation of trading profits). However, if the offer of £10,000 from the Patribean Ambassador reflected the market value (and Amari had no other chargeable gains in that tax year), no CGT would be payable as the disposal would have fallen within his annual exemption (£11,100). Subsequent sale of Simba would be sale of a business asset and, for the above reasons, we recommend this is how it is treated. For the sake of completeness, however, we have also covered the tax position if Simba is a private asset. If evidence of exclusively private use is available, we should be happy to consider it further.

Option (a): tax issues

8. The taxes to be considered here are VAT, income tax and NICs.
9. In a sale at auction, the seller of the goods is the principal. The auctioneer is the agent of the seller. As Billings have stated, the seller pays a fee for the auctioneer's services ("selling commission") which is subject to VAT at 20%. Where the seller is a taxable person for VAT purposes, the price for which the goods are sold ("the hammer price") is treated as including any VAT chargeable. In principle, therefore, under Option (a) Amari would be liable to account for any VAT on the sale ("output VAT") less any VAT on associated costs ("input VAT").
10. VAT is chargeable on the value of the supply. It is necessary to consider next how this must be calculated. For VAT purposes, Simba is classified as a work of art ("WOA"), being an original sculpture in bronze. Billings refer in their letter to the VAT Margin Scheme and the Auctioneer's Scheme. These schemes are aimed to reduce the VAT chargeable on sale of certain second-hand goods, including WOAs. This is achieved by calculating VAT on the profit margin (if any) rather than on the full sale consideration. As Amari created Simba as an original artwork, we do not consider it falls to be treated, in his hands, as "second-hand goods". Moreover, the conditions governing eligibility to use the schemes are stringent. In particular, the Margin Scheme cannot be used where, historically, any VAT relating to the WOA has been reclaimed by the seller. The

Auctioneer's Scheme is available only where the seller is not VAT-registered, or can use the Margin Scheme. We consider it unlikely, therefore, the schemes could apply to a sale by Amari of Simba and we proceed on the basis that the value of the supply would be the hammer price.

11. A supply of goods is VAT-exempt in circumstances where any input VAT incurred in acquiring or importing the goods was "non-deductible". In this context, "non-deductible" has a special meaning. It refers to VAT, which is blocked from deduction by legislation, of which an example frequently encountered is VAT on business entertaining. We assume Amari did not deduct VAT initially incurred when the bronze was imported as, at that time, he was not VAT-registered. In principle, a claim for certain pre-registration VAT can be made (though such a claim would now be time-barred). However, VAT which was simply not deducted is not, for these purposes, "non-deductible VAT". Likewise, for any VAT which Amari incurred post-registration e.g., on goods used in the process of producing Simba, such as power for firing the furnace and materials consumed in the casting process). Accordingly, we do not consider the conditions for exempting the sale from VAT would be satisfied here.
12. It follows from the above that VAT will be chargeable at 20% on the hammer price, which is treated as VAT-inclusive (i.e., £150,000 x 1/6 = £25,000). One exception, however, is where the sale is for export, in which case it is zero-rated, and no VAT is chargeable. This may be a possibility here, as Billings have advised that the sale is likely to attract interest from American collectors.
13. In either case, VAT on related expenditure (e.g., the costs of removing and transporting Simba, selling commission etc.) is input VAT and may be deducted by Amari from output VAT in the normal way.
14. The net profit on sale, less VAT and allowable expenses would be chargeable to income tax and to NICs at the top rate of 3.25%.
15. Under Option (a), Amari will be entitled to donate the net proceeds of sale in cash to Caloseni. This is particularly tax-efficient if the conditions for Gift Aid are satisfied and which we consider next.

Gift Aid Relief

16. Where an individual makes a cash donation to a charity (including a charity established in an EU Member State) and signs a Gift Aid declaration, the individual obtains income tax relief. The charity is also able to claim from HMRC an amount equal to basic rate tax on the gift. In order to benefit from Gift Aid relief, the individual must be chargeable to UK income tax or CGT. The gift must not exceed four times the amount of tax paid in that year (on income and/or gains). This is known as "tax cover". Relief is given by extending the basic rate band (and, where appropriate, the higher rate band) by the grossed-up amount of the gift. This means that less income is taxed at the higher/additional rates. As an additional rate taxpayer, assuming he has sufficient tax cover, Amari will obtain relief on the gift at an effective rate of 25%. Relief may be claimed in the tax year the gift is made, or carried back to the previous year, assuming (as here) a self-assessment return has not already been filed.

Example

A, an additional rate taxpayer, gifts £100 out of income.

If Gift Aid does not apply, A pays tax on that income of £45.

If, however, the gift is made to C (a charity) under Gift Aid, A's tax is £20, a saving of £25 and C receives £125 (£100 from A, plus £125 x 20% from HMRC).

Thus, where Gift Aid applies, it benefits both the donor and the donee charity.

For the sake of completeness, we briefly consider the tax treatment if Simba is a private, not a business, asset.

Private Asset: Option (a)

17. Under Option (a), no VAT is chargeable because the sale would not be in the course or furtherance of Amari's business and therefore would be outside the scope of the tax. VAT on related expenditure (e.g., costs of removing and transporting Simba, selling commission etc.) would not be deductible and would be a cost. As the sale proceeds would not be profits of a trade or profession, income tax would not be chargeable. No deduction could be claimed on related expenditure (as the costs are not incurred wholly and necessarily in the course of a trade or profession). No NICs would be chargeable.
18. Where there is a disposal of a private asset, however, CGT is, in principle, chargeable. This can give rise to valuation difficulties since certain costs (e.g., acquisition, repairs, expenses of sale) are deducted in computing any chargeable gain. Given the state of the evidence, this could provoke a dispute with HMRC. As Amari is a higher/additional rate taxpayer, the rate of CGT is 20%.

Option (b): tax issues

19. Under Option (b), VAT is again relevant. Caloseni (not Amari) would be the seller. However, donating Simba to Caloseni is the disposal of a business asset by Amari for no consideration. This is deemed to be a supply of goods for VAT purposes. Neither the Margin Scheme nor exemption would apply: see paragraphs 10 and 11 above. Output VAT is calculated on the cost of purchasing identical goods at the time Amari gifts Simba to Caloseni. In practice, this is likely to be the hammer price achieved (e.g., £150,000). Amari's VAT liability would then be £25,000 on a tax inclusive basis. As for Option (a), he would be entitled to reclaim VAT on related expenditure: see paragraph 13 above.
20. The treatment of the auction sale itself would depend on Caloseni's own tax position, for example, whether Caloseni is a taxable person for VAT purposes. These are matters on which Caloseni should seek independent advice. In passing, in case it is helpful, we note that, under UK law, the supply by a charity of goods donated to it for onward sale is zero-rated.
21. In principle, for income tax purposes, the disposal by Amari of stock in trade for no consideration is deemed to be a sale at market value. However, unlike the position for VAT, where the goods are gifted to a charity no trading profit arises. Accordingly, under Option (b), Amari would not be chargeable to income tax or NICs.
22. Under Option (b), however, as the gift is of goods and not cash, neither party is entitled to the Gift Aid relief outlined at paragraph 16 above.

Private asset: Option (b)

23. Gifting a private asset would not trigger liabilities to VAT, income tax or NICs. No deduction would be available on related expenditure. For CGT, however, if the asset is gifted to a charity, exemption from CGT may be claimed. As above, no Gift Aid is available where the gift is of an asset instead of cash.

Weighing up the options

24. Our understanding is that, quite properly, Amari wishes to maximise the value of his gift to Caloseni at the least cost to himself. Unless it can be argued successfully that Simba is a private asset (which we doubt), Options (a) and (b) both involve tax costs on disposing of a business asset. We now compare each option.

Option (a) considered

25. Advantages:
 - 1) output VAT chargeable is no greater than under Option (b)

2) VAT on selling commission etc. is fully deductible.

If Amari sells in his own name, stating he is raising funds for the Appeal, this may achieve a higher price and also have the effect of indirectly promoting his business. As Amari will donate the net proceeds under Gift Aid, Caloseni benefits significantly. We consider HMRC will readily accept the tax treatment we have outlined.

26. The disadvantage is Amari will incur NICs and income tax on the profits from the sale, but with some relief under Gift Aid.

Option (b) considered

27. Advantages:

- 1) Amari will not be liable for income tax or NICs.
- 2) Caloseni may be entitled (subject to obtaining independent advice) to treat the auction sale as outside the scope of VAT or zero-rated.

28. Disadvantages:

- 1) VAT on the deemed supply will be a cost to Amari.
- 2) Caloseni will not be entitled to claim Gift Aid relief and may incur irrecoverable VAT (e.g., on selling commission and, if it agrees to cover them, the costs of removal etc.).
- 3) A UK sale of Simba may also raise issues of Belgian charity law on which Caloseni should seek independent advice.

Illustrative comparison

29. Until the hammer price and related expenses are known, we cannot provide precise figures, but set out below a comparison based on the following assumptions:

1. Hammer price: £150,000
2. Selling commission: £15,000 (plus £3,000 VAT).
3. Costs of removal etc: £10,000 (plus £2,000 VAT).
4. Historic costs (e.g. purchase, importation, creation, market value on appropriation to trading stock) are ignored, as these may require discussion with HMRC.
5. Amari is an additional rate taxpayer and his input VAT is fully deductible.
6. Caloseni is not a taxable person and is unable to deduct VAT.

Under Option (a), in addition to the value of Simba, Amari's costs are:

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Taxes on net profit, calculated as follows:	
Hammer price	150,000
Less:	
VAT	£25,000
Selling commission and removal etc. costs (net of deductible input VAT)	<u>£25,000</u>
	£50,000
	<u>(50,000)</u>
100,000	
Income tax (after Gift Aid) @ 20% =	£20,000
NICs @ 3.25% =	<u>£3,250</u>
Total	<u>£23,250</u>

A donation of £100,000 under Gift Aid gives Caloseni £125,000.

Under Option (b), in addition to the value of Simba, Amari's costs are:

VAT on deemed supply	£25,000
Cost (net of deductible VAT)	£10,000
Total	<u>£35,000</u>

Assuming no VAT on auction sale, Caloseni might expect to receive (£150,000 - £18,000) = £132,000.

Note: if Caloseni pays removal etc. costs, this will reduce to £120,000 and Amari's costs will be £25,000.

30. On a cost/benefits basis, Option (a) seems likely to produce a marginally better result overall. In case it is helpful, we have considered two other options.

Other options

31. Option (b) could be varied by Amari transferring Simba to Caloseni for a nominal consideration (say £1). This would almost eliminate the VAT chargeable on a deemed supply. Our understanding is that Amari and Caloseni are not "connected persons" (e.g., Amari does not control Caloseni or act as its trustee). Accordingly, it would not be open to HMRC to substitute an open market value. However, we consider such an arrangement is likely to attract unwelcome attention from HMRC. They may argue it was not in the course of Amari's business and challenge VAT deduction. Moreover, any agreement by Caloseni to indemnify Amari for VAT or other costs is likely to be viewed by HMRC as consideration and liable to VAT. If any consideration were to pass from Caloseni to Amari (even if nominal), Simba would not be "donated goods". The auction sale could not be zero-rated. We therefore recommend against varying Option (b) in this way.
32. Another possibility is for Amari to make a cash gift to Caloseni and not dispose of Simba at all. This would produce the most tax-efficient result since, firstly, there would be no liability to VAT, income tax or NICs; secondly, both Amari and Caloseni would benefit from Gift Aid relief as explained at paragraph 16 above; and thirdly, this option would sidestep any issue of whether Simba is a business, or private, asset and avoid the costs involved in its removal, transportation and disposal. Use of such an option, of course, would depend on Amari having available funds to make a donation, as well as having sufficient tax cover. There may also be commercial considerations, e.g., the role of Billings in the transaction, any beneficial publicity generated by the sale and perhaps, most importantly, whether the ultimate hammer price may exceed expectations. There may be additional reasons known to the parties which favour Option (a) or (b).
33. We will, of course, update our Report as necessary, following the proposed meeting between interested parties which will be attended by Sam Turner, our tax manager.

Widford Westmill LLP
11 May 2023