# The Chartered Institute of Taxation

## Application and Professional Skills

## VAT and Other Indirect Taxes

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## Suggested answer

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Dear Pete

**Proposed acquisitions**

Thank you for your letter dated 3 May 2021, with enclosures, requesting advice on these exciting proposals.

Based on the information you have provided, my advice and recommendations regarding the tax implications of the proposed transactions are set out in this letter. This is for the sole use of Sandsails Ltd ("Sandsails"). I have highlighted some points relevant to your personal tax position. My colleague, Sally Lunt, in our Private Client Department, will be happy to look at this in more detail if you wish.

I am not, of course, advising Max Slazenger ("Max") or Chington Links Golf Club Ltd ("the Golf Club"), although some of my comments may be relevant to their tax positions. They must rely on their own advisers.

Summary of advice and recommendations

1) Provided Max is not a taxable person for VAT purposes, no VAT will be chargeable on the purchase of the Golf Course property (which includes The Hideaway and Gorse Cottage). I recommend obtaining a warranty from Max to this effect, together with an undertaking that he will not elect to waive VAT exemption ("opt to tax") before completion of the purchase. If Max is unable to give these assurances and VAT is chargeable, Sandsails will be entitled to deduct such VAT (to the extent the property is to be used for making taxable supplies). As Sandsails operates annual VAT accounting, however, this will involve some cashflow disadvantage.

2) Sandsails will not be entitled to a corporation tax deduction, since purchase of the property will be of a capital nature. However, interest on any borrowing will be deductible.

3) Stamp duty land tax ("SDLT") will be chargeable on purchase of the Golf Course property by Sandsails. The amount of SDLT chargeable will depend on who is the purchaser of "The Larches" and whether the "linked transactions" rule applies. There are good arguments, however, that the rule does not apply. I recommend the transactions are treated separately but, when making the land transaction return, the circumstances are disclosed to HMRC.

4) I recommend against Sandsails purchasing "The Larches" and letting it to you on favourable terms. Although Sandsails would obtain certain corporation tax deductions, such an arrangement would create a taxable benefit in kind ("BIK") in your employment. Sandsails would be liable to higher Employer National Insurance Contributions ("NICs"). Higher rate SDLT would be chargeable plus the annual tax on enveloped dwellings ("ATED"). Moreover, the BIK would significantly increase your personal charge to income tax. I recommend, therefore, you purchase "The Larches" in your own name.

5) As "The Larches" is a dwelling, no VAT is chargeable on the purchase.

6) There are certain obstacles to merging the Golf Club with Chington Zephyrs ("Zephyrs"), not least because of their different structures and some tax irregularities in the Golf Club. I recommend, therefore, Sandsails acquires only selected assets of the Golf Club.

7) The neatest way of integrating Zephyrs and the activities of the Golf Club would be for Sandsails to incorporate a new subsidiary ("Newco") into which the activities of Zephyrs are hived-down. Newco would have widely-drawn objects (to encompass sand sailing, golf and any other sports you wished to add) and to make transitional arrangements for existing members in order to foster goodwill.

8) Neither the Golf Club nor Zephyrs are currently "eligible bodies" for VAT purposes. Only an eligible body is entitled to exempt its subscriptions from VAT. I recommend against pursuing the VAT exemption route, since this would preclude Newco exercising control or extracting profits.

I will now cover these issues in more detail, beginning with the Golf Course property

Golf Course property: VAT

The Golf Course is a civil engineering work and The Hideaway is a non-residential building. These are both "new", as they were completed less than three years ago. Freehold sale by a taxable person in the course of a business is subject to VAT (whereas the sale of Gorse Cottage, which is a dwelling, is exempt). According to Terraspec's report, however, construction was originally undertaken as a private project. Max is receiving income from letting the property, but this is substantially below a market rate. It is arguable, therefore, that Max is not carrying on a business for VAT purposes. Even if he were, he would not be required to register for VAT. This is because, in applying the registration threshold, sale of capital assets is ignored and the letting income would be exempt.

It follows, therefore, that any charge to VAT on the sale should be resisted. I recommend seeking a warranty from Max that the sale is not made in the course or furtherance of a business, together with an undertaking that he will not opt to tax the sale. If he is unwilling to do this, VAT will be chargeable. Sandsails could stipulate that the consideration is VAT inclusive, but again Max may not agree. An apportionment would be required as Gorse Cottage is a dwelling. Based on Terraspec's valuation, therefore, VAT would be charged on £505,000 of the consideration. Any VAT charged would be deductible, to the extent Sandsails intends to use the property for making taxable supplies. There may be some restriction if, for example, Gorse Cottage is used to make exempt supplies or for private use, e.g. by staff. Any charge to VAT, however, will cause a cashflow disadvantage, as Sandsails currently operates annual VAT accounting.

If Sandsails were to defer purchasing until the property is no longer new (until, say, November 2021) the sale would be wholly VAT exempt unless Max opts to tax. You may not wish to delay matters that long.

Golf Course Property: corporation tax

Sandsails will not be entitled to a corporation tax deduction for the costs of purchasing the property, as this is capital in nature. Interest and running costs, are however, allowable against corporation tax in the normal way.

Golf Course property: SDLT

SDLT is calculated on the chargeable consideration (including any VAT lawfully charged), on a slice-by-slice basis, according to prescribed rate bands. The Golf Course property is "mixed" (i.e. it includes residential and non-residential elements). Assuming a consideration of £625,000, and that the purchase is not linked to another transaction (see below), the calculation would be as follows:

| **Mixed rate band** | **SDLT rate** | **SDLT** |
|---|---|---|
| Up to £150,000 | Nil | Nil |
| £150,001 to £250,000 | 2% | 2,000 |
| Over £250,000 | 5% | 18,750 |
| **SDLT chargeable** | | **20,750** |

The linked transaction rule

It is necessary, however, to consider whether the linked transaction rule applies here given the intended purchase of "The Larches" (see below). Even if separate contracts are used, transactions are linked if they form part of a single scheme, arrangement or series of transactions between the same vendor and purchaser or, in either case, a person connected with them. An example would be where, using separate conveyances, the same vendor sells a house to A (an individual) and its garden to B (A's spouse). For SDLT purposes there would be a single linked transaction.

You are considering two alternative purchase options:

(a) Sandsails purchases the Golf Course property; you purchase "The Larches"; or
(b) Sandsails purchases both properties.

If option (a) is chosen, there is a risk HMRC will regard the two transactions as linked. This is because, in both transactions, the vendor is Max and you are connected with Sandsails as its majority shareholder. The rule applies such that the two purchases are treated as one mixed use property transaction (i.e. the Golf Course property plus "The Larches") for SDLT purposes. The total consideration (of, say, £1,525,000) would be subject to the mixed rate bands. SDLT chargeable would be £65,750, with payment apportioned between you and Sandsails.

I consider there are good arguments the linked transactions rule does not apply here (assuming, of course, that the price of each property was agreed separately and was not influenced by any understanding that both would be purchased together). I would argue your purchase of "The Larches" is not part of a single scheme, arrangement or series of transactions, but a private transaction having no connection with Sandsails' business. This means that, under option (a) there would be two land transactions, each requiring a separate land transaction return. As regards the Golf Course property, SDLT would be £20,750 and, for "The Larches", £35,000. (see below). As SDLT is a self-assessed tax and subject to a penalty regime, however, I recommend that when Sandsails files the land transaction return, a covering letter is sent to HMRC disclosing the circumstances. This should avoid any risk of penalties if HMRC were to disagree with the treatment adopted and raise an assessment.

If option (b) is chosen, the linked transaction rule does not apply. However, a different anti-avoidance rule (aimed at a company owning a dwelling occupied by an individual) is relevant, which I consider below.

I turn now to consider in more detail the tax issues relevant to "The Larches"

"The Larches": VAT

Whoever is the purchaser, VAT will not be chargeable as "The Larches" is a dwelling. You are not a taxable person and therefore would not be entitled to reclaim any VAT on related costs. In principle, the same would apply if Sandsails is purchaser (because any letting of the property would be VAT exempt) unless the input VAT falls within de minimis reliefs.

"The Larches": SDLT

If you purchase in your own name (and HMRC accept the linked transaction rule does not apply, see above), SDLT would be chargeable using the "residential" rate bands. Based on a price of £900,000, the calculation would be as follows:

| **Residential rate band** | **SDLT rate** | **SDLT** |
|---|---|---|
| Up to £125,000 | Nil | Nil |
| £125,001 to £250,000 | 2% | 2,500 |
| Over £250,000 | 5% | 32,500 |
| **SDLT chargeable** | | **35,000** |

If, however, Sandsails purchases “The Larches”, the transaction will involve a company purchase of a high value dwelling (i.e. costing more than £500,000). Higher rate SDLT is chargeable at 15% (i.e. £900,000 x 15% = £135,000). There is an exception for a company carrying on a property-letting business. However, this does not apply where the individual occupying the dwelling is a connected person (e.g. a majority shareholder in the company). In addition, Sandsails would be charged ATED in each year. Based on a value of £900,000, this is currently £3,700.

The Larches”: other tax issues

If Sandsails is purchaser, as well as increased SDLT and ATED, there would be other adverse tax consequences.

The costs of purchase would not be allowable for corporation tax as the purchase is capital in nature. Any capital gain on subsequent sale would be taxable at 19% and if you wished to withdraw the proceeds from the company there would then be double taxation as you would pay tax on this as a dividend or salary.

Interest on borrowings and other outgoings, however, would be allowable. Any rent which you pay would be chargeable to corporation tax as property income.

If Sandsails is purchaser and lets the property to you on favourable terms (as you suggest) this will result in a taxable BIK of your employment as a director calculated each year using the following formula:

Taxable Benefit = (ARV + AYR) - R

Where:

ARV is the Annual Rental Value. Although Terraspec have estimated this as £30,000, in practice HMRC accept that the historic rateable value may be used. I understand this was £1,250

AYR is the Additional Yearly Rent. Where the cost of the property (e.g., £900,000) is more than £75,000, AYR is calculated by multiplying HMRC’s Official Rate of Interest (“OIR”, currently 2.25%) after deducting £75,000, i.e., £825,000 x 2.25% = £18,562.50;

R is any rent which you actually pay.

The taxable benefit, therefore, could be as high as £19,812.50 (i.e., £1,250 + £18,562.50) if you pay no rent. This would have to be declared by Sandsails on Form P11D and taxed at your marginal rate. Sandsails would also be liable to Class 1A NICs on the value of the BIK (calculated as 13.8% x £19,812.50 = £2,734.13), but there would be no additional Employee NICs.

If you purchase “The Larches” personally, you would obviously avoid the BIK. More significantly however, provided it is your “principal private residence”, there would be no tax on any capital gain made on a future sale due to principal private residence relief.

Conclusions and recommendations on purchasing “The Larches”

For the reasons outlined above, I recommend you purchase “The Larches” in your own name as the tax costs of Sandsails purchasing the property are likely to outweigh any advantages.

I turn now to your thoughts about acquiring the Golf Club undertaking and integrating it with Zephyrs.

The Golf Club undertaking

In conjunction with purchasing the Golf Course property, Sandsails wishes to merge the undertaking with Zephyrs. This raises certain obstacles. First, although Max owns the land and buildings, he does not own the Golf Club. This is a company limited by guarantee ("CLBG") formed by its Members (i.e. the original subscribers to the Memorandum of Association, which is its foundation document). In order to acquire the Club undertaking, it would be necessary for Sandsails to negotiate not with Max but with the Members (or, possibly, with the Golf Club's Executive Committee if they are empowered to act on the Members' behalf under the Articles of Association). In general, a merger is achieved using one of three routes, namely, by acquiring:

1) The legal entity; or
2) The trade or business as a transfer of a going concern ("TOGC"); or
3) The assets.

Acquiring a CLBG is cumbersome, as the original guarantors must be released, and new guarantor(s) substituted. The acquirer, however, would be stuck with the CLBG, governed by its existing foundation documents (amendment of which would be cumbersome). Unlike Sandsails, which is a company limited by shares, a CLBG is not, in my view, a suitable vehicle for carrying on a profit-making trade. A further consideration is liabilities (see below), since, in principle, acquiring a legal entity means its liabilities are also acquired. I therefore recommend against using this route.

There is a TOGC where an undertaking ("the transferor") transfers the assets of its whole trade (or of a part capable of separate operation) which the transferee can carry on in place of the transferor. I have some hesitation in viewing the Golf Club as such a trade. In any event, disposal of the whole undertaking would be tantamount to a dissolution. There is also the issue of staff contracts transferring under employment protection legislation (TUPE) which Sandsails may not want. I therefore recommend against the second route.

I recommend Sandsails uses the third route, namely, selecting and purchasing only those assets which it requires (whilst not agreeing to take on any historic liabilities). These are likely to be minimal (i.e. stock, grass-cutting machinery, membership list). As it will no longer have the means to carry on its activities, it is likely the Golf Club will be wound-up. There is a risk its liabilities will exceed its assets. I am not advising the Golf Club, but this factor may be relevant to Sandsails' purchase negotiations and how the golfing activities are to be carried on in the future, so I shall comment briefly on it. Again, TUPE would need to be considered if staff are taken on.

Golf Club liabilities

I consider there have been tax irregularities for VAT, corporation tax and income tax.

The VAT registration threshold is likely to have been exceeded at some time in the past unless subscriptions were VAT exempt. I do not consider exemption applies. This is because the Golf Club is not an "eligible body", as defined in VAT legislation. In order to be such a body, the Club must satisfy three tests. First, it must be "not-for-profit", i.e. precluded from making a distribution. Second, it must apply any surpluses to the continuation or improvement of its exempt activities (or for the purposes of another not-for-profit body). Third, it must not be subject to commercial influence.

The Golf Club fails the first test because its foundation document contains nothing to preclude the Members distributing surpluses amongst themselves outside of a winding-up. It may be that it fails the other tests, too. It follows that, once the Golf Club crossed the VAT threshold, it should have registered and charged VAT on subscriptions, bar sales, shop takings and commission. VAT will be chargeable on disposal of the assets. Arrears of VAT will be due, together with penalties and interest. I recommend Sandsails stipulates that any price agreed is VAT-inclusive.

There are also corporate tax liabilities. While some of the Club's income might be exempt as mutual trading, other income streams (e.g. shop sales, bank deposit interest) fall into charge. There will be penalties for failing to make a return. Payment of staff wages in the form of cash in hand suggests there have been irregularities for PAYE and NICs. Mr Greensward's occupation of Gorse Cottage will be a BIK unless HMRC accept the assertion that it is necessary for security.

If the Golf Club's liabilities exceed its assets, it will be insolvent and must, in any event, be wound up. I have given thought to the position of the Golf Club members and how best to achieve your objective of integrating the golfing activities with Zephyrs. To this, I now turn.

Integrating the sporting activities

As currently drafted, the Constitution of Zephyrs is specific to the sport of sand sailing. It does not extend to golf (or other sports, such as tennis and bowls which you wish to develop). As proprietor, Sandsails could amend the Constitution to widen its scope. A neater solution, however, might be to set up a new entity, to integrate the various club activities and provide for different types of membership. The most suitable vehicle would be a wholly-owned subsidiary, with objects drafted in suitably wide terms ("Newco"). This would leave Sandsails as the top company, able to concentrate on wider commercial strategy. The activities of Zephyrs would be hived-down into Newco. In order to further your long-term commercial objectives, reflect Max's wishes and foster goodwill amongst existing Golf Club members (some of whom, I understand, are influential people), you might consider offering them free membership of Newco for the unexpired period of their subscriptions or, possibly, other benefits. Another advantage of using Newco is that any commercial risk (e.g. in adding new sports) would be ring-fenced from Sandsails' core business. My firm would be happy to advise further on corporate structuring.

VAT exemption for Zephyrs

You asked whether Zephyrs should have been treating subscriptions as VAT-exempt. As already advised, in order for sports club subscriptions to be exempt, the club must be an eligible body. Zephyrs is a proprietary club carried on for the profit of Sandsails, its proprietor. It follows that subscriptions have been correctly treated as standard rated for VAT. I think it also arguable that the package of benefits currently available to its members goes beyond the limits of exemption even if Zephyrs were otherwise eligible.

Newco, for similar reasons, would not be able to claim VAT exemption.

I hope I have covered all the points you raised and look forward to advising further as negotiations proceed.

Yours sincerely,

Jo

**Jo Gupta**
Tax Manager