Chartered Institute of Taxation
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Sample Paper

Application and Professional Skills

VAT and Other Indirect Taxes

Suggested solutions

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Dear Alex

SUPERSTATIONERY LTD

Thank you for your letter dated 1 November 2018 and your request for advice in relation to:

1) Importing cash boxes v buying from the UK, (including pre-registration VAT and the grants);
2) Capital purchases; and
3) Online sales

Importing v buying from the UK

1) You would be financially better off by around £27,813 per annum through importing rather than buying from Fountain Ltd in the UK. There will be extra administration but this should not outweigh the saving.
2) The grants are outside the scope of VAT. Using the second grant to secure the new premises and fit it out will be permitted uses of the money.
3) You should recover VAT on pre-registration assets and services.

Please see Appendix 1 for more information on these points.

Capital Assets

I recommend that:

1) You should offer a higher lease premium in return for a lower rent to save SDLT.
2) You should not opt to tax the new warehouse for VAT because the potential exempt input VAT is likely to be below the de-minimis limits.
3) You should lease the forklift truck rather than buying it.
4) SuperStationery Ltd should cancel the lease on the car and you should enter into a personal contract for a car instead.

Again, more information is provided in Appendix 1.

Online sales

For VAT purposes, selling online to individuals in the UK is treated in the same way as for your current sales to business retailers so you would add VAT at 20% to the total price of the product that you wish to sell at, which would include any packaging and shipping costs.

Sales to individuals in other EU member states would also have the same VAT consequences as for UK sales, until/unless you exceeded the distance selling threshold in a particular member state. This is a calendar year test. Most member states have a 35,000 Euro limit (although Germany, Luxembourg and The Netherlands have a 100,000 limit). Where your net sales exceed the distance selling threshold, you would need to register in that member state and charge local VAT to the customer. You will need to ensure that your system is designed to be able to monitor these limits.

Sales to individuals outside the EU would be zero rated exports and although you would not charge VAT, they are treated as taxable supplies, so your VAT recovery would be unaffected. You would need to keep evidence of export, for example shipping certificates affixed to the package.

Returns from non EU member states could be re-imported free of duty and import VAT under ‘returned goods relief’. This can be claimed on the certificate affixed to the package, if the goods arrive back via the post.

Replacement products supplied free of charge can be shipped to a customer with you providing a credit note for the original item and a new invoice to cover the replacement. Effectively, you would not therefore have to charge VAT twice on replacements for faulty products.

I hope I have explained this to your satisfaction.

If you have any queries then please do not hesitate to call me.

Yours sincerely

Nadia

APPENDIX 1

PURCHASE OF THE CASH BOXES FROM BANGLADESH

The calculation below shows a comparison between the cost of buying the goods from Fountain Ltd in the UK and the cost of importing the goods from Bangladesh. As you can see importing would save you around £27,813 annually compared to purchasing from Fountain Ltd in the UK. This is a significant saving.

You will have increased administration with importing and may incur other costs but overall the savings through importing will still be significant compared with purchasing in the UK.

In order to import, you will need an EORI number. If you did not get one when registering for VAT online, it is a relatively simple process of completing an online form. I can help you with this if required. You will also need to appoint a freight agent to clear the goods on your behalf. The shipping company that you have found to bring the goods in should be able to act for you.

You will need to supply them with the commodity code for the goods, the value, as detailed in the attached appendix and ensure that they do not claim preference as the goods do not originate in Bangladesh for preference purposes. Your shipping agent will act as a ‘direct’ representative on your behalf, so you are solely liable for any underpayments of Customs Duty and Import VAT.

You will be able to recover the import VAT and will get a C79 certificate to evidence the payment. You might want to consider setting up a duty deferment account, as this will give you between 15-45 days interest free credit before the customs duty and Import VAT is paid to HMRC. You will need a Customs Comprehensive Guarantee (CCG) to operate one and a bank/recognised insurance company will act as guarantor. This will cost you and will be another cost to factor into your operations In the meantime, you could use your freight agent’s account but they will charge for this.

Costs of purchasing cash boxes:

	Cost from buying from the UK £	Cost of importing £	Notes
Cash boxes	100,000	60,000	
Annual fixed charge	10,000	10,000	
Prompt payment discount	(5,000)	0	5% x £100,000
Buying commission	3,000	3,000	
Freight and insurance	0	1,500	
Costs abroad	0	3,500	
Customs Duty	0	2,187	Notes 1-4
VAT/Import VAT	0	0	Note 5
Total	108,000	80,187	

Notes

Note 1

There are six methods available in order to value goods and usually ‘Method 1’ is used, which takes the price of the goods as the value for duty. However, there are some restrictions in the legislation. One of these is that where the price is subject to a condition that cannot be valued then the value of the cash boxes cannot be determined under Method 1. As a fee flows back to Fountain Ltd, and it is uncertain how much of it relates to the ‘kick back’ and how much is in return for actual services provided, then HMRC is unlikely to accept this value. We can however use ‘Method 2’ which looks at the sales price of identical goods. HMRC is likely to accept the list price of £80,000 as the value for duty and import VAT.

The Customs duty is calculated as follows:

Component:	£	Notes
Cash boxes	80,000	1
Annual fixed charge	0	2
Buying Commission	0	2
Freight & Insurance	1,000	3
Total	81,000	
Duty at 2.7%	2,187	4

Note 2

The annual fixed charge does not relate to the imported goods so is not included in the value for duty. However, SuperStationery Ltd would be advised to ask Xhiago LLC for an invoice for the goods only (along with a copy of the list price to evidence the arms’ length price). The buying commission is not included in the value for duty either.

Fountain Ltd should raise a separate invoice to SuperStationery Ltd for the annual fixed charge and buying commission, which itemises what the payments are for, to justify their exclusion from the value for duty.

It is more likely that HMRC would query an invoice that isn’t broken down into its constitute components, where you are declaring a different value for duty to that shown on the invoice/accompanying documents.

Note 3

Freight and insurance has to be included for duty but only freight and insurance up to the point of introduction into the EU is included.

Note 4

The processing undertaken in Bangladesh is simple and will not confer origin on the cash boxes. The GSP rate of 0% is not available in your circumstances and the full rate will be due.

Note 5

The VAT and Import VAT are not a cost to the business as they will be recoverable in full on the next VAT return. There will be a slight cash flow issue in having to pay it before recovery but given that VAT is still lower under the importing route, then this does not change the advice:

Component:	Buying from the UK	Importing	Notes
Cash boxes	100,000	80,000	(a)
Annual fixed charge	10,000	10,000	(b)
Buying Commission	3,000	3,000	(c)
Freight & Insurance	0	1,500	(d)
Prompt payment discount	(5,000)	0	
Customs Duty	0	2,187	
Total	108,000	96,687	
VAT at 20%	21,600	19,337	

Note (a)

The value for duty of £80,000 will also be the value for import VAT.

The invoice received from Fountain Ltd for a UK supply will be split into the goods costing 95,000, with VAT at 20%. The annual fixed charge and buying commission are services for VAT but will also incur 20% VAT as the place of the supply will be the UK, where the recipient SuperStationery Ltd belongs (see note (b)).

Note (b)

Assuming the marketing fee is paid to Fountain Ltd, it will incur VAT, whether the cash boxes are bought from the UK or imported. It is a service and the place of supply will be in the UK as it is a 'business to business' transaction and the place of supply is where the recipient, SuperStationery Ltd belongs.

Note (c)

Although the buying commission is not included for customs duty or import VAT, it will be reverse charged by SuperStationery Ltd and incur VAT, as for note (b) above.

Note (d)

Both non EU and EU freight is liable to import VAT.

GRANTS

The grant that you have received is outside the scope of VAT, so you will not receive a VAT invoice nor will you need to put this income on your VAT return. The further grant, should you receive it, will also be outside the scope of VAT.

The second grant is going to be given on the condition that it is spent on the company's 'approved objects'. These are contained in a document called the 'Articles of Association' and all companies have a set of Articles. If SuperStationery Ltd's has adopted model Articles then these state that a company is to carry to business as 'a general commercial company'. Using the grant to buy the premises, fit out the premises, purchase stock, pay off creditors, including paying back the loan given by Samuel would all be permitted uses for the grant, as this would fall within the wide definition given in the Articles.

Whilst we are on the subject of company law, you will need to file accounts for the period that begins from when the company was incorporated on 1 June 2018 until the end of its first period of account 30 September 2019. You will see later on that you need to file corporation tax returns for different periods as you do not trigger the start of a period for tax until the company started to trade on 1 September 2018. If you need help in preparing accounts or corporation tax computations, this is something that we can do and I can quote for this should you require it.

Pre-registration VAT

You haven't completed your first VAT return yet. You are allowed to recover, on your first VAT return, VAT incurred on services relating to the business, as long as it was incurred in the six months prior to VAT registration and goods used in the business that were purchased within the four year period prior to VAT registration, which are still on hand at the date of registration. You can also recover the input tax if the VAT was incurred before the company was set up. You are a director of the company and SuperStationery Ltd will need to reimburse you for the expenses, which will allow this to happen.

This means that you can recover in total £116 (which is 50% of the VAT on the lease of the car for July to 30 November 2018: 280/6 x 5) on your first VAT return.

You can also recover £58 (£350/6) of VAT incurred on the legal costs of setting up the company, assuming these were incurred within six months prior to 1 September 2018.

You can also recover the VAT in full on the van of £916 (£5,500/6) on your first VAT return and the VAT on the uniforms of £167 (£1,000/6). You will need the VAT invoices to evidence the VAT you have paid.

NEW PREMISES

SDLT

The lease premium and rental of the warehouse will incur SDLT, structured in the way it is. A lease premium up to £150,000 would incur no SDLT, so you wouldn't have any SDLT to pay on the premium of £48,000 (£40,000 plus 20% VAT), whereas the net present value of the rent incurs £2,900 SDLT (1% x (440,000-150,000)). If you get the £100,000 grant, you could offer the landlord a higher lease premium in return for a lower rent to save some SDLT. The net present value of the rent would reduce as a consequence of the higher premium. You would still have grant money left to do the rest of the works needed.

VAT

The VAT charged to you by the landlord would be fully recoverable if you were to use the entire premises for your storage of cashboxes. If, however, you rent out one quarter of the premises to the car parts dealer then unless you make an option to tax you would normally be restricted on your VAT recovery (this is called being partially exempt). Taking the VAT on the premium of £8,000 (£40,000 x 20%) and VAT you suffer on the annual rent of £11,000 (55,000 x 20%), if 25% of the VAT relates to the part you are renting out then potentially £4,750 would be irrecoverable. However, you are allowed to recover all the VAT you incur where the VAT relating to exempt supplies is no more than £7,500 a year, so provided that the VAT relating to the quarter rented out (and any other exempt supplies) does not exceed this, then you can recover it in full without having to opt to tax.

As the car parts dealer is used to not paying VAT on his rent and cannot recover VAT, he would not want you to opt to tax the building as his rent would increase by 20% that he can't recover. As I do not foresee any issues with you becoming "partially exempt", based on the information you have provided, then I would recommend that you do not opt to tax.

Direct Tax

Rental Income

Usually rental income is assessed as a separate amount in a Company's tax computation. This can be an administrative hassle, where you have to work out the expenses that relate to the let part and deduct them from the rental income.

However, you can simplify things by treating the rental income that you receive from the car spares business as part of the company's overall trading profits, as it relates to the temporary letting of surplus space and the amount is relatively small. You would be assessed on the rent accruing in the Corporation Tax (CT) period to which it relates. You will then be allowed to deduct the expenses that relate to both the area you use and the renting out of the surplus area as one deduction against your total trading profits.

Interest paid to Samuel

The monthly interest paid to Samuel will need to be paid under deduction of 20% income tax. A CT61 will be required on a calendar quarter basis to report this. SuperStationery Ltd will need to request a form (which is done online).

Trading profits

Although for company law purposes you are preparing accounts initially for a 16 month period, you will have two different periods of account for CT purposes. You will need to prepare a CT computation for 1.9.18-31.8.19 and one for the final one month period 1.9.19-31.9.19. You will calculate your trading income (ignoring capital allowances) for the entire 13 month period and then split it 12/13:1/13 between the two computations.

The re-plastering and re-wiring will be deductible in full against your trading profits and save you tax of £1,900 (19% x £10,000). The actual erection of the new shelving relates to the installation of the shelving itself and should qualify for capital allowances (see below).

Capital allowances will be available on the erection costs, the new shelving itself and the new fire door and fire alarm system. You have a 100% annual investment allowance available so the £13,000 (£3,000 + £7,000 + £3,000) will be fully deductible against your trading profits. The van that you purchased will also be eligible for the annual investment allowance. The net of VAT cost of £4,583 will be fully deductible (the VAT having been recovered on your first VAT return).

The new forklift truck, if purchased, would also qualify for the annual investment allowance and £20,000 would be deductible saving you tax of £3,800. However, if you lease one then you will not get capital allowances but instead will deduct the lease costs of £150 per month (£1,800 a year) against your trading profits. This would save you £342 a year in tax (£150 x 12 x 19%). Buying the truck would give you a greater offset for tax in the first year. However, if you lease one then you could pay back some of the loan to Samuel, and you will save interest on the loan. Please find below a calculation to show the difference in savings over a four year period (the anticipated life span of the truck). I would recommend that you lease the truck as it will cost you £3,316 less than if you bought it.

Comparison of tax relief on buying fork lift v leasing:

Year	Tax saving on buying	Tax saving on leasing	Notes
Year 1	(3,800)	(342) (737)	Note 1
Year 2	0	(342) (737)	
Year 3	0	(342) (737)	
Year 4	0	(342) (737)	
Total savings	(3,800)	(4,316)	
Total cost	10,000	7,200	Note 2
Net cost	6,200	2,884	

Notes:

Note 1

By using the spare £18,200 to pay back Samuel, £910 of interest is saved, but as this payment itself saves tax, the net saving is £737 (910 x 81%)

Note 2

VAT would be recoverable either way, so is not a cost to the business.

The truck would be worth around £10,000 after the end of four years so the true cost is £10,000 (£20,000-£10,000)

The lease on the car of £257 (this is net of the 50% VAT reclaimable of £23) would be deductible against trading profits. As the emissions of the car are high then SuperStationery Ltd will only be able to deduct 85% of the lease costs of £218 each month. This will save the company £497 per year in tax (£218 x 12 x 19%). The personal use does not affect the deduction for the company but will result in a taxable benefit on you and NIC for the company (see below).

The legal costs of £292 (net of VAT) are a capital cost associated with setting up the company. This is not deductible against your trading profits and you will not obtain tax relief for the cost anywhere in your CT computation.

The uniforms costing £833 net of VAT will also be a deductible trading expense.

Taxable Benefits

The car provided to you will result in a tax charge of 37% of the list price. Assuming the £27,000 is the list price this will result in a yearly benefit of £9,990 (apportioned pro rata where only provided for part of a year). If you are correct in your projection of withdrawing £30,000 in the first year, then you will be a basic rate taxpayer and suffer £1,998 in income tax (£9,990 x 20%).

SuperStationery Ltd will have to pay Class 1A NIC on the benefit as well, which will amount to £1,379 (13.8% x £9,990).

This means that by SuperStationery Ltd taking out the lease, £5,698 (total cost £3,360 – VAT of £280 -£497 CT saving + income tax £1,998 + NIC £1,379 – £262 CT on the NIC) is the yearly cost. You would be better off taking out a personal lease on the car of £350 per month, as this would result in a net cost of £4,200. As you only have one months' notice on the contract, this would be easy to achieve.

It would also be beneficial to extract profits by way of a mixture of salary and dividends. Around £8,400 of salary would incur no income tax or NIC (for both you and SuperStationery Ltd) and would save 19% Corporation Tax. Amounts above this taken as a dividend also do not incur NIC and would result in the lowest overall tax bill.