



The Chartered Tax Adviser Examination

May 2020

Application and Professional Skills

VAT and Other Indirect Taxes

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing.
- In order to secure a pass in this paper, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- Write on one side of the paper only. Do not write in the margins.
- 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 tick the appropriate box on the cover sheet.
- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

You are Tania Nicholson, a tax consultant in a firm of Chartered Tax Advisers. You have received a letter (**EXHIBIT A**) from Jeremy Wilkinson, the interim Finance Director of an existing client, Horticulture Technology Ltd, which is a charitable research institute. He is seeking advice on the tax implications of the options identified by an internal working group (**EXHIBIT B**) to secure a new laboratory, together with high-specification laboratory equipment which will be acquired or leased from a US corporation. Details of the basis on which this asset will be acquired are set out in an email from the supplier's Sales Director, Harvey Brooks (**EXHIBIT C**).

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Jeremy Wilkinson

EXHIBIT B: Options identified by the in-house working group to procure the proposed facility and its indicative use on completion

EXHIBIT C: Email from Harvey Brooks, Stanford Panalytical Inc

EXHIBIT D: Pre-seen information

Requirement:

Write a report to Jeremy Wilkinson setting out the tax implications and your recommendations in relation to the proposed new laboratory and acquisition of the equipment.

Continued

Continuation

EXHIBIT A

Letter from Jeremy Wilkinson

Mrs T Nicholson
Pannell & Andrews LLP
12 High Street
Yardarm
Y33 4BB

Horticulture Technology Ltd
Arden Innovation Park
Downtown
DO11 2DE

1 May 2020

Dear Tania

VAT – Acquisition of new laboratory and allied matters

I am the interim Finance Director of Horticulture Technology Ltd and your name has been passed to me by our Chairman, Sir Donald James. I hope that you can assist us by providing me with a report to present to our internal working group in relation to the construction and fitting-out of a new laboratory and the acquisition of equipment for it.

Background information relating to the site of the proposed laboratory

In June 2014, Horticulture Technology Ltd acquired 10 acres of land in Arden, which was previously the contaminated site of a manufacturing plant. Decontamination of the land and the construction of infrastructure works to serve the whole site was completed on 31 March 2015 and the land was split into two areas.

On eight acres of the land, the group constructed laboratories and associated research facilities, along with its administrative offices.

The remaining two acres of the land (the “Commercial Land”) were intended to be held as an investment which the company, together with other investors, would redevelop to provide industrial units for leasing to third parties. The decontamination and infrastructure works relating to this land cost £700,000, plus VAT of £140,000. The VAT was reclaimed in full under the terms of the group’s partial exemption special method as attributable to future taxable supplies. So far, Horticulture Technology Ltd has not attracted any investors to develop the Commercial Land but, in conjunction with its land agent, it has actively sought opportunities to exploit it.

Given that we have made little headway in developing the Commercial Land, it is now proposed that part of it (“the Research Plot”) be used as the site for a new stand-alone laboratory. The historical cost (inclusive of decontamination and infrastructure costs) apportionable to the Research Plot is £250,000, plus VAT of £50,000. The planning authority has approved the change of use. We will need to spend a further £120,000, plus VAT, to ensure that the Research Plot is fully serviced and suitable for development. In relation to the balance of the Commercial Land, we will continue to actively market it for the provision of industrial units to lease to third parties.

New laboratory – options identified and our requirements

An internal working party has formulated three options relating to the funding of the construction and fitting-out of the new laboratory. They are set out in Appendix A to this letter (**EXHIBIT B**), along with its projected use for both publicly and privately-funded research. Can you please report to us on the tax implications of the options identified by the working group and recommend which you consider to be the most tax efficient? Irrespective of the option selected, work on the new facility will commence in August 2020, with occupation scheduled for 1 September 2021.

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Continuation

Acquisition of Triterpene Designer

I also enclose an email (**EXHIBIT C**) from the Sales Director of a US corporation, Stanford Panalytical Inc, which sets out two options relating to the acquisition of a triterpene designer which will be located in the new laboratory. A triterpene designer enables a particular enzyme to generate customisable, high value chemicals from plants which will improve existing triterpenes to make, for example, better medicines, improve pesticides, etc.

It is proposed that we be designated as importer, and as such, we assume liability for all duties and taxes chargeable on entry of the equipment into the UK. The triterpene designer will be used both for publicly and privately-funded research (there is no accurate data of the projected use of the triterpene designer attributable to these activities).

Can you advise us which of the three options (**EXHIBIT C**) will be better from a tax perspective and explain any import obligations for us?

I look forward to hearing from you shortly.

Kind regards

Jeremy Wilkinson
Interim Finance Director

Continued

Continuation

EXHIBIT B

Options identified by the in-house working group to procure the proposed facility and its indicative use on completion

From: j.anderson2@horticulturetechnology.org
To: j.wilkinson@horticulturetechnology.org
Date: 21 April 2019

Proposed new laboratory – funding options and projected use

Dear Jeremy

The working group, based on advice supplied by our property advisers, King James plc, has identified the following three funding options relating to the new laboratory. As requested, I include details of its projected use. We look forward to receiving professional advice on the tax implications of our proposals.

Option 1

Horticulture Technology Ltd engages ABC Developments Ltd to construct and fit-out the laboratory in accordance with our specification for a fixed price of £12.5 million, plus VAT. The price excludes preparatory works of £120,000, plus VAT, to ensure that the Research Plot is fully serviced and suitable for development. If we proceed with this option, we will require external funding of £8 million secured on the new laboratory at interest rates of between 3.6% and 3.8%, with the balance of the projected cost funded from existing resources.

Option 2

Horticulture Technology Ltd grants a 175-year lease of the Research Plot ("the superior lease") to a pension fund identified by King James plc ("the Fund") for a peppercorn. The Fund is unrelated to Horticulture Technology Ltd. Before the superior lease is granted, Horticulture Technology Ltd will fund and complete the preparatory works at the cost of £120,000, plus VAT. The market value of the Research Plot on completion of the preparatory works has been estimated at £380,000, plus VAT.

ABC Developments Ltd will be engaged by the Fund to plan, design and construct a building which meets Horticulture Technology Ltd's requirements (as reflected under Option 1), with the Fund meeting the cost of construction, which is expected to be £11.5 million, plus VAT. Horticulture Technology Ltd will not be a party to the construction agreement.

On completion of the new laboratory, the Fund will grant Horticulture Technology Ltd a 25-year full repairing and insuring lease ("the under lease") at an annual rent of £430,000, plus VAT. King James plc has alerted us that the Fund will opt to tax the facility in order that it may reclaim VAT on construction and related costs. Horticulture Technology Ltd has the option to acquire the superior lease from the Fund for £1.00 at any time following expiry of the under-lease.

Before occupation of the completed building, Horticulture Technology Ltd will separately engage ABC Developments Ltd to fit-out the facility at a projected cost of £1 million, plus VAT.

Option 3

This is the same as Option 2 except that the superior lease will be granted for a premium of £400,000 plus VAT and the annual rent payable by Horticulture Technology Ltd under the under lease will be increased to £475,000 plus VAT to reflect the premium payable by the Fund.

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Continuation

Projected use of the laboratory

The laboratory will be occupied by 125 researchers, along with a further 10 members of staff providing administrative and technical support to all research staff. No identifiable part of the laboratory or individual member of staff will be exclusively concerned with the publicly-funded research. No research benches in this new laboratory will be let to third parties.

As regards the research staff, 100 will spend 90% of their time working on publicly-funded research. The remaining 25 researchers will spend 50% of their time on such research. The balance of all researchers' time will be spent on privately-funded research and consultancy services invoiced by Horticulture Technology Enterprises Ltd. These services are all chargeable to VAT.

Historical financial data relating to research activities to be undertaken in the new laboratory suggests that annual income of £1.7 million will accrue from research grants, charitable donations, etc. to support publicly-funded research, with £200,000 annual commercial income (exclusively chargeable to VAT).

Best wishes

Jane Anderson
Estate Manager

Continued

Continuation

EXHIBIT C

Email from Harvey Brooks, Stanford Panalytical Inc

From: harveybrooks@standfordpanalytical.com
To: jwilkinson@horticulturetechnology.org
Subject: Purchase of Triterpene Designer
Date: 20 April 2020

Hi Jeremy

Following our in-depth discussions with David Said and James Newton relating to Horticulture Technology Ltd's requirements for a bespoke triterpene designer with the operating software, we can offer this to you on one of the following bases:

- 1) A sale at an agreed price of \$1.65 million plus freight and insurance of \$5,000, for delivery to Horticulture Technology Ltd's preferred UK port of entry [Note: candidates should use an exchange rate of \$1 = £0.85.]
- 2) An operating lease for five years, comprising 60 monthly payments of \$28,800 (including interest of \$3,380), plus a final payment of \$125,000 should Horticulture Technology Ltd exercise the option to take title to the equipment at the end of the lease. The final payment reflects the market value of the triterpene designer given that it has an expected life of six years.

Subject to completion of the new laboratory, the equipment will be delivered to Horticulture Technology Ltd's preferred port of entry in the UK in August 2021.

Since we do not have a presence in the UK, you will need to arrange for customs clearance of the equipment at the port of entry and will meet the cost of all duties and taxes payable on importation [Note: the Customs Duty rate is 3.70%.]

I look forward to hearing from you as to which basis Horticulture Technology Ltd is minded to accept.

Best wishes

Harvey Brooks
Sales Director

Continued

Continuation

EXHIBIT D

Pre-seen information

<u>Client</u>	Horticulture Technology Ltd
<u>Legal status</u>	Company limited by guarantee
<u>Date of incorporation</u>	1 April 1983
<u>Company number</u>	09876543
<u>Board of Directors</u>	Professor Sir Donald James (Chairman) Professor D E George Professor M C Watkins Dr H A Walker Dr C F James Mr E G Edwards
<u>Registered Office</u>	Arden Innovation Park Downtown DO11 2DE
<u>Secretary</u>	Mr A F Wilson
<u>Principal activities</u>	To undertake publicly funded research and to develop opportunities and to promote the advancement of science in plant and microbial sciences, and to disseminate the results of such research for the public benefit. Publicly funded research is supported by grants, awards and donations from Research Councils, government departments, charities and the European Commission. This form of research is directed at the advancement of knowledge or for the benefit of the general community, rather than commercial exploitation which is undertaken by Horticulture Technology Enterprises Ltd.
<u>Wholly owned subsidiary</u>	Horticulture Technology Enterprises Ltd Principal activities: Privately funded contract research, consultancy services supplied to commercial companies and research benches hired to external parties.
<u>Taxation</u>	Horticulture Technology Ltd is a registered charity within the meaning of s.478 Corporation Tax Act 2010 and is not subject to Corporation Tax in respect of its charitable activities. The trading activities of its subsidiary, Horticulture Technology Enterprises Ltd are subject to Corporation Tax; however, profits subject to tax are gifted to Horticulture Technology Ltd resulting in a £nil tax charge payable.
<u>VAT</u>	Representative member of VAT group: Horticulture Technology Ltd, with the other member being Horticulture Technology Enterprises Ltd. VAT number: 123 4567 89 VAT registration effective from 1 April 1983 VAT status: The group is a partly exempt body. A partial exemption special method has been approved by HMRC. Under the terms of the method, its tax years run to 31 March.

Continued

Continuation

The method envisages:

- 1) save for non-attributable input tax incurred on capital projects, non-attributable input tax is deductible by reference to the ratio of Group income derived from taxable supplies to the aggregate of Group income derived from taxable and exempt supplies (under this methodology, VAT deductible on Group overhead expenses has been of the order of 6% in the last four tax years), and
- 2) where VAT bearing expenditure relating to a capital project which is within the scope of the capital goods scheme exceeds £1.5 million, non-attributable input tax is deductible to the extent that it is used, or to be used, fairly and reasonably to make taxable supplies, expressed as a proportion of the whole use or intended use of the asset. "Capital project" represents capital expenditure on assets which have an estimated economic life of 10 years or more.

Option to tax

An option to tax dated June 2014 (and acknowledged by HMRC in July 2014) was exercised on the Commercial Land (title number TN45561) which forms part of Horticulture Technology Ltd's main site.

Summarised Consolidated Income Statement for year ended 31 March 2019

	<u>Unrestricted Funds</u>	<u>Restricted General Funds</u>	<u>Restricted Capital Funds</u>	<u>Total 2019</u>	<u>Total 2018</u>
	£'000	£'000	£'000	£'000	£'000
<u>Income</u>					
<u>Income from charitable activities</u>					
Grant income	12,223	7,122		19,345	18,998
Capital and maintenance grants	22	98	860	980	875
Other charitable income	330			330	435
<u>Income from trading activities</u>					
Commercial research income	1,340			1,340	1,025
Rental income – research benches let to third parties	85			85	79
<u>Investment income</u>	122			122	105
<u>Other income</u>	35			35	25
<u>Total income</u>	<u>14,157</u>	<u>7,220</u>	<u>860</u>	<u>22,237</u>	<u>21,542</u>
<u>Expenditure</u>					
Charitable activities	(11,355)	(6,833)	(788)	(18,976)	(17,412)
Fund raising and publicity	(153)			(153)	(322)
Trading expenditure	(1,123)			(1,123)	(1,988)
Other resources expended	(1,880)			(1,880)	(1,567)
<u>Total expenditure</u>	<u>(14,511)</u>	<u>(6,833)</u>	<u>(788)</u>	<u>(22,132)</u>	<u>(21,289)</u>

Continued

Continuation

<u>Net income/(expenditure)</u>	(354)	387	72	105	253
Funds brought forward	<u>2,611</u>	<u>2,001</u>	<u>58,013</u>	<u>62,625</u>	<u>62,372</u>
<u>Funds carried forward</u>	<u>2,257</u>	<u>2,388</u>	<u>58,085</u>	<u>62,730</u>	<u>62,625</u>

Summarised consolidated balance sheet at 31 March 2019

	<u>2019</u>	<u>2018</u>
	<u>£'000</u>	<u>£'000</u>
<u>Fixed assets</u>		
<u>Tangible assets</u>		
Freehold land and buildings	58,550	59,800
Plant and machinery	<u>3,254</u>	<u>3,139</u>
	61,804	62,939
Intangible assets	<u>80</u>	<u>90</u>
<u>Total fixed assets</u>	<u>61,884</u>	<u>63,029</u>
<u>Current assets</u>		
Stocks	145	128
Debtors	3,481	2,891
Cash	<u>17,234</u>	<u>18,234</u>
	20,860	21,253
<u>Current liabilities</u>		
Amounts falling due within one year	(20,014)	(21,657)
<u>Net current assets/(liabilities)</u>	<u>846</u>	<u>(404)</u>
<u>Net assets</u>	<u>62,730</u>	<u>62,625</u>
<u>Funds</u>		
<u>Unrestricted funds</u>		
General reserve	<u>2,257</u>	<u>2,611</u>
<u>Restricted funds</u>		
General reserve	2,388	2,001
Fixed assets reserve	<u>58,085</u>	<u>58,013</u>
	<u>60,473</u>	<u>60,014</u>
Capital employed	<u>62,730</u>	<u>62,625</u>