Chartered Institute of Taxation
Excellence in Taxation

The Chartered Tax Adviser Examination

May 2019

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 table information, you may assume that 2018/19 rates and allowances continue to apply for 2019/20 and future years. Candidates referring to actual or pending rates and allowances for 2019/20 and future years will not be penalised.

You are Charles Brown, an indirect tax adviser with a firm of Chartered Tax Advisers. Your tax partner, Tim Woodstock, has received a letter (**EXHIBIT A**) from Linus Franklin, Finance Director of Kure Leisure plc which operates 16 holiday parks in England. Linus has asked for a report that he may present to Kure's Board on the tax implications of a proposed acquisition of Target Ltd and Tim has asked that you prepare a draft for his review.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Linus Franklin to Tim Woodstock

EXHIBIT B: Extract from the Information Memorandum provided by Target Ltd

EXHIBIT C: Summary of tax issues identified during due diligence on Target Ltd undertaken by Kure Leisure plc's accounting and tax staff

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report for review by Tim, addressed to the Board of Kure Leisure plc advising on the acquisition of Target Ltd.

Continued

Continuation

EXHIBIT A

Letter from Linus Franklin to Tim Woodstock

Mr T Woodstock
Peters Mason LLP
10 Nero Drive
London
EC2 2CC

Kure Leisure plc
Globe Court
Hampton Business Park
York
YO11 4BA

1 May 2019

Dear Tim

Acquisition of Target Ltd – Tax issues

I hope that you and the family are keeping well. We are in the process of negotiating the acquisition of Target Ltd, a holiday park operator trading in Northshire (a county within the UK). Currently we have no parks in this area, so we are keen to expand our operations there if the overall cost is reasonable.

I enclose background information extracted from the Information Memorandum issued by Target Ltd (**EXHIBIT B**), together with a summary of issues identified during our due diligence into Target Ltd (**EXHIBIT C**).

Target Ltd's shareholders have expressed a preference for the transaction to be structured as a share sale for cash of £7.05 million (which reflects the long-term loans of £2.5 million that we would assume and ascribes a value of £300,000 to accumulated tax losses of £1.8 million at 31 March 2017).

We are minded to try to acquire Target Ltd's assets and assume its long-term debts for cash of £6.75 million. The assets that we will acquire, along with the indicative value attributed to them, are detailed in the Information Memorandum. We have already received advice to confirm that a purchase of assets would be a Transfer of a Going Concern.

We need your advice on whether the acquisition should be structured as a purchase of Target Ltd's shares or assets and on the extent to which the tax issues identified during our due diligence may impact upon the price that we should pay for the business (assuming the indicative values given).

Accordingly, I require from you a report addressed to the Board which covers:

1) Under/over-statements of Target Ltd's tax liabilities so that we may assess the price that we should pay for the business, along with your observations on the value that Target Ltd has ascribed to its accumulated tax losses.

2) A recommendation as to how the acquisition should be effected.

3) The tax treatment of the following proposed spend on updating Target's facilities:
    (a) The rebranding of Target's restaurants and bars at a cost of £300,000 to reflect the Californian surfing and 1960s themes in Kure's outlets.
    (b) The replacement of the outdoor swimming pools at Target's parks with indoor pools with flumes, etc., at a projected cost of £800,000.

I look forward to receiving your report.

Kind regards

Linus

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EXHIBIT B

Extract from the Information Memorandum provided by Target Ltd

Target Ltd was incorporated in 1980 and has been VAT registered since 1 June 1982.

The majority of the shares in Target Ltd are held by the Wills family, with a significant minority held by an independent investor, Oxalis Ltd.

	Position	Shareholding (%)
Dennis Wills	Director and Chairman	40
Jamie Wills	Managing Director	15
Tina Wills	Marketing Director	10
George Wills	Facilities Director	5
Oxalis Ltd		30

Oxalis Ltd is incorporated in the British Virgin Islands. It invested in the business in 2013 attracted by its potential for long term growth and consistent revenue streams, particularly given that more recently people have chosen to holiday in the UK rather than going abroad.

Target Ltd operates two holiday parks in Northshire: “Woodcombe Heights” and “Ocean Breaks”. The parks have a total of 950 static caravan pitches of which 200 pitches are used for the provision of holiday accommodation in caravans owned by Target Ltd, with the remainder being occupied under licence to caravan owners. In addition, there are 120 pitches for touring caravans at Woodcombe Heights. All caravan pitches are fully serviced with electricity and gas points and are plumbed-in to supply water and sewerage services.

At Woodcombe Heights, Target Ltd has granted 10-year licences over 20 pitches on which the licensees have constructed wooden chalets which they occupy throughout the year. The chalets are "residential park homes" and meet the requirements of zero-rated caravans.

Target Ltd's principal sources of income were:

Financial year 31 March:	2018	2017
	£’000	£’000
Licence fees – static caravans	3,250	3,200
Pitch fees – touring caravans	900	875
Supply of electricity, gas, water and sewerage to static and touring caravan pitches	245	240
Restaurant and bar sales	1,200	1,100
Supermarket sales	600	575
Sale of new and second-hand caravans	6,950	6,550
Provision of holiday accommodation and associated income	1,900	1,875
	£15,045	£14,415

Dennis Wills, aged 68, now wishes to pursue other interests outside business matters. Oxalis Ltd considers this is an opportune time to take the profit accruing on its investment and deploy the funds elsewhere.

Against this background Target Ltd's shareholders wish to sell their shares for cash of £7.05 million, with the purchaser also to assume the company's long-term debt of £2.5 million. The company has accumulated Corporation Tax losses of £1.8 million at 31 March 2017 which may be available for set off against future chargeable profits. The directors of Target Ltd have ascribed a value of £300,000 to the losses.

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The assets which a purchaser will acquire (along with their indicative values) are:

Asset	Value (£)
Freehold interest in 200 acres of land and buildings comprising both holiday parks including: serviced static and touring caravan pitches; restaurant and bar outlets; visitors' leisure facilities (swimming pools, children's play areas, astroturf mini-football pitches, all-weather tennis and basketball courts and fishing lakes); reception areas, supermarkets and sales centres and finally, 12 self-contained staff flats	6,000,000 (inclusive of the staff flats valued at £65,000 each)
Freehold reversion to 20 pitches at Woodcombe Heights which are currently subject to licences granted to occupiers of chalets	150,000
200 static caravans situated on Target Ltd's pitches and used by it to provide visitors' holiday accommodation	1,700,000
Plant and machinery and fixtures and fittings	700,000
Materials, restaurant and bar stocks	200,000
Goodwill	500,000

Target Ltd will retain debtors, trade creditors and cash balances.

EXHIBIT C

Summary of tax issues identified during due diligence on Target Ltd undertaken by Kure Leisure plc's accounting and tax staff

VAT

1) Removable contents – new static caravans

(a) In the last four years, Target Ltd sold a total of 500 new static caravans, realising £23.2 million, net of output tax of £128,000 attributable to the caravans' removable contents. The cost of the caravans acquired from manufacturers was £16 million, net of VAT. In the course of our due diligence, we established that the manufacturers had treated 4% of the price as relating to removable contents, charging Target Ltd £16 million, plus VAT of £128,000 (£16 million x 4% x 20%) which Target Ltd recovered as input VAT. When Target Ltd sold the caravans, it applied its normal mark-up of 45% to the cost price but charged the same VAT on each caravan as that charged on its purchase (i.e. £128,000 in total). Accordingly, VAT has not been accounted for on the gross profit secured by Target Ltd in respect of the elements relating to removable contents.

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(b) In relation to the sales of second-hand caravans, Target Ltd has adopted the following approach:

(i) Where a caravan was purchased direct from the manufacturer and used by Target Ltd for the provision of holiday accommodation, 2% of the sales proceeds received were apportioned to standard rated removable contents. This percentage represents an independent valuation of a representative sample of the contents of Target's second-hand caravans which are readily removable. Thus, the fridge, cooker, blinds and loose furniture have been valued on the basis of their projected market value as used goods. Income derived from the sale of these caravans in the last four years was £3 million, inclusive of VAT. On this basis, the output tax accounted for on the removable contents was £10,000.

(ii) If a used caravan was acquired by Target Ltd from a non-VAT registered person (for example, it was taken in part exchange on the sale of a new caravan to a park customer), Target Ltd accounted for VAT on the contents readily removable from the caravan by applying the 2% factor to the net margin of all second-hand caravans sold in a VAT period. For example, in the VAT period to 31 December 2018, it sold 20 such second-hand caravans achieving a net positive margin of £162,000 after making an allowance for losses totalling £10,000 on five caravans. The VAT accounted for on the removable contents was £540.

The basis of valuation adopted by Target Ltd in relation to the sale of the contents of second-hand caravans differs from the standard method agreed between HMRC and the National Caravan Council Ltd and the British Holiday and Home Parks Association Ltd: under this method, 10% of the tax-exclusive selling price of a caravan is attributed to the removable contents.

2) <u>Reduced rate – provision of fuel and power and water and sewage services to static caravans</u>

Of the static caravan pitches, 750 are occupied under licences granted to caravan owners. Under the terms of the licence, an owner may not occupy a caravan during the period 1 January to 31 March (only 39 weeks are permitted under the terms of the licence). Fuel and power and water/sewerage supplied to each pitch is metered, but because it is disproportionately burdensome and expensive to read the meter for each pitch at the start and end of every period of use, Target Ltd has charged owners fixed weekly rates during the licence period of £5 for fuel and power and £2 for water/sewerage services. In the last four years, Target Ltd has accounted for VAT at the reduced-rate on supplies of fuel and power totalling £29,250 and has zero-rated supplies of water/sewerage services.

3) <u>Grant of 10-year licences of chalets at Woodcombe Heights</u>

Under the planning consent granted by the local authority in 2010 "owners are prohibited from occupying mobile homes permanently or staying there overnight during the period January to March". In the recent past, some occupiers have used the chalets as their permanent residence, staying overnight during the prohibited period. The Local Authority is aware of the practice and, for social reasons and lack of resources, has not taken enforcement action despite powers to do so. In the last four years Target Ltd has exempted from VAT £420,000 received on the grant of 10-year licences to these pitches. Given the inaction of the Local Authority, Target Ltd considers that the occupation restriction has lapsed.

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Continuation

4) Option to tax

Target Ltd has not opted to tax its interests in the land which will be transferred and has advised that it is not intending to do so.

Corporation Tax

1) Deduction claimed for restoration costs in Corporation Tax returns for 31 March 2016 and 31 March 2017.

During Target Ltd's financial years 2016 and 2017, it expended £450,000 on replacing eight acres of grass surfaces in areas used as touring caravan pitches at Woodcombe Heights park. The area resurfaced represented approximately 15% and 60%, respectively, of the total area set aside for all static caravan and touring caravan pitches at this park. The grass surfaces had been in place for 30 years but were no longer fit for purpose and were replaced with a bonded astroturf surface. Replacement natural grass surfaces were discounted as a viable commercial option as it would have resulted in these areas being vacant for two holiday seasons. Target Ltd treated the expenditure as repairs when filing its tax returns. HMRC has challenged this, considering the expenditure to be capital.

2) The tax written-down value of Target Ltd's assets in the general pool is £325,000. They have a market value of approximately £480,000.

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EXHIBIT D

Pre-seen information

Client

Kure Leisure plc

Shareholders

Name	Ordinary Shares of £1 each
Darius Nel	2,600
John Harris	2,500
Linus Franklin	1,100
Francis Curren	800
Merlin Capital Partners	3,000

Directors

Darius Nel	Chief Executive	age 54
John Harris	Chief Operating Officer	age 53
Linus Franklin	Finance Director	age 39
Francis Curren	Commercial Director	age 46

Business

Principal activity: the ownership and management of 16 holiday caravan and leisure parks in England under the Golden Days brand.

Incorporated on 1 April 2000 under number 012345678 (England & Wales).

Registered office: Globe Court, Hampton Business Park, York, YO11 4BA.

Kure Leisure plc is a holding company, with its operating subsidiaries and their activities comprising:

1) Kure Leisure (Northumberland) Ltd – the operating company for holiday parks situated in North East England.

2) Kure Leisure (Cornwall) Ltd – the operating company for parks situated in Cornwall.

3) Kure Leisure (Dorset) Ltd – the operating company for parks situated in Dorset.

4) Kure Leisure (Essex) Ltd – the operating company for those parks operating in Essex and Kent.

5) Kure Insurance Ltd – registered insurer, principally underwriting the risk of damage to owners' caravans parked on the Group's sites.

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Continuation

VAT

Representative member of VAT group: Kure Leisure plc with the other members comprising:

Kure Leisure (Northumberland) Ltd
Kure Leisure (Cornwall) Ltd
Kure Leisure (Dorset) Ltd
Kure Leisure (Essex) Ltd
Kure Insurance Ltd

VAT number 987 6543 21

VAT registration effective from 1 June 2000

With the written agreement of HMRC, the Group operates a partial exemption special method which provides for the sectorisation of the holiday park operations and its insurance business. VAT incurred on Group overhead expenses is apportioned by reference to the relative values of Group taxable and exempt supplies made in a tax year.

Summarised Income Statement

	31 March 2018 £'000	31 March 2017 £'000
Turnover	57,600	56,500
Cost of Sales	(35,100)	(34,500)
Gross profit	22,500	22,000
Administrative expenses	(17,100)	(16,900)
	5,400	5,100
Other operating income	18	23
Operating profit	5,418	5,123
Interest payable	(2,125)	(2,020)
Profit before taxation	3,293	3,103
Tax on profit	(1,026)	(977)
Profit for the financial year	2,267	2,126
Dividends paid	900	850

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Continuation

Summarised consolidated balance sheet

	31 March 2018		31 March 2017	
	£'000	£'000	£'000	£'000
Fixed assets:				
Intangible assets – goodwill		2,800		3,200
Tangible assets:				
Freehold land		63,500		65,000
Leasehold land		27,000		28,000
Park plant and machinery		3,100		1,400
Fixtures and fittings		1,700		1,600
Motor vehicles		400		475
Office equipment		300		250
		98,800		99,925
Current assets:				
Stocks	6,200		7,400	
Debtors	4,600		7,100	
Cash	2,800		1,950	
	13,600		16,450	
Creditors:				
Amounts falling due within one year	(20,100)		(22,400)	
Net current liabilities		(6,500)		(5,950)
Total assets less current liabilities		92,300		93,975
Creditors:				
Amounts falling due within more than one year		(31,258)		(35,200)
Net Assets		61,042		58,775
Capital and reserves:				
Called-up share capital		10,000		10,000
Retained earnings		51,042		48,775
		61,042		58,775