THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Domestic Indirect Taxation

November 2021

TIME ALLOWED
3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.

- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.

- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.

- Except as set out below or indicated by additional information in the question, you may assume that 2020/21 legislation (including rates and allowances) continues to apply for 2021/22 and future years.

  1) You MUST assume that the UK remains within the European Union.

  2) You MUST ignore all temporary Covid related legislation including furlough, grants, loans and the reductions in VAT and SDLT rates.

  Except in relation to points 1) and 2) above, candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. Walkerderm Ltd was incorporated on 1 November 2020, by Dr Laura Walker, a consultant dermatologist registered with the General Medical Council. Dr Walker is the sole director and shareholder and delivers all of its services. All of its customers are UK-resident private individuals. It is not VAT registered.

Walkerderm Ltd makes supplies to two types of patients, as follows:

1) Dermatology customers suffering from skin complaints. The company supplies medical consultations and prescriptions for goods, if they are needed. This activity generated sales of £35,000 in the 12 months to 31 October 2021.

2) Customers seeking cosmetic injectable treatments, such as Botox, lip-fillers, etc., which are injected by Dr Walker at the time of the consultation. Most of these patients also purchase non-prescription goods such as skin creams and other similar items for after-care, which are paid for separately. This activity generated sales of £75,000 in the 12 months to 31 October 2021.

Customers often collect their prescription goods at the pharmacy next door to Walkerderm Ltd's clinic. When this happens, Walkerderm Ltd receives a fee from the pharmacist. The total earned from this in the 12 months to 31 October 2021 was £5,000.

If the prescription goods could be dispensed by Walkerderm Ltd directly, this could generate up to £20,000 of sales, which would be much more profitable than the current arrangement. Accordingly, Walkerderm Ltd is in discussions with a company called Pharmafix Ltd, which supplies registered pharmacists to businesses in the medical sector.

Pharmafix Ltd's directors have advised that no VAT would be due on its supplies of pharmacists to Walkerderm Ltd, because Pharmafix Ltd will supervise the services provided by the pharmacists and it will provide insurance cover for their work. The pharmacists would work at Walkerderm Ltd's clinic.

The directors also advise that Walkerderm Ltd would be able to zero-rate supplies of prescription goods if they were dispensed by pharmacists supplied by Pharmafix Ltd, with the added benefit that Walkerderm Ltd would be able to recover the input tax on those goods.

Walkerderm Ltd now intends changing its business model for dermatology patients. It is planned to introduce a single annual fee for "holistic skincare". This will be paid monthly and will cover the cost of regular consultations with Dr Walker and will include any prescription goods. As these prescription goods can be applied by the patients themselves, they will be sent directly to their home address.

Requirement:

Explain, with reference to relevant case law, the VAT treatment of the supplies made by Walkerderm Ltd and advise on the VAT implications of the Pharmafix Ltd proposal. (15)

2. Mr and Mrs Tulip operate as a trading partnership which is registered under the Flat Rate Scheme for VAT. It accounts for VAT on its income using the basic turnover method and applies the 12% flat rate for “any other activity” to its turnover. The partnership is run from Tulip Farm and has two main businesses.

The first business is a supervised activity centre known as the Jungle in the Barn. The Jungle in the Barn offers services in a number of specially designed rooms, built inside the farm’s old barn. Children’s parties and school groups generate around £50,000 per annum. The partnership also provides catered parties for stag and hen groups, which generate around £40,000 per annum.

The second business is the operation of a rare breed sheep farm, which generates annual sales of animals of around £45,000 and around £25,000 in sales of wool and related products. The wool is a premium product because of the breed of sheep; however, the farm is not very profitable. The farm is also open for visits by younger children attending parties at the Jungle in the Barn. No extra charge is made for these visits.

Mr and Mrs Tulip wish to expand both businesses, as follows:

1) They intend to expand the Jungle in the Barn by adding three new “puzzle rooms” for parties of families and young adults. A specialist company, Roombuild Ltd, will design, construct and fit these rooms inside the existing floorplan of the barn. Roombuild Ltd will source all of the materials. The cost will be £100,000 plus VAT. They expect this expansion to increase sales by £40,000 per annum.

2) They plan to spend £10,000 plus VAT on a marketing campaign to expand the wool business, and a further £10,000 on more sheep for wool. This will increase farm sales by £20,000 per annum, of which wool sales will be 50% by value.

In addition to the plans to expand, the partnership has decided to refurbish the Jungle in the Barn and has asked Roombuild Ltd to add a new entrance to the building and to upgrade and refit the existing rooms. This is expected to cost £150,000 plus VAT. Roombuild Ltd will provide the building materials and undertake the work. The partnership will also purchase specialist equipment directly, costing £18,000 plus VAT.

Requirement:

Discuss how Mr and Mrs Tulip should proceed in relation to the expansion proposals and refurbishment works including whether they should remain within the Flat Rate Scheme.

(15)

3. Mr Mohamed Abdul undertakes property investment and development through two separate vehicles: Abdul LLP and Abdulco Ltd. The entities are registered together as a VAT group. The VAT group has no other members.

Abdul LLP

Abdul LLP, which lets residential properties, is owned 60% by Mohamed and 40% by his business partner, Tariq Imran. It holds a portfolio of eight freehold residential dwellings, which it rents out on short-term tenancies.

The market values of the residential properties are:

Property Number	Market Value
	£
1	610,000
2	875,000
3	230,000
4	170,000
5	360,000
6	445,000
7	190,000
8	325,000
Total	£3,205,000

Abdulco Ltd

Abdulco Ltd is a construction company and has been providing its services to Abdul LLP at a market rate for many years. The company also provides services to third parties. Abdulco Ltd is 100% owned by Mohamed and he is its sole director. Abdulco Ltd also owns a single large commercial property which it uses as the headquarters of its construction business. Abdulco Ltd built the headquarters seven years ago, at a cost of £2 million, and recovered all of the VAT incurred.

Retirement

Tariq wants to retire from Abdul LLP and accordingly it has been agreed that Abdul LLP will sell its residential property portfolio to Abdulco Ltd at market value.

As part of the retirement, Abdul LLP will be wound up and the proceeds will be distributed to each partner in accordance with their LLP share.

After the transfer, Mohamed intends to manage both the property portfolio and the construction business from the company headquarters.

The professional costs of the restructuring to be borne by Abdul Ltd are expected to be significant and the company intends to make an input tax reclaim after the transaction has completed.

In addition to the restructuring, Abdulco Ltd intends to purchase a newly-completed building from an unconnected third party. The building is made up of a ground-floor shop, with an apartment on the first floor. The property is currently empty. The total price is £450,000 (plus VAT as applicable), of which £160,000 relates to the apartment and £290,000 relates to the shop.

Abdulco Ltd intends to let out both parts of the property to third parties.

Requirement:

1) Calculate how much SDLT will be payable on the transaction proposed and set out the relevant administrative matters. (12)

2) Explain the VAT implications of the above transactions. (8)

Total (20)

4. John Franks is a VAT registered artist whose turnover from the sale of paintings in the 12 months to 30 September 2021 was £125,000 plus VAT. All painting sales take place in the UK. He currently has no other income, but he is about to start some new business activities. John has considered forming a company to perform the new activities but has ruled this out on the grounds of cost and additional administration.

John has written a course on street art, which he will sell to the public as a classroom course. It will be made up of 12 half-day sessions, which will be held in his studio. John will teach nine sessions, where customers will create a number of pieces of artwork whilst learning a range of art techniques. Although taught in the context of street art, the techniques have a broad application across different types of art. John has recently hired an employee who will teach the remaining three sessions, which will cover the history of street art. Each customer's progress will be assessed during the course and a grade will be given by John, which will be included on a certificate that he will issue to the customer.

The price of the course is £900, for which customers receive the classroom sessions, a printed manual containing study material and a day trip to London, where John will give a guided tour of street art. The day trip includes train travel to and from London and lunch in a restaurant on the day.

John will sell paints for use during his classroom sessions, for a separate charge. Alternatively, customers can bring their own paints.

The course will also be sold in a distance learning format for £500. Customers can choose to receive a printed copy of the course manual or a digital version sent by email. The manual provides a self-study course. Customers will be given access to pre-recorded webinars and can complete online multiple-choice tests. John has provided his telephone number in the course manual, in case customers need additional help. The intention is that he will answer questions briefly and direct customers to the relevant part of the course manual, rather than provide tuition over the telephone. The day trip to London is not included in the distance learning course.

Distance learning customers can choose to pay £100 to take an online examination on the history of street art. Customers who successfully complete the examination will receive a certificate issued by John.

It is expected that all customers will be individuals living in the UK, as the courses will only be marketed locally.

Requirement:

Explain, with reference to relevant caselaw, the VAT treatment of the supplies of artwork, courses, art materials and examinations. (20)

5. Propco 2016 Ltd owns the freehold of a two storey office building, which it purchased in November 2016 for £2 million plus VAT. Propco 2016 Ltd is registered for VAT and it notified HMRC of an option to tax on the building prior to the purchase.

Propco 2016 Ltd has defaulted on its mortgage and the bank has appointed a Receiver, under the Law of Property Act 1925. The directors of Propco 2016 Ltd are not cooperating with the Receiver.

The property currently has one tenant, Oak 2015 Ltd, which occupies the ground floor. The Receiver will collect rents and pay suppliers.

A new tenant has been found, Pine 111 Ltd, for the vacant first floor of the building. A 10 year lease was signed last week, but no VAT invoice has been issued or payment received yet. The Receiver received a letter from Pine 111 Ltd today saying that, as it is a charity and the office will only be used as a call centre for collecting voluntary donations, VAT should not be charged on the rent.

Prior to Pine 111 Ltd moving into the building, the Receiver sold office furniture under a statutory power of sale, in order to clear the leased office space. The Receiver agreed to sell the goods to a local furniture shop for £2,500 and arranged for a contractor to dismantle the goods ready for collection by the purchaser. The contractor quoted £1,700 plus VAT for its services. However, the purchaser pulled out of the transaction. The contractor subsequently offered to dismantle and remove the goods for a fee of £500 plus VAT, on condition that it could resell any of the items which it removed. The Receiver accepted the offer.

Requirement:

Explain the VAT treatment of the above transactions, including how the Receiver should invoice and account to HMRC for any VAT charged. (15)

6. Gasket Ltd is VAT registered and trades as a vehicle servicing and repair garage. Mr Peel is the sole shareholder and director. He sends the business records to an external accountant at the end of each month, so that quarterly VAT returns can be prepared. Mr Peel reviews the VAT return figures before submission. The accountant also prepares a monthly bank reconciliation, annual stock take, and annual financial statements, all of which are normally completed without significant queries arising. Mr Peel and Gasket Ltd have always had a good compliance history with HMRC.

The company received a VAT inspection in June 2020. During the inspection, the HMRC officer raised concerns about the amount of output tax declared.

In November 2020, the officer wrote to Gasket Ltd setting out details of a 'parts to labour' calculation. HMRC applied a mark up to the value of parts purchased during the 02/20 VAT return period, to calculate expected income from the sale of parts. HMRC compared this figure to the declared value of parts sold during the period, to arrive at a percentage of sales which it believes to have been deliberately underdeclared. This 'Inaccuracy Percentage' has been applied to the outputs declared, from the company's first VAT return (period 02/15) to period 08/20. The calculations show underdeclared output tax of £50,000. HMRC asked Mr Peel to provide an explanation.

Mr Peel replied to HMRC in December 2020 saying that he had no knowledge of the underdeclarations and thought the discrepancies were due to a former employee who had been caught stealing parts from the business and may also have stolen cash. The employee was dismissed in April 2020, having been with the business for six months. The stock thefts were identified by the annual stock take prepared by the external accountant, details of which were enclosed with Mr Peel's letter.

The officer arranged a further inspection, which took place in March 2021. He inspected the stock room and then left. Mr Peel heard nothing further from HMRC until a Notice of Assessment for VAT of £60,000 was received dated 1 November 2021, covering VAT return periods 02/15 to 08/21. The assessment was based on the same Inaccuracy Percentage detailed in HMRC's November 2020 letter.

HMRC have imposed a penalty of 100% of the underdeclared VAT and have sent a Personal Liability Notice to Mr Peel. The Notice states that he is personally liable to pay the whole penalty, as HMRC believe there has been a deliberate underdeclaration which is wholly attributable to his actions. Mr Peel maintains he has no knowledge of VAT being underdeclared.

Requirement:

Explain the possible implications for Mr Peel personally and recommend actions which could be taken to protect the interests of Mr Peel and Gasket Ltd. (15)