# The Chartered Institute of Taxation

## Advanced Technical

## Domestic Indirect Taxation

## May 2024

## Suggested answers

**Answer 1**

Since the Club is a partly exempt business, non-attributable input tax must be apportioned on a fair and reasonable basis, with only that attributable to taxable supplies recoverable. The methodology may be based on the default standard method or a partial exemption special method ("PESM") proposed by the Club and approved in writing by HMRC. Generally, a PESM will take effect no earlier than the start of the tax year in which the Club submits its proposal.

The Club has adopted the standard method, with £4,860 recoverable in 2023/24 on non-attributable input tax incurred on its general overhead expenses and £43,200 deductible on the clubhouse works.

If the standard method does not result in a fair and reasonable apportionment of non-attributable input tax, with the difference between that deductible under its terms and a methodology based on 'use' more than £50,000, the Club may reclaim the difference under the override mechanism.

The standard method has merit in its simplicity and results in a fair and reasonable apportionment of non-attributable input tax incurred on general expenses relating to the Club's primary activity. However, that is not so in relation to the clubhouse works and its future operating expenses.

Since the standard method reflects the full value of VAT exempt sporting services when quantifying deductible input tax, it is distortive. The provision of player facilities (locker rooms, showers, etc.) is ancillary to use of the course, whereas taxable supplies of catering and refreshments take place exclusively within the clubhouse. They represent independent supplies which players, social members and visitors can access as they wish and make separate payments for such goods and services. Given that identifiable parts of the clubhouse are to be used to effect taxable supplies of catering and refreshments, the provision of player facilities ancillary to the exempt sporting services and general administrative areas which support all Club activities, a methodology which reflects this will result in a fairer apportionment of non-attributable input tax incurred on the clubhouse.

Appendix 1 identifies the floor area attributable to these supplies which, when weighted by reference to their intended use, results in taxable use of 62.5% of input tax incurred on the works, compared with 27% under the standard method. Under this methodology, non-attributable input tax deductible in 2023/24 would be £100,000 (£160,000 x 62.5%) compared to £43,200 under the standard method. Accordingly, the override substantial difference threshold will be met, with the Club entitled to claim a credit for £56,800 on its June 2024 return.

The Club may have to compromise with HMRC on aspects of the method; in particular, the allocation of floor space to the sectors. Of course, the Club may proceed with an alternative methodology provided it results in a fair and reasonable appointment, it is readily auditable by HMRC officers and its administration is proportionate.

Rather than relying on the override in future years, the Club should apply for a PESM with effect from 1 April 2024 whereby non-attributable input tax is allocated to the following sectors and recovered in accordance with the recovery rate applicable to them:

1) A "General Activities" sector encompassing all supplies made by the Club. Non-attributable input tax allocated to this sector shall be apportioned by reference to the following formula, expressed as a percentage, rounded up to two decimal places:

$$\frac{\text{Value of the Club's taxable supplies in a tax year}}{\text{Value of the Club's taxable and exempt supplies in a tax year.}}$$

2) The Clubhouse sector. Non-attributable input tax relating exclusively to the construction of the clubhouse and its operating expenses shall be allocated to the following sub-sectors by reference to their floor space:
(a) catering and bar supplies.
(b) facilities provided for individuals participating in golf.
(c) parts of the building used to administer all Club activities.

Non-attributable input tax allocated to a sub-sector shall be apportioned by reference to the following formula, expressed as a percentage, rounded up to two decimal places:

Value of the Club's taxable supplies in a tax year attributable to the subsector
Value of the Club's taxable and exempt supplies in a tax year attributable to the subsector.

On completion of the clubhouse, the Club must establish the capital goods scheme baseline, based upon the average recovery rate applicable in all the tax periods up to first use. During the lifetime of the scheme, the adjustments must take account of changes in a tax year of the floor space occupied by a sub-sector, as well as changes in the relative values of taxable and exempt supplies.

**Appendix 1**

**St Jude Golf Clubhouse**
**identification of intended use and associated floor area**

| | **Directly Attributable m²** | **Proportion of Plant Room/common areas, ground floor m²** | **Total m²** | **Intended use** | **% taxable use** | **Weighted taxable use-m²** |
|---|---|---|---|---|---|---|
| Kitchen, restaurant, bar, store rooms, lounge and relaxation area and first floor circulation area | 320 | 36 | 356 | Taxable catering and refreshments | 100% | 356 |
| Players' facilities | 155 | 17 | 172 | Ancillary to participation in golf | 0% | 0 |
| Administrative areas supporting the totality of the Club's activities | 65 | 7 | 72 | All club's taxable/exempt supplies | 27% | 19 |
| | 540 | | | | | |
| Pro-rate plant room and ground floor common areas by reference to identified areas | 60 | (60) | | | | |
| | 600 | | 600 | | | 375 |
| Proportion of taxable use 375/600m² | | | | | | 62.5% |

Notes:

1) The lounge and relaxation area has been included in the catering and bar sector given that it will be used by members and visitors alike to better enjoy the adjoining catering and bar facilities.

| Marking schedule | Marks |
|---|---|
| Basis of apportionment of non-attributable input tax | 2 |
| Identification of benefits and deficiencies of the standard method (1 mark for each of the following substantive points, subject to a maximum of 4 marks):<br>1) Simplicity of the standard method.<br>2) Inclusion of the full value of exempt sporting services is distortive under the standard method.<br>3) The standard method takes no account of the use of discrete areas and related construction costs.<br>4) Player facilities in clubhouse are ancillary to use of the course.<br>5) Catering services are supplied exclusively in the clubhouse.<br>6) Separate payment for catering/refreshments. | 4 |
| Description of alternative methodology (1 mark for each of the following substantive points, subject to a maximum of 4 marks):<br>1) Description of alternative methodology,<br>2) Identify relative merit of alternative.<br>3) Administration.<br>4) Use of sectors?<br>5) Likely attitude of HMRC to proposal.<br>6) Method based upon capital items exclusively.<br>(Other valid methodologies will gain full credit) | 4 |
| Computation of the financial benefit accruing from alternative method:<br>1) Computation of taxable element.<br>2) Computation of exempt element.<br>3) Residual element.<br>4) Overall input tax recoverable. | 4 |
| Application of the override | 2 |
| Merits of seeking a PESM and outline of its terms (where alternative methodologies are suggested, credit will be given for an outline PESM based thereon) | 2 |
| Observations on the operation of the capital goods scheme – baseline, adjustments, etc | 2 |
| | **20** |

**Answer 2**

At issue here is whether Gary is acting as a taxable person making taxable supplies in the course or furtherance of a business (s4, VATA 1994). The Act says nothing on services supplied in the course of employment, so we must fall back on caselaw and EU assimilated law.

In *C & E Commissioners v Hodges* [2000] EWHC 1568, the High Court had regard to articles 9 and 10, Principal VAT Directive (2006/112/EC)). Article 9 provides that a taxable person is any person who independently carries out an economic activity; with article 10 excluding persons bound by a contract of employment or by other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and employer's liability.

Since the Directive does not define "contract of employment", UK Courts apply domestic law as do HMRC in their internal guidance at VTAXPER 34000. The leading case *Ready Mix Concrete v Minister for Persons and National Insurance* (1968) 1 AER 433 provides that the minimum conditions for a contract of employment are:
(a) Mutuality of obligation; namely, the employer will provide work for the worker and, in return for a wage or other form of remuneration, the worker will apply his own time and skill to perform the service.
(b) the worker will provide the service personally, with its performance subject to a sufficient degree of control by the employer – see *Express and Echo Publications Ltd v Tanton* [1999] ICR 693 and *Market Investigations Ltd v The Minister of Social Security* (1968) 2 QB 173 on these aspects.

If either of these conditions is absent, the worker is not an employee. Where both are present, then the economic reality test falls to be considered; the main factors being: firstly, the extent to which the worker is integrated into the employer's undertaking and secondly, the extent to which the worker operates a business on its account having regard to, for example, the provision of equipment, where the balance of the financial risk lies, the opportunity to make a profit, the basis of payment, liability to third parties, etc., see *Market Investigations Ltd (citation above)*. In so assessing, the Courts look beyond the terms of the parties' agreement to establish the true working relationship – see - *Autoclenz Ltd v Belcher* [2011] UKSC 41.

On the facts given, since Gary may decline work offered, mutuality of obligation is absent. Therefore, no contract of employment subsists.

Alternatively, given the scope of article 10, is Gary bound to PPSZ under terms which create a relationship of employer and employee having regard to Gary's working conditions, his basis of remuneration and the extent to which PPSZ may be liable for Gary's actions? Such factors were addressed by the CJEU in *Kingdom of the Netherlands* (Case C-235/85) and *Recaudadores de Tributos de las Zonas* (Case C-202/90) and applied by the FTT in *Talbot v Revenue & Customs* [2008] UKVAT V20665. Under the terms of the Retained EU Law (Revocation and Reform) Act 2023 ("RRA") both CJEU rulings represent assimilated EU case law binding on lower UK Courts.

1) Working conditions: Although Gary must adhere to the company's procedures and is held out as PPSZ's employee, the absence of supervision and day-to-day control by the company, his entitlement to turn down work, the freedom on the hours worked and the requirement to provide his own tools and equipment all point to limited integration within PPSZ, with Gary retaining considerable scope to organise the activity independently.

2) Remuneration and economic risk. Although PPSZ pays Gary, not the customer, he assumes a disproportionate degree of financial risk. He quotes for the work, is required to complete the job at the agreed price, assumes all the financial risk in the event of non-payment (or delayed payment) and moreover meets the cost of insurance cover. The financial risk to the company is relatively modest, with perhaps greater reputational risk.

3) Liability for Gary's defaults. Given the contractual relationship is between PPSZ and the customer, liability rests with the company for non-performance, damage to property, etc. However, this must be balanced by the fact that losses may be met by the insurer under the policy purchased by Gary. Taking account of all relevant factors, on balance it is considered that Gary Bailey was acting independently under his arrangement with PPSZ and accordingly is liable for VAT on his services to it.

| Marking schedule | Marks |
|---|---|
| Treatment of services delivered under a contract of employment absent from VATA 1994 | 1 |
| Scope of taxable person in the Principal VAT Directive | 2 |
| Scope of contract of employment:<br>1) Courts have regard to UK employment law principles in the absence of guidance in VATA 1994 and the VPD, with HMRC taking the same approach in its internal guidance.<br>2) Minimum conditions required for a contract of employment in UK law.<br>3) Economic realty test and identify indicia developed in cases.<br><br>Conclusion: Gary Baily engaged under contract of employment or not? | <br><br><br><br>1<br>1<br>2<br><br>1 |
| Identify relevant UK & EU caselaw relating to establishment of a contract of employment and criteria applicable under article 10, PVD (½ mark for relevant cases, subject to a maximum of 2 marks) | 2 |
| Continued application (or otherwise) of PVD and related caselaw under Retained EU Law (Revocation and Reform) Act 1923 | 1 |
| Identification of relevant factors in concluding whether Gary Bailey is an independent contractor in business on his own account under the arrangement agreed with PPSZ (1 mark for each relevant factor, subject to maximum of 4 marks):<br>1) Mutuality of obligation.<br>2) Personal service.<br>3) Degree of control exercised by PPSZ.<br>4) Absence of supervision.<br>5) Relative financial risk of parties.<br>6) Liability to third parties for defaults.<br>7) Holding himself as an employee.<br>8) Gary in business on his own account?<br>(Marks will be awarded irrespective of a candidate's overall conclusion) | 4 |
| | **15** |
| Bonus marks: Up to 3 marks were awarded to candidates who advised on Gary Bailey's options given HMRC's stated position and, on the facts given, whether he was acting and a principal or agent. | |

**Answer 3**

VAT

*Supplies by ZZE Developments ("ZZE"), Robert Palmer ("RP") and Acorn Property Investment Ltd ("Acorn")*.

1) Construction services supplied by ZZE to RP and thereafter to Mr and Mrs Delaine are zero-rated.

2) The freehold transfer by RP of the partly completed dwelling is zero rated (item 1(a), Group 5, Schedule 8, VATA 1994) since:

   a) he has "person constructing" status having commissioned ZZE to construct a dwelling on land in which he has an interest,
   b) on 12 April 2024, the dwelling had proceeded beyond foundation level,
   c) the transfer of the building to Acorn is a major interest grant in the property, and.
   d) while ordinarily zero rating will be precluded given the planning restricting preventing completed dwellings from being the owner's principal or primary place of residence, the restriction does not apply here since Acorn will not occupy the property but rather sell it onto the Delaines as owner occupiers.

   Because of his zero rated supply, RP may recover in full VAT incurred on associated costs (it is unlikely that the property incorporated goods excluded from credit under the builders' "Blocking Order").

3) In contrast, although Acorn's supply represents a major interest in a dwelling, it is questionable whether Acorn has person constructing status given the limited time that it held its interest, and so is likely to be standard rated

   More fundamentally, note 13, Group 5, Schedule 8, VATA 1994 precludes zero rating since statutory planning consent prevents Mr and Mrs Delaine from using the completed dwelling as their principal place of residence. Note 13 deems the grant to be holiday accommodation (note 11(a), Group 1, Schedule 9, VATA 1994) and so standard rated since the building is less than three years old

SDLT

*Land transfer to Acorn.*

SDLT is chargeable on the consideration provided in return for a chargeable interest in land. Consideration may be money or money's worth, with Acorn's assumption of RB's loan representing consideration. Since RP and Acorn are connected persons, (s53, FA2003), the chargeable consideration is deemed to be the market value of the property on completion i.e., £220,000, excluding VAT as the supply by RP to Acorn is zero rated.

The SDLT rate applicable depends upon whether the property is residential or non-residential/mixed property. "Residential property" encompasses a building that is in the process of being constructed for use (examiner's emphasis) as a dwelling (s116(1)(a), FA 2003).

The transfer of the land to Acorn is a higher rate transaction given that:

1) Acorn is a company,
2) the subject matter is a single "dwelling" not subject to a lease that has more than 21 years to run; and
3) the consideration exceeds £40,000. Here, a "dwelling" includes a building that is in the process of being constructed as a dwelling (paragraphs 2, 4 and 18, Sch. 4ZA, FA 2003).

Consequently, the SDLT charge will be £6,600 (£220,000 @ 3%), subject to the availability of sub-sale relief.

*Sub-sale relief.*

As Acorn acquired its interest in the property on 12 April and transferred its entitlement in the property to Mr and Mrs Delaine on 19 April, with both contracts completed on 3 May 2024, Acorn will not be required to account for SDLT by claiming sub-sale relief on the submission of its SDLT return on or before 17 May 2024.

The relief is barred where securing a tax advantage was the main (or one of the main purposes) of the arrangements. It is clear from its context (and accepted by HMRC in its published guidance), that "tax advantage" here is concerned solely with SDLT. On the facts given, the arrangements were not concerned with securing an SDLT saving, with Mr & Mrs Delaine as the ultimate purchasers paying the SDLT due.

*Land transfer from Acorn to Mr and Mrs Delaine.*

The consideration for SDLT purposes is that attributable to the land in its condition at the date of transfer i.e., £220,000. There is no evidence that the agreement for the sale of the land is so interlocked with the building agreement concluded with ZZE such that the land agreement is incapable of independent completion. Therefore £180,000 representing the projected cost of completion of the works does not fall to be treated as part consideration for SDLT purposes.

Since the land represents residential property for Mr and Mrs Delaine and the completed dwelling is in addition to an existing residence, the basic SDLT rates are increased by 3%. Thus, SDLT of £6,600 is payable, with Mr and Mrs Delaine required to file a SDLT return by 17 May 2024.

| Marking Guide | Marks |
|---|---|
| VAT: | |
| VAT status of supplies by:<br>ZZE Developments Ltd<br>Robert Palmer<br>Acorn Property Investment Ltd | <br>1<br>2<br>2 |
| Total - VAT | 5 |
| | |
| SDLT: | |
| Land transfer by RP to Acorn:<br>Chargeable consideration.<br>Application of s53, FA 2003.<br>Residential property?<br>Identify higher rate transaction, accompanied by analysis.<br>Computation of SDLT | <br>1<br>1<br>1<br>1<br>1 |
| Sub-sale relief:<br>Conditions<br>Claim required.<br>Tax avoidance | <br>1<br>1<br>1 |
| Land transfer from Acorn to Mr and Mrs Delaine<br>Consideration applicable<br>Computation of SDLT | <br>1<br>1 |
| Total - SDLT | 10 |
| Total Marks | 15 |

**Answer 4**

VAT

Cladding

Work closely connected to the construction of a dwelling, including snagging, can typically be zero rated.

To be zero rated, HMRC consider that remedial cladding services must meet the following conditions:

1) The dwellings were zero rated when originally supplied by CompactHome Ltd ("CH").
2) The original cladding was part of the original specification and accordingly, zero rated.
3) The original cladding is defective.
4) Remedial work must be undertaken as soon as possible.
5) The work must be commissioned by the person who was engaged by CH to supply the original zero-rated works.
6) There must be a clause in the contract to rectify construction faults.

In principle CH may benefit from zero-rating on services received from CladSupply ("CS") where CS was the original cladding provider. However, HMRC are challenging whether such clauses are sufficiently linked to the original construction to allow the zero rate to apply and so it is likely that this work will be subject to VAT.

Where CS's remedial work relates to cladding installed by other sub-contractors, HMRC will view this as a separate supply to that of the original construction; accordingly, CS's service to CH will be standard rated.

For CH to recover the VAT chargeable by CS, there must be a direct and immediate link to a taxable supply. In the context of cladding remediation, HMRC suggest that this is not connected to a taxable supply on the basis it does not form a cost component of the historic zero-rated supply of a dwelling.

Input tax incurred on CS's supply which is intended to meet CH's legal obligations under existing contracts may be deductible, however HMRC's position is that there must be ongoing taxable income from the property for this to apply and so CH's input tax recovery is at risk. Alternatively, CH may be able to treat the VAT incurred as non-attributable input tax and recoverable subject to any application of the partial exemption regulations on the basis that the costs are required to be incurred as part of CH's wider taxable activity, but this would be subject to debate with HMRC.

Where CH meets the legal costs of customers, this will be third party consideration. Typically, CH will not be able to recover this VAT as it was not the recipient of the supply. In *Redrow Group plc* [1999] BVC 96, Redrow was able to recover VAT on third party costs on the basis that it received some ancillary benefit that was related to its taxable activity. In that case however, Redrow was engaged in a tripartite agreement with the supplier and ultimate customer, directing the supplier. This is not the case for CH.

This was tested further in *Aimia Coalition Loyalty UK Ltd* [2013] UKSC 15 and whilst the courts confirmed that a payment from a taxable person could be both consideration for a supply of services to it, and to a final consumer, the 'economic reality' determines whether this is the case. In this case, there was a direct link between Aimia's input tax and a contractual obligation created by Aimia in a previously taxed sales transaction. In CH's case, it is unlikely to be able to argue it has received any supply, ancillary or otherwise, from the lawyers. Whilst ultimately CH was required to meet its legal obligations in fixing the cladding, HMRC would not see the legal costs as having a direct and immediate link to the historic taxable supplies CH made. Therefore, the VAT it pays here will be irrecoverable.

Roof Insulation

The provision and installation of energy saving materials, including insulation, is zero rated.

The provision of free services made from a business' own resources does not fall within the deemed supply rules. The installation of roof insulation would therefore fall outside of these rules.

However, the materials consumed in providing the upgrade will be seen as a free supply of goods. Whilst CH may be providing labour from its own resources, associated materials will be purchased from third parties. As these are at a cost of over £50 to CH, it will need to account for a deemed supply at the standard rate of VAT.

The value of the deemed supply will be the amount that CH would otherwise have to pay to purchase identical goods. This would be limited to the value of materials used to provide the new roof.

Insurance Premium Tax

The standard one-year warranty provided by CH will not fall within the scope of IPT as this does not meet the definition of insurance and is part of CH's legal obligations to ensure the insulation works.

The extended warranty however will fall within the scope of IPT. This is a separate agreement that protects the customer against a loss. This is also a UK risk as the houses are in the UK. Insulation does not fall within the higher rate items in Schedule 6A, FA 1994. Therefore, IPT will be due at the standard rate of 12%.

Where a customer pays for insurance via a taxable business and part of the fee is paid to the insurer, and part to the intermediate supplier, consideration must be given to the scope of IPT on the payment to the intermediary.

An anti-avoidance measure was introduced to bring such payments within the scope of IPT for the intermediary where higher-rate contracts were involved. However, CH is receiving commission in respect of a standard-rate contract and therefore this provision does not apply.

Where payments are charged under separate contracts and it is clear in the contract that the customer is paying two separate businesses, the commission payment is seen as outside the scope of IPT.

Following *Homeserve* [2009] EXHC 1311 case, there is not a separate contract if the insurance and commission payments are related, and the customer has no choice in the insurance provider. CH's payments meet this definition and will be subject to IPT. CertainSure as the insurer will be the party liable to account for the IPT on the full £300.

| Marking Guide | Marks |
|---|---|
| **VAT** | |
| Zero-rating for snagging closely connected to construction | 0.5 |
| Conditions for zero-rating – must be the same supplier engaged to correct faults | 1 |
| HMRC position that there must be a contractual requirement to correct faults | 1 |
| Conclude on likely standard rating where CladSupply previously installed the cladding as HMRC do not link to previous zero rated construction, and clearer position where other contractors were used | 1.5 |
| | |
| Input tax must have direct link to taxable supply – risk of challenge in respect of connection with historic supplies | 1.5 |
| Post-supply input tax recoverable where there is an obligation under an existing contract | 1 |
| Alternative argument to show as overhead | 1 |
| Third party consideration where meeting homeowners' costs | 0.5 |
| Consider VAT recovery on third party costs, need to show ancillary benefit and recipient of supply – Redrow case | 1 |
| Discuss 'economic reality' argument, plus direct link to taxed output transaction – Aimia case | 1.5 |
| Conclude VAT irrecoverable | 0.5 |
| Zero rating for roof insulation | 0.5 |
| | |
| No deemed supply on services provided from own resources | 0.5 |
| Conclude that there is a supply of good via the materials consumed, therefore deemed supply at the standard rate | 1 |
| Value of deemed supply is the value of materials | 1 |
| **Insurance Premium Tax** | |
| One-year warranty will not fall within IPT as it is not a contract of insurance | 0.5 |
| Three-year warranty will fall within IPT as it has hallmarks of insurance | 0.5 |
| UK risk as properties are located in the UK | 0.5 |
| Insulation wouldn't be a domestic appliance and so standard rate of IPT to apply | 0.5 |
| Anti-avoidance measure to automatically bring commissions within the scope of IPT only applies to higher-rate contracts | 1 |
| Payment outside scope of IPT if charged under separate contracts and separately disclosed | 0.5 |
| Consider whether there are separate contracts for IPT purposes, including reference to Homeserve | 1.5 |
| Conclude IPT due on the full amount, and due by CertainSure as insurer | 1 |
| **TOTAL** | **20** |

**Answer 5**

Practicalities of Continuing to Trade

As LocalTrade is the controlling party, Alan has also assumed control of the other two subsidiaries in the VAT group. As LocalTrade is the representative member of the VAT group, Alan can either remove LocalTrade and re-register this as a separate entity, or he can opt to retain control of the solvent subsidiaries.

Given the intra-VAT group activity, Alan is likely to benefit from retaining the VAT group. LocalTrade's interest income would be considered exempt from VAT if generated from entities outside the VAT group. If it is expected to continue, it would add complexity to LocalTrade were it separately registered.

However, the subsidiaries would likely want to be removed from the group due to their joint and several liability with LocalTrade. Whilst they will remain jointly and severally liable for the historic period even after leaving the group, this would protect their position going forwards. Where it becomes clear Alan cannot rescue LocalTrade he should remove it from the VAT group to reduce the exposure to the subsidiaries.

Alan must immediately tell HMRC of his intention to retain control over the entire group.

The appointment of Alan as an administrator would have triggered the end of a 'pre-appointment' VAT return period. This should cover all transactions made up to the day before his appointment and outside Alan's responsibility. He should, however, complete this based on the data he has access to within the business. Alan will need to continue to submit returns post-appointment, the first of which will run from the date of appointment to the end of LocalTrade's standard VAT return period. Post-appointment returns should include all activities of the VAT group where Alan decides to not to de-group LocalTrade. Alan can submit the returns on paper, as there is an exemption from Making Tax Digital for businesses in administration.

If VAT has been accounted for by LocalTrade on supplies that remain outstanding, Alan should claim bad debt relief on a post-appointment return (including relief arising pre-appointment), subject to meeting the relevant conditions and time limits.

In respect of aged purchases however, paragraph (1), s26AA, VATA 1994 means that Alan would not need to repay input tax on unpaid purchases that relate to pre-insolvency periods given that he has only received notification from the supplier after LocalTrade entered administration. If these conditions are not met, however, Alan must repay input tax claimed on payments outstanding for six months, with the adjustment made to a current post-appointment return.

Sale of Subsidiary

The sale of shares in a subsidiary to a UK customer would be exempt from VAT, with typically associated input tax irrecoverable (principally that incurred on professional fees).

However, the Upper Tax Tribunal affirmed the decision of First Tier Tribunal in *Hotel La Tour* [2023] UKUT 178 (TC) to the effect that VAT incurred on costs associated with an exempt share sale are deductible where the sale is undertaken in furtherance of a taxable business and the cost of the services are not incorporated into the price of the shares sold.

Alan may therefore be able to argue that VAT on his professional costs is recoverable. He would be selling the subsidiary for the sole purpose of funding LocalTrade's ongoing taxable business and could evidence that all proceeds of the sale are therefore reinvested in making those taxable supplies. Given that the ruling of the Upper Tribunal in *Hotel La Tour* is binding on First Tier Tribunals, it seems unlikely that HMRC would challenge Alan on VAT recovery.

Whilst Alan has not yet made the purchase of the equipment, VAT recovery can be obtained based on his intention to do so.

Where Alan ultimately decides against the equipment purchase and instead uses the cash to meet historic costs, the clear link to future taxable supplies will no longer exist. Alan may argue that the costs instead relate to the business more broadly and should be seen as an overhead. However, there is a risk that HMRC impose that the costs are related solely to the exempt share sale.

Where this occurs, the 'use' of the input tax will have changed from the intention on which it was recovered, Alan will need to make an adjustment for the input tax previously recovered under the clawback rules as per Regulation 108(1), SI 1995/2518. This will be for the full amount of input tax recovered as the initial recovery of 100% will need to be adjusted to 0%.

| Marking Guide | Marks |
|---|---|
| VAT grouping – Alan obtained control of all entities | 0.5 |
| VAT grouping options, disband or continue with both insolvent and solvent entities | 1 |
| Comment on activity of LocalTrade and conclude VAT group would be beneficial to retain. | 1 |
| Requirement to notify HMRC of intention to retain control of whole VAT group | 0.5 |
| Subsidiaries likely want to be kept separate if joint and several liability position worsens over time. | 1 |
| Pre-appointment VAT return – covers the period up to the day before appointment | 1 |
| Pre-appointment return not Alan's responsibility, recommend he still completes this with the records he has available | 1 |
| Post-appointment return – first period runs from date of appointment to the end of the standard quarter | 1 |
| Post-appointment return should include activity of the whole VAT group | 0.5 |
| Exemption from Making Tax Digital for insolvent businesses | 0.5 |
| Bad debt on sales – Alan should consider making a claim | 1 |
| Bad debt on purchases – potential for s26 AA to apply, including relevant conditions | 1 |
| Share sale ordinarily exempt from VAT | 0.5 |
| Exempt sale would prevent VAT recovery on professional fees | 0.5 |
| Consider potential to link the costs to future taxable supplies, including consideration of *Hotel La Tour* case | 1.5 |
| Conclude Alan may be able to recover VAT on these costs see UTT decision on appeal from the FTT and hence likely HMRC challenge | 1 |
| Recovery can be based on intention before equipment is purchased | 0.5 |
| If intention is changed and use of the costs is deemed to change, requirement to pay back input tax under clawback regulation 108, SI 1995/2518 | 1 |
| **TOTAL** | **15** |

**Answer 6**

The provision of free goods to individuals outside of the business falls within the business gift rules and hence VAT only becomes due where the cost of providing these goods exceeds £50 in any 12-month period. However, where consideration is provided in exchange for the goods this instead becomes a supply within the scope of VAT. Where such consideration is non-monetary, this becomes a barter transaction.

MerchToGo must consider these rules in respect of each marketing scheme. This will determine whether, and the value on which, MerchToGo must account for VAT. HMRC has recently looked to bring more supplies to influencers within the scope of VAT, on the basis that the retailer obtains some benefit from the influencer's actions. This suggests that there is a barter transaction with the influencer providing a supply of equal value to the goods to the retailer.

Free goods can also fall outside of the gift rules if these are samples. HMRC defines samples narrowly as they must be provided with the intention of promoting sales and allowing a potential customer to determine the nature of the product.

Regarding goods provided to the online bloggers, there is no commitment from the blogger to provide a review. This does not impact whether the blogger receives the goods, as MerchToGo is sending these out speculatively.

Therefore, the provision of goods to the bloggers would not be made for any consideration, as the key element of reciprocity is not present for there to be a supply for VAT purposes. These would also not be considered samples, as without any engagement from the blogger, they cannot be said to be promoting sales either from the blogger directly, or their readers.

Instead, the provision of these goods falls within the business gift rules. As MerchToGo knows that it is providing over £50 of goods to each blogger, it will need to account for output tax under Paragraph 6(2), Schedule 6, VATA 1994. Specifically, the value will be determined under Paragraph 6(2)(a) – this will be the cost to MerchToGo of purchasing identical goods. This is the cost price rather than the retail price, meaning MerchToGo will need to account for output tax of £12 on each item.

However, where the blogger posts a review with an affiliate link, this clearly amounts to reciprocity given that the blogger activity promotes the goods in return for continuing income.

In addition to the monetary consideration, HMRC may also look to link the provision of the goods as further non-monetary consideration. This means that these goods would fall within the barter transaction rules instead of being gifts.

MerchToGo would need to account for VAT on the retail price rather than the cost price of the goods in this instance. Given the additional cost, MerchToGo should look to put in place a clear agreement for the commission so this can be shown as a separate transaction and hence ensure that the provision of the goods continues to be seen as a gift.

The provision of goods to celebrities will be considered a barter transaction as there is clear reciprocity and a contractual arrangement for the celebrities to provide a service. MerchToGo will therefore need to account for output tax.

As there is no cash consideration, the supply of the goods will need to be valued, and this will also be the value of the celebrities' supply to MerchToGo. Historically the valuation would be based on the cost price of the goods, as this is the amount that MerchToGo is forgoing to obtain the services. However, HMRC's current position is that the barter transaction's value is the retail price of the goods. Therefore, it is likely that MerchToGo will need to account for output tax on the full retail price of £1,000. It will also need to issue a VAT invoice to the celebrities.

Given this is a barter transaction, MerchToGo is also making a purchase from the celebrities. The provision of the celebrities' services would be taxable, with an equal value to the goods provided. Where the celebrities are VAT registered, MerchToGo should request that the celebrities issue a VAT invoice for their services. MerchToGo should be entitled to recover this VAT.

The prototype product, while a promotional object, will not be considered a sample as it cannot be purchased by regular customers. Instead, this will be seen as a gift to the celebrities on which VAT will be due. As this cannot be purchased on the market, the value of the deemed supply will either fall within Paragraph 6(2)(b) or (c), Schedule 6, VATA 1994, as either the market value of a similar product, or the cost of production if no similar product exists.

| Marking Guide | Marks |
|---|---|
| Difference between gifts of goods and barter transactions – impacts on whether VAT is due and valuation | 1 |
| Recognition of HMRC policy regarding influencers providing services to retailers | 0.5 |
| Identify that samples fall outside VAT entirely, with no deemed supply | 1 |
| Online Bloggers – no reciprocity of service and hence no consideration for VAT purposes | 1.5 |
| This wouldn't be seen as a sample as there is no clear link to promotion or testing of product quality with a view to future sales | 1 |
| Conclude goods to online bloggers fall within gift rules | 0.5 |
| Valuation of the supply – determine this is on cost price to MerchToGo | 1 |
| Consideration of affiliate link and ongoing income showing reciprocity and hence there being a transaction within the scope of VAT | 0.5 |
| Discuss whether this also brings the original provision of goods within the scope of VAT as part of a barter transaction | 1 |
| Therefore VAT due on retail price rather than cost price | 0.5 |
| Recommend agreements are put in place to clearly separate the provision of the goods and the income from the affiliate link. | 1 |
| Goods provided to celebrities will be a supply for VAT purposes – barter transaction due to the requirement for the service to be provided | 1 |
| Valuation of the supply – discuss cost vs retail price | 1 |
| Requirement for MerchToGo to issue VAT invoice | 0.5 |
| Possibility for MerchToGo to obtain a VAT invoice from the celebrity and recover the input tax | 1 |
| Prototype product clearly for promotional purposes but explicitly excluded from samples as it is not purchasable by customers | 1 |
| Fall within gift rules – consideration of value given that there is no identical product on the market | 1 |
| **TOTAL** | **15** |