



# The Chartered Tax Adviser Examination

May 2017

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## VAT on UK Domestic Transactions, IPT & SDLT

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### Advisory Paper

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TIME ALLOWED – 3 ¼ HOURS

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- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation and annotate your question paper. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.
- 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 2016/17 rates and allowances continue to apply for 2017/18 and future years. Candidates referring to actual or pending rates and allowances for 2017/18 and future years will not be penalised.

1. You are a Chartered Tax Adviser with a firm of solicitors and you have received the following letter from Linda Brown, the Finance Director of ABZ Developments Ltd, a property developer and investment company.

Ms M Rose  
Law Services LLP  
234 High Street  
Oxford  
OX1 3NB

ABZ Developments Ltd  
Rio House  
23 Barton Road  
London  
WC2 0BX

2 May 2017

Dear Mary

It's sometime since we last spoke; I hope that you are well. The following matters have cropped up on which I would welcome your advice:

- 1) At a cost of £2.5 million (excluding VAT) we will acquire a building in Bristol which comprises eight self-contained flats with all of the facilities normally associated with dwellings. Currently the accommodation is used by Richard Lewis University to house graduate students and their partners, but the occupants will vacate the property before completion.

To enable me to complete the financial projections for this acquisition, please could you provide me with an estimate of the Stamp Duty Land Tax charge?

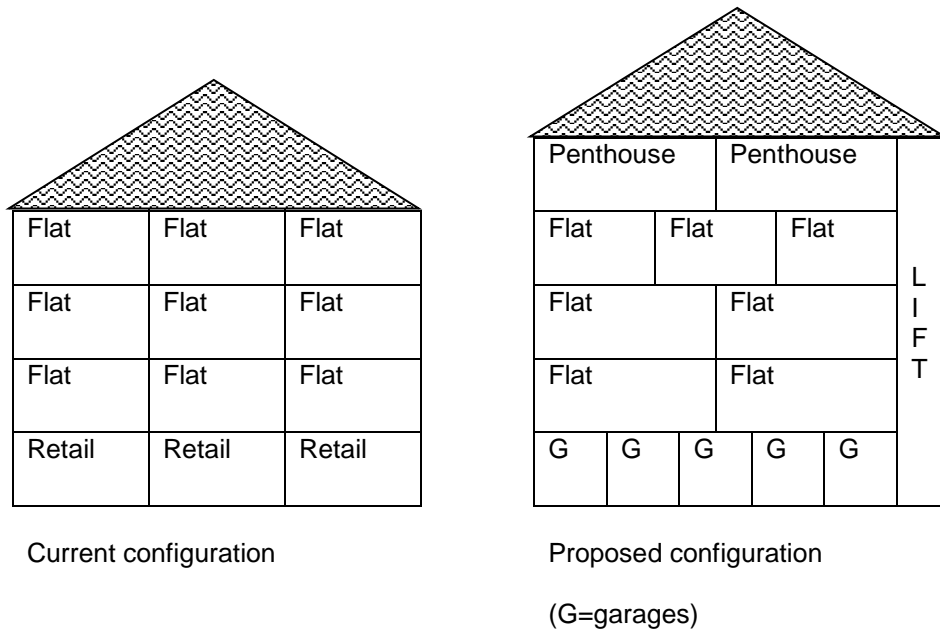
- 2) At a cost of £3 million (the transaction was treated as VAT exempt by the seller), we recently acquired a mixed use building in London. We have not, and will not opt to tax the property. Currently at street level we have three retail units, with three self-contained flats on each of the three upper floors (making a total of nine flats). We have obtained planning consent to undertake the works set out below. The apportioned projected contractor's charges for the works, excluding VAT, are noted below.
- (a) At a cost of £100,000, convert the retail units into five garages on which we will grant short leases of probably five years in duration. We have already identified users of these garages and they will not be linked to the residential accommodation.
- (b) In relation to the first and second floors, at a cost of £400,000 we will reconfigure the space to create four large flats.
- (c) Due to the space needed for the lift shaft, on the third floor, at a cost of £200,000 we will change the layout of the current accommodation to produce three smaller flats.
- (d) At a cost of £1 million, we will add a fourth floor to accommodate two penthouses.
- (e) We will add a lift to provide access to the residential accommodation at a cost of £100,000.

Should it be relevant, the associated professional fees will be £250,000, which may be pro-rated to the described works by reference to the projected cost. For the avoidance of doubt: firstly, the cost of the new roof and other common areas has been apportioned across the identified areas and included in the costs above; secondly, payments to the contractor will be made on the basis of the value of the works certified by our architect – invoices will not be issued by the contractor for defined areas given that it is a single contract.

Continued

1. Continuation

I have set out below diagrammatically the proposed changes to the internal configuration of the building.



The planning consent contains no restriction on the separate use or disposal of the new accommodation.

On completion of the works:

- 1) Although we propose to grant 99-year leases on each of the penthouses, one of them will be temporarily occupied by the Group's newly appointed Managing Director before he moves into his new home in 9-12 months' time. He will pay a monthly rent of £1,500 and thereafter we will market the penthouse for £1 million for a 99-year lease.
- 2) The seven flats are to be let on the open market on short-term leases.

Please could you supply me with an estimate of VAT irrecoverable on the works (in case it should be relevant, under our partial exemption method, the Group currently recovers 66.26% of its residual input tax).

Yours sincerely

Linda Brown

**You are required to write a letter to Linda Brown providing and explaining:**

- 1) **The amount of Stamp Duty Land Tax payable on the Bristol property.** (5)
- 2) **An estimate of the irrecoverable VAT arising on the redevelopment of the London property.** (15)

Total (20)

2. You are a VAT specialist with a firm of Chartered Accountants. You have been asked by an audit manager to make a presentation to audit staff in advance of the audit of a major motor dealer client, focusing on the following issues:
- 1) The client's entitlement to claim credit for VAT incurred on trading stock of cars and vans, and the adjustments, if any, to be made when vehicles are removed from trading stock.
  - 2) Cars/vans made available for private use by staff and family members for:
    - (a) no charge or;
    - (b) a nominal sum.
  - 3) Cars loaned temporarily to potential customers for no charge.
  - 4) The VAT treatment of breakdown cover purchased at the customer's option where:
    - (a) cover is underwritten by an insurer or;
    - (b) the cover is supplied free of charge by the dealer.
  - 5) Fuel supplied for private use by employees, directors and family members of the senior management team.
  - 6) The value on which VAT is chargeable on a new car sold under a hire purchase agreement where, with the knowledge of the finance company, the dealer has inflated by a similar amount both the part-exchange value of the customer's current car and the sale price of the new car to ensure that the finance company's minimum deposit criteria is met without resort to a cash payment from the customer.

**You are required to draft notes on these issues for your presentation. (15)**

3. Dan Smith was appointed as the first Finance Director of Och Pie Ltd on 1 February 2017. The company is a long established operator of bakery stores which also have cafe areas. Its sole shareholder is Paul Robertson. Paul continues to have significant hands on involvement in the business.

In April 2017 HM Revenue & Customs conducted a VAT inspection which focused on the VAT return to 28 February 2017 which Dan had prepared based on the accounting system, but which Paul had signed. Paul or his wife had previously prepared the returns. The visit was followed up by an official taxpayer notice from HM Revenue & Customs requiring the production of sales listings, till rolls, purchase listings and expense invoices for the year to 28 February 2017. Dan then undertook a more detailed review of the VAT records for that year and identified the following issues:

- 1) The VAT treatment of the food being sold in their two biggest and most profitable shops (Chattlegate and Wilkesborough) is different to that in their smaller shops (Wood Street and Crest Road). In Chattlegate and Wilkesborough customers eating in the cafe area are charged VAT on hot meals served to them but not on cold food such as sandwiches. In Wood Street and Crest Road VAT is charged on all food consumed on the premises, but the VAT on cold food has not been declared or paid over to HM Revenue & Customs.
- 2) Where a customer asks staff to heat a pie or pasty for them to eat immediately, VAT is charged in all their shops. However, the VAT charged to customers on these sales has not been declared or paid to HM Revenue & Customs.
- 3) Many supplier invoices used to support a recovery of VAT (e.g. suppliers of crisps, chocolate, packaging and cleaning services) do not look valid. The amounts shown do not agree to the figures entered in the accounting system and many invoices do not look genuine.

Dan reported his findings to Paul, but Paul said that Dan must be mistaken and he would investigate himself.

**You are required to explain the VAT implications and the actions which Dan should take in respect of the above. Your answer should also include an explanation of a taxpayer notice, of HM Revenue & Customs' powers of inspection, and of any potential personal consequences for Dan.**

**You are NOT required to discuss the ethical position.**

(15)

4. You are an indirect tax manager at a firm of Chartered Tax Advisers and you have received the following email from the Tax Partner, Derek Baker.

From: Derek Baker  
To: Denise Buckley

Date: 2 May 2017

Subject: Jack Morris – VAT registration

Dear Denise

I have a meeting with Jack Morris next week on the following matter.

Jack is a kitchen installer. On 1 April 2011 he commenced trading on his own account; prior to then, he was an employee of a kitchen furniture retailer. Under an agreement for services, Jack has installed high quality kitchens for New Hampton Kitchens Ltd ("Hampton"). The salient conditions of the agreement are:

- 1) He is required to give priority to the installation of kitchens supplied by Hampton and may not take on work for other kitchen suppliers without Hampton's prior consent.
- 2) Jack is required to carry out the installation, or make available a suitably qualified employee (no one has been taken on by Jack yet) between the hours of 8am to 6pm on weekdays, except for days of absence agreed in advance.
- 3) Jack is required to provide his own van, tools and protective clothing, but Hampton will reimburse consumables necessary for the work and a mileage allowance.
- 4) Jack receives a monthly retainer, plus a bonus based upon completed sales. He is paid by Hampton on the basis of invoices rendered, gross of Income Tax and NIC.

With Hampton's consent, in April 2013 he commenced providing installation services on same terms to another upmarket kitchen supplier, Perfect Kitchens Ltd ("Perfect") in return for a monthly retainer and bonus, gross of Income Tax and National Insurance Contributions.

Jack has submitted annually to HM Revenue & Customs income and expenditure accounts, and paid Income Tax and NIC on the basis of the returned figures. HM Revenue & Customs have never directly considered his self-employed status.

A summary of Jack's accounts is set out below (you may assume that income and expenditure accrues evenly over the financial years and his expenses are inclusive of VAT):

<u>Year to 31</u> <u>March</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
	£	£	£	£	£	£
Income received:						
Hampton	74,000	48,000	60,000	65,000	68,000	70,000
Perfect			<u>22,000</u>	<u>18,000</u>	<u>20,000</u>	<u>18,000</u>
Total income	<u>74,000</u>	<u>48,000</u>	<u>82,000</u>	<u>83,000</u>	<u>88,000</u>	<u>88,000</u>
Expenses:						
Purchase of van	12,000					
Tools	2,400		1,200	600	180	240
Clothing	600	180	180	120	60	120
Van repairs	<u>180</u>	<u>600</u>	<u>480</u>	<u>600</u>	<u>180</u>	<u>240</u>
Total expenses	<u>15,180</u>	<u>780</u>	<u>1,860</u>	<u>1,320</u>	<u>420</u>	<u>600</u>

Continued

4. Continuation

In April 2012 Jack's wife suffered a serious illness requiring him to care for her. As this affected his future earnings, HM Revenue & Customs were advised of the position and supplied with estimates of future earnings before giving Jack more time to meet his Income Tax liabilities.

Hampton went into liquidation last month. Jack has been advised by the liquidator that, as an unsecured creditor, there is no prospect that his claim for unpaid fees from April 2017 will be met.

Last week Jack received a letter from HM Revenue & Customs stating that having reviewed his accounts, it had been concluded that he should have been registered for VAT with effect from 1 April 2012, and on this basis he had a liability to VAT of £73,806. HM Revenue & Customs have given Jack until 15 May 2017 to provide all relevant information before a final decision is made. HM Revenue & Customs have confirmed that he is not required to supply information pertaining to his income and expenses incurred since March 2017 since it is not seen as relevant to their enquiries.

In advance of my meeting with Jack, could you consider firstly, whether HM Revenue & Customs has correctly concluded that Jack should be registered for VAT; secondly, what is his potential liability to VAT; and thirdly, how might he mitigate this liability? At this stage, I do NOT require you to consider the issue of penalties for late notification of a liability to register.

I look forward to hearing from you.

Kind regards

Derek

**You are required to respond by email to the matters raised by Derek Baker. (15)**

Historic annual VAT registration and de-registration/exemption from registration limits were:

<u>Limits effective from 1 April</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
	£	£	£	£	£	£
Registration	73,000	77,000	79,000	81,000	82,000	83,000
De-registration/exemption from registration	71,000	75,000	77,000	79,000	80,000	81,000

5. You are Peter Downs, a Tax Adviser at WMorris LLP, a firm of Chartered Tax Advisers. You have been appointed by Merciless Capital Ltd, a newly established UK private equity and stock trading business, to prepare VAT returns and to provide VAT advice. Merciless Capital Ltd has been set up by Michelle Citarella, a former banker who is a director. You have received the following email from the Finance Director, Will Moore:

To: Peter.Downs@WMorris.co.uk  
 From: Will.Moore@MercilessCapital.co.uk  
 Date: 28 April 2017  
 Subject: VAT return for period ended 31 March 2017

Dear Peter

Further to our phone call earlier this week I have pulled together the information that you requested in order to prepare Merciless Capital Ltd's VAT return for the quarter ending 31 March 2017.

The company only began trading and registered for VAT with effect from 1 February 2017; therefore, there is little income at the moment. Merciless Capital Ltd has made investments in Carrozzo SPA, an Italian web application design business (taking a 15% shareholding) and Fisher Ltd, a UK company designing online fraud prevention software (in which a 25% shareholding has been purchased). In addition it bought and sold some small holdings of shares at a profit.

Details of the company's transactions during the period to 31 March 2017 are below (all figures quoted are exclusive of any applicable VAT).

	<u>Receipts</u>	<u>Expenses</u>
	£	£
Initial investment by Michelle	4,500,000	
Director's fees charged to Carrozzo SPA	6,000	
Director's fees charged to Fisher Ltd	6,000	
Loan interest received from Fisher Ltd (an ongoing arrangement)	5,000	
Sale of shares in Blue Eagle plc to Hedgingtons LLP (a British Virgin Islands business)	50,000	
Sale of shares in Blue Eagle plc to Green Flame SAU (a Spanish business)	36,000	
Sale of shares in Red Box plc to Keys GmbH (a German business)	27,000	
Sale of shares in Vito Fit Inc to Grace Common Investment Fund (a UK pension scheme)	29,000	
Purchase of shares in Carrozzo SPA, Fisher Ltd, Blue Eagle plc, Red Box plc and Vito Fit Inc		200,000
Brokerage charges on share transactions		9,000
Legal advice from Italian lawyers on the investment in Carrozzo SPA		90,000
UK legal advice on the investment in Fisher Ltd		75,000
Office rent and service charges (subject to VAT)		600,000
Staff car park – annual rent (subject to VAT)		88,000
Furniture, decoration, artworks and antiques for the office		2,420,000
Computers, printers and software licenses		300,000
Website design and branding services		340,000
General legal advice (office lease, employment contracts)		190,000
Financial market data feeds and installation costs (used for stock trading)		45,000
Advice on company logo and intellectual property invoiced on 12 November 2016		28,000
Legal advice on incorporation invoiced on 7 October 2016 to Merciless Capital Ltd		37,000
Totals	<u>£4,659,000</u>	<u>£4,422,000</u>

Continued



5. Continuation

In addition to the expenses set out above, further legal advice on incorporation at a cost of £15,000 plus VAT was invoiced to and paid by Michelle. The company has not yet reimbursed her for this.

I would like to understand our VAT position better, so in addition to preparing the return, I would also be grateful if you could explain:

- 1) How the VAT recovery calculations are performed.
- 2) The scope to recover VAT incurred prior to registration.
- 3) The recovery methods available.

I look forward to hearing from you. However, if you have any questions on the data provided please contact me.

Kind regards

Will

**You are required to prepare a memo to Will Moore which:**

- 1) **Computes the amount of input tax that Merciless Capital Ltd is entitled to deduct in the period ended 31 March 2017.** (10)
- 2) **Provides answers to the questions raised in his email.** (10)

Total (20)

**You are NOT required to discuss the Capital Goods Scheme nor compute VAT recoverable if the company was to adopt a use based method.**

6. You are an indirect tax specialist at a firm of Chartered Tax Advisers, Helmer LLP. You have received an email from Alex Edmonds, who has just been appointed as Empress plc's new Tax Manager.

To: Liz.Williams@Helmer.co.uk  
From: AEdmonds@Empress.com

Date: 2 May 2017

Subject: Insurance Premium Tax accounting

Dear Liz

It was good speaking with you at the seminar last week. I know my predecessor always found the Helmer LLP tax seminars really useful.

As discussed, in addition to the recent changes that have taken place, we are conscious that another Insurance Premium Tax rate change is due to take effect from June 2017 and I have been asked to provide a briefing paper to our Chief Finance Officer on the effects of this. I would appreciate your support on this and have set out below the information that I have gathered on Empress plc's products and our current approach to Insurance Premium Tax accounting.

#### Insurance products

We have three core products that we sell:

- 1) Extended warranty products sold to householders through the Empress plc website or through our telesales.
- 2) Extended warranty products sold through a high street retailer (for which we pay the retailer a fee for arranging the sale out of the premium that we receive).
- 3) Repair contracts.

All of the above products relate to household appliances (e.g. kitchen appliances but also computers and computer peripherals).

Our best selling product is currently the 'Gold Package' which provides three years of extended warranty cover, has a dedicated claims and support helpline and offers customers the ability to make monthly payments. These payments are based on the full value of the premium which is entered into our accounts when the policy is taken out and cover commences. However, we have noticed an increase in the last few months of customers failing to pay on time – this is not a big issue at the moment but we are monitoring it.

Our 'Platinum Package' product is less successful and you may have seen reports in the press recently about the remediation project that we are now undertaking. Essentially, the Platinum Package is a six year extended warranty which has been found to be unsuitable for a segment of the market to which it has been sold. The remediation project will identify these policyholders and issue a refund of the premium paid plus 8% of the value of the premium as a compensation payment.

#### Current Insurance Premium Tax Accounting Arrangements

Empress plc currently accounts for Insurance Premium Tax under the Special Accounting Scheme. I have also been asked whether it would be beneficial to us to change to an alternative method of accounting (which I understand some of our competitors use).

Continued

6. Continuation

I know you assisted my predecessor with Insurance Premium Tax advice during previous rate changes so I would be grateful if you could provide me with a summary of the following points so I can include this in my board paper:

- 1) An explanation of the Insurance Premium Tax liability of our products and the changes required ahead of the June 2017 rate change.
- 2) A summary of how the Special Accounting Scheme operates, and advice on whether changing our tax points would be more efficient for us.
- 3) Any Insurance Premium Tax implications that will need to be considered in respect of the Remediation Project.

I look forward to hearing from you. In the meantime if you have any questions please contact me.

Kind regards

Alex

**You are required to draft an email to Alex Edmonds addressing the points raised in his email.**

(15)