Chartered
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The Chartered Tax Adviser Examination

November 2019

Domestic Indirect Taxation

Suggested solutions

QUESTION 1

To: andrew.trew@shl.co.uk
From: mrobinson@vatadvisers.co.uk
Date: 1 November 2019
Subject: VAT treatment of development

Dear Mr Trew

Thank you for your e-mail about the planned development of student residences. My advice is set out below.

VAT liability of supplies

The letting of student accommodation is an exempt supply of land therefore any VAT incurred by Student Halls Ltd in the course of the development will not be recoverable.

Gym membership fees are standard rated. If a third party operates the gym, the rent charged to the operator by Student Halls Ltd would be exempt but I recommend opting to tax so that the income is standard rated and associated input VAT may be recovered (for example on fit out costs). There may be a partial exemption issue to explore further if residents' rents cover their use of the gym as this would be treated as a single, exempt, supply.

VAT on expenditure

The construction services from the main contractor are zero-rated if the new building qualifies as either dwellings or is to be used for a Relevant Residential Purpose (RRP).

The student residences should qualify as dwellings, as they:

- consist of self-contained living accommodation (HMRC accept that 'cluster flats' will meet this requirement if they have their own front door, and share a kitchen and common area);
- have no provision for direct internal access from the dwelling to any other dwelling;
- are not prohibited by the terms of any covenant, statutory planning consent etc. of being disposed of separately (HMRC accept that student accommodation will still qualify under this);
- have statutory planning consent granted in respect of the development and the construction will be carried out in accordance with that consent

Student accommodation also qualifies as use for a RRP, and it is possible for a building to qualify as both dwellings and use for a RRP. You are therefore free to rely on either provision so I have considered the benefits of each below.

1. Dwellings

You will not be required to issue a certificate to allow zero-rating for the construction of dwellings. There are also no change of use rules for dwellings. Sub-contractors may zero-rate their services supplied to the main contractor in the course of the development of new dwellings.

2. Relevant Residential Purpose

When determining if the building is used 'solely' for a RRP up to 5% non-qualifying use can be ignored (e.g. for the gym). Any method which produces a fair and reasonable result may be used to calculate the qualifying use and here, a floor area calculation appears appropriate. It will be necessary to issue a certificate to the main contractor to allow them to zero-rate their services under the RRP provisions, and the zero-rate will not apply to the services of sub-contractors (unless the accommodation also qualifies as dwellings, following the decision in *Summit Electrical Installations Ltd 2018 UKUT 0176).* There are also anti - avoidance provisions which apply to RRP buildings if they are not used for a RRP during the 10 years following completion.

Recommendation

The main issue (which is not raised in your email) is whether you intend use by others in non-term time. If you do, you would not be using the building solely for RRP, and therefore could not secure the zero rating on this basis. There is a concession for Higher Education Institutes to ignore this use, but you could not take advantage of this.

I therefore conclude that provided you are making a standard rated charge for the use of the gym, it would be better to treat the building as dwellings. If the use by the residents is included in their rent then there could be some irrecoverable VAT in which case we can explore the RRP route, but this would be subject to the intended non-term time use. We should also discuss whether the use of a development company would be possible as this presents a more VAT efficient structure.

Other points to consider

As the common room is only for use by residents it is accepted that the construction of this area is zero-rated. However, as the gym will be used by others, the construction of this area is standard-rated.

Whilst the building work and related materials will qualify for zero-rating, architect's services will not qualify. It may, however, be possible to appoint a main contractor to supply a design and build service, thereby including the architectural design (and other professional services) in the overall zero rated charge. As the architect has already been appointed, there would need to be a novation or assignment of his contract in order for this to work. Alternatively, Student Halls Ltd could use a development company to construct the building and then make a grant of the building to Student Halls Ltd. This would be a zero-rated first grant of a major interest in a new residential building and therefore the VAT incurred by the development company would be recoverable (including VAT on professional fees). If you think this option may be viable given the commercial aspects then we should discuss this further.

The main contractor will however be required to charge 20% VAT on certain items which do not qualify as building materials, such as carpets, "white goods" or fitted bedroom furniture; although the installation of such goods can be zero-rated.

I trust that this meets your needs, if you have any questions please contact me.

Kind regards
Monty

MARKING GUIDE

TOPIC	**MARKS**
Exempt rental income so VAT incurred is irrecoverable	1
Gym: consider liability of income depending on how operated and impact on input tax recovery	2
Build qualifies as dwellings and RRP	2
Services of architect do not qualify for zero-rating but can use design and build contract	2
Possibility to set up a development company to make zero-rated first grant	1
Can choose whether to apply zero-rate for dwellings or RRP	1
Consider benefits of each e.g. change of use, certification and 95% test, non-term time use	2
Conclusion on best option for client	1
Common room zero-rated but gym standard rated	1
Standard rated materials which are not 'building materials'	1
Presentation and higher skills	1
TOTAL	**15**

QUESTION 2

To: Andreas Rivers, Audit Partner
From: Susan Smith, Indirect Tax Manager
Date: 7 November 2019
Subject: VAT review of income

Introduction

I have set out below my review of the income streams as requested.

VAT Analysis

1) With regards complimentary rooms provided for coach drivers, this is a question of supply and consideration. It is my view that the coach driver has not provided Inner City Stays Ltd with anything in return for the hotel stay and therefore there is no barter transaction here. This is distinct from previous case law considering free meals for coach drivers which acted as an incentive for the coach drivers to increase custom at service stations (*Westmorland Motorway Services Ltd* (1998) BVC154). However, as it is the tour operator in this case which receives the benefit of the free hotel room I consider that VAT should only be accounted for on the price paid for the group booking i.e. treating this as a discount promotion.

2) For hotel stays over 28 consecutive days the charge for sleeping accommodation is relieved from VAT (note this is not an exemption but a specific VAT relief). The supply does not become exempt from VAT, it is still taxable and the normal input tax rules apply. The relief applies from the 29th day of the stay, when Inner City Stays Ltd should charge VAT only on the part of the payment that is not for accommodation (i.e. meals, drinks and other services) plus at least 20% of the remainder must be treated as being for facilities (although if the value of the facilities is more than 20%, you must charge VAT on the true amount). It is industry practice to charge VAT on long stay room rates at 4% (i.e. 20% of standard rate).

3) Where accommodation is provided free of charge for employees, VAT incurred in relation to the provision of this is regarded as being for business purposes and therefore it may be reclaimed. This is because it is necessary for the running of the business to have the employees on site, and this makes the running of the business easier. The Value Added Tax (Supply of Services) Order 1993 should not be applied as the provision of the room is for business purposes; whereas the legislation at para 10(1) Sch 6 VATA 1994 specifically states that the value of the supply should be Nil.

4) With regards a room booking where the guest does not turn up to occupy the room, VAT will be due on all such prepayments, even when the underlying supply does not take place (except in cases where the customer receives a refund). This has been the case since 1 March 2019, whereas previously some 'forfeited deposits' could be treated as compensatory and VAT-free. The current policy is also in line with the *Air France-KLM (C-250/14)* case, which implied that all 'no show' income should be treated as taxable, even where no room allocation has been made. This is in contrast to previous case law (*Societe thermal d'Eugenie les Bains C-277/05*) where it was decided that if no room had been allocated then the payment was not consideration for a supply. Therefore, Inner City Stays Ltd should account for VAT on its room rates even where the guest does not turn up.

5) Parking income is standard rated when supplied by a VAT registered provider. However the fines will be outside the scope of VAT as they constitute damages as decided by the Tribunal in *Bristol City Council (17665).*

Input tax recovery

On the basis of the income from parking fines, Inner City Stays Parking Ltd has a substantial amount of outside the scope income. It is therefore necessary to consider whether this has an impact on input tax recovery. It is not always the case that such a non-economic activity will lead to a restriction on

input tax recovery however, in the case of *Vehicle Control Services Ltd [2016] UKUT 316* it was decided that residual input tax relating to both taxable and outside the scope income must be apportioned such that a restriction is applied to the proportion relating to the outside the scope income.

I consider that Inner City Stays Parking Ltd should carry out a calculation to apportion the income from its economic and non-economic activities in order to restrict a proportion of the residual input tax relating to outside the scope income from fines. This is on the basis that the outside the scope income does not carry the right to deduct input tax, and this is not an insignificant proportion of Inner City Stays Parking Ltd revenue. The calculation must be done on a fair and reasonable basis, and a revenue calculation would appear appropriate and straightforward in this situation, resulting in a 73% restriction based on the figures you have provided. In addition, any VAT on the direct costs of generating this income is disallowed.

Kind regards

S Smith

MARKING GUIDE

TOPIC	**MARKS**
Complimentary rooms for coach drivers; VAT on price paid for group booking	2
Hotel stays over 28 days; reduced value rule	2
Staff accommodation without charge VAT recovery	2
Hotel no shows income: identify as outside the scope if no room allocated, and comment on implications of KLM decision	2
Parking income s/r, fines o/s	2
Impact of outside the scope income on input tax including VCS case law, conclusion on impact for client	4
Presentation and higher skills	1
TOTAL	**15**

QUESTION 3

Mrs K Compton
Bank of Avon plc
New Street
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Peter Gordon
South West VAT LLP
Templegate
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7 November 2019

VAT and Stamp Duty implications of transaction

Dear Mrs Compton

Thank you for taking me through the options for the acquisition by Bank of Avon plc. I have set out below my advice.

Acquisition of shares

The sale of shares is exempt therefore Bank of Avon plc will not incur any VAT if it acquires the shares in the target company. However, Stamp Duty at 0.5% will apply on the acquisition of shares, totalling £10,000 in this case. The Stamp Duty will need to be paid by Bank of Avon plc within 30 days. Usually this is an overall irrecoverable cost to the company. It is not immediately recoverable and although it forms part of the cost of the shares, these are often exempt from tax, anyway, when sold, by virtue of the Substantial Shareholding Exemption.

Acquisition of business trade and assets

There will be no Stamp Duty on the transfer of the trade and assets of the business and as there are no properties being bought, there will be no Stamp Duty Land Tax either.

On the face of it, it would therefore appear to be beneficial for Bank of Avon plc if the acquisition can be treated as a TOGC rather than an acquisition of shares in order to save the 0.5% Stamp Duty, however see my point below in relation to the possibility of a self-supply charge.

As you know, one key condition for TOGC treatment here is the intention to continue the same business, as the VAT group company that acquires the business will be making supplies only to other VAT group members after the acquisition.

HMRC's previous policy was that the business ceases in this scenario, as the intra VAT group supplies are disregarded by virtue of s43(1)(a) VAT Act 1994. However, the case of *Intelligent Managed Services Limited ([2015] UKUT 0341* considered this situation and it was decided that the existence of a VAT group does not change the nature of the business of each group member, and viewed objectively it intended to carry on the same kind of business. It is therefore possible for TOGC treatment to apply where the same business is continued, albeit with supplies only being made to other VAT group members. HMRC issued Brief 11 (2016) to clarify their position following this case. I therefore consider that the transfer of assets in the proposed transaction may be treated as a TOGC.

As the transfer is into a partly exempt VAT group, a self-supply may be triggered, such that it is necessary for the representative member to account for output tax on the assets acquired. There are certain exclusions from the self-supply charge including Capital Goods Scheme items and goodwill. Transferred assets (for example, the computers that you mentioned) which were acquired by the software business within the last 3 years may be subject to a self-supply charge under s44 VAT Act 1994, and should be considered individually. As the majority of the value in the transferred business will be in intellectual property and staff this is likely to fall under the exclusion for goodwill so it would be worth exploring this aspect further. The value of the self-supply is the open market value of the transferred assets (less any exclusions as noted above).

Where a self-supply charge applies, the corresponding input tax may be recovered in accordance with the VAT group's partial exemption method and so is likely to result in a cost to Bank of Avon plc, and may even be directly attributed to exempt banking activities depending on the use of the new platform. The input tax on the self-supply cannot be attributed to the self-supply itself and cannot feed into the partial exemption calculation. As a high level indication on the figures provided, and assuming that the computers were bought less than 3 years ago, I expect the VAT on self-supply charge to be in the region of £20,000. Therefore, assuming that Bank of Avon plc's PE recovery rate is lower than 50%, this is a higher cost than the Stamp Duty on the purchase of shares option outlined above.

Please note that the self-supply charge would not apply if the transfer is into a single VAT registered entity, therefore you may wish to consider this option and the possibility of VAT grouping at a later date (so that VAT would not apply on supplies between Bank of Avon plc and the software company). This would be subject to HMRC's powers to refuse VAT grouping for protection of the revenue, and we should discuss this in more detail. Obviously, there would be a continuing VAT cost to the group on the supplies made by the target whilst it remained outside the VAT group.

Conclusion

Due to the self-supply charge I conclude that it would be preferable for Bank of Avon plc to acquire the shares rather than the assets as a TOGC, from a VAT and Stamp Duty perspective. However there are points to consider in more detail as noted above so I would suggest we meet so we can also discuss other considerations such as tax liabilities which will be transferred with the business/company. You may, for example, want to influence the seller in terms of the timing of the transfer into a new company and how this takes place.

There are other factors to consider such as the VAT history of Techbox Ltd which will transfer to the new owner under a share sale, whereas any VAT liabilities do not transfer under a TOGC (when the purchaser does not keep that seller's VAT number, which I would recommend you did not do, even if the transfer were possible, which it does not seem to be here). There are also special rules when property or Capital Goods Scheme items are transferred as part of a TOGC, which should be considered. The Capital Goods Scheme is a way of adjusting the amount of input tax claimed on the purchase of capital assets in line with taxable use over a period of time (either five or ten years depending on what the asset is. I can provide more detail on the Capital Goods Scheme if this is something which you are not familiar with.

If you wish to add a new company to the existing VAT group it will be necessary to complete forms VAT50 and VAT51.

I trust that this is helpful, however please contact me to discuss any of the points.

Yours Sincerely

Peter Gordon

MARKING GUIDE

TOPIC	**MARKS**
No VAT on acquisition of shares	1
SD will apply on acquisition of shares, but not on transfer of assets	1
Conditions for TOGC being outside the scope, otherwise standard rated	2
Key condition here being the intention to continue the same business as it will be making supplies only to other VAT group members after acquisition	1
Despite HMRC's previous policy that the business ceases as supplies to and by the same person, consider IMSL case law e.g. VAT group doesn't change nature of business of each group member, apply to client to conclude TOGC treatment can apply	4
Self-supply by rep member of group as partly exempt. Input tax cannot be attributed to self-supply itself and cannot feed into PE method. Cover exclusions from self-supply e.g. CGS, goodwill etc	4
Consider PE of VAT group, if used solely for making exempt supplies then irrecoverable in full	2
Value of self-supply is OMV of TOGC, less any exclusions	1
Consider other implications e.g. transfer of VAT liabilities, VAT grouping forms, CGS items	2
Presentation and higher skills	2
TOTAL	**20**

QUESTION 4

<table>
<tr><td>Mr J Martinside
J Martinside Plumbing Ltd,
6, The Cottages,
A Village
Somewhere
XY7 6AB</td><td align="right">Townfoot Advisers LLP
3 Townfoot,
Anytown,
Somewhere,
XY1 4XX</td></tr>
</table>

1 November 2019

Dear Joshua,

VAT

J Martinside Plumbing Ltd ("JMP") will be obliged to notify its liability to be registered within 30 days of the end of the 12-month period in which its turnover exceeds £85,000. Your figures suggest that will happen in December and JMP will then have until 30 January 2020 to notify HMRC and it will be registered with effect from 1 February 2020. From that date, JMP will have to account for VAT on its takings and will be able to recover the VAT on the costs of its taxable supplies, apart from that on "non-deductibles" like business entertainment and company cars available for private use (but half the VAT on leased cars would be recoverable).

It may be advantageous for JMP to register immediately as the contract with Jerry Builders Ltd ("JBL") involves the supply of goods, rather than being "labour only". Any VAT incurred on materials, etc., used before the date of VAT registration will be irrecoverable, whereas the VAT on such costs incurred after registration will be recoverable (and so will not form part of JMP's costs). However, once the company is VAT registered, it will have to account for VAT on its work for local householders and it may be difficult to pass this VAT on by way of increased charges. I suggest that this is taken into account when we determine when JMP should be registered, assuming that it registers voluntarily. You may want to consider increasing the estimated costs of work you quote for to allow for the VAT you will have to pay to HMRC after allowing for any VAT recovery on materials.

Most of the work that you do for householders will be subject to the standard (20%) rate of VAT. However, some of it may qualify for the reduced (5%) rate of VAT. This applies to the installation of energy saving materials, such as thermostatic radiator valves and central heating and hot water controls, insulation and draught stripping, and to certain grant funded supplies of heating systems.

As the Hillside development consists of self-contained dwellings, the installation of plumbing and heating systems, etc., should be zero-rated. Consequently, you should not charge VAT on the invoices you raise to JBL, but you will be able to reclaim VAT on the materials and hardware that you use (and you should obtain and keep VAT invoices from the relevant suppliers). Zero-rating also applies to supplies to JMP by subcontractors, so they should not charge VAT on their invoices (and JMP should not reclaim any wrongly charged VAT). Although the installation service of "white goods" – washing machines, dishwashers and the like – would qualify for zero-rating, JMP would have to charge VAT on the machines themselves. Unlike sanitary ware and boilers, etc, "white goods" do not qualify as "building materials" and hence the machines themselves cannot be zero rated when installed in new homes.

Provided that you work directly for Jerry Builders (Care Homes) Ltd ("JBC") on the new care home, you should be able to zero-rate your work on it. You must obtain a certificate from JBC confirming that your work relates to a building that it will use for a qualifying residential purpose (such as use as a residential care home). Zero-rating is restricted to supplies made to the person who uses the building for a qualifying purpose, so you would have to charge standard-rate VAT if you were working for a main contractor (e.g. JBL) on the job, rather than JBC, or if you did not have the certificate of qualifying use. Any contractors that you appoint would also have to charge VAT on their work.

JMP will be able to reclaim the VAT on goods bought in the 4 years preceding registration that are "on hand" at the date of registration, provided that it has the VAT invoices issued by suppliers to support the claim. This will include the VAT on the van as well as on any materials and tools. I suggest that you compile a list of the items you want to claim for and store the related purchase invoices separately in case HMRC wants to verify the claim. Although it is also possible to reclaim the VAT on services (such as legal services) supplied in the six months preceding registration, a claim is possible only if the services have not been used in connection with supplies you made before registering. As the legal services you mention were used in connection with "pre-registration" supplies, no claim will be possible in respect of them.

Yours sincerely

John Doe

MARKING GUIDE

TOPIC	**MARKS**
Outline of registration requirements and consequences of registration.	1
Calculation of effective date of registration from information provided.	1
Consider earlier, voluntary, registration and trade off between input VAT on materials in the Hillside project and output VAT on "private" work, impact on estimates, etc.	2
Consider lower rating for "energy saving" and grant funded work	1
Liability of work on Hillside project, including availability of Z/R for sub-contractors.	2
Treatment of "white goods" supplied and installed	1
VAT treatment of work on the care home, zero-rating subject to certification and work only for a qualifying use by the person supplied.	2
Treatment of work on the care home if acting as a subcontractor and treatment of sub-contractors' supplies	2
Availability of "pre-registration" VAT claim and associated formalities, treatment of services supplied pre registration	2
PHS	1
TOTAL	**15**

QUESTION 5

<table>
<tr><td>Mr A Beck
The Rose and Crown
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Somewhere
XX3 4AB</td><td align="right">A N Accountants LLP,
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Somewhere,
XX1 1AX</td></tr>
</table>

2 November 2019

Dear Mr Beck

VAT

Thank you for your letter of 29 October to John Buck. John has asked me to respond.

HMRC might accept that there was a "reasonable excuse" for the lateness in filing and/or paying one (or possibly two) returns around the time of your father's death. Whilst HMRC might not be sympathetic to an approach now, it may result in the removal of, or reduction in, the penalties you have suffered. Obviously, you will need to file returns, and make payments on time in future, to avoid further penalties. Once you have filed and paid on time for a 12 month period, you will fall outside the default surcharge regime unless and until there are more defaults.

The "annual accounting scheme" might help with your VAT administration if, and only if, you are able to keep records of expenditure and daily gross takings during the year. It requires an annual VAT return to be filed – two months after the end of the VAT year – in place of the usual quarterly returns. You would need to make monthly (or quarterly) payments towards your estimated annual VAT liability over the course of the year and a final balancing amount when the annual return is filed. It is a condition of the scheme that those entering it are up to date with their VAT returns, so any outstanding returns will need to be filed before an application to go onto the annual accounting scheme is made. Your current turnover is well within the £1.35m annual accounting threshold. If you are not confident about keeping up to date income and expenditure records through the year, it would be prudent not to adopt annual accounting, as reconstructing records after the end of the year would be both difficult and time consuming.

The visiting officer may believe that your bar trade and the catering business run by your wife are effectively one business or should be treated as one for VAT purposes.

HMRC's anti-avoidance powers allow them to issue a direction amalgamating the activities of ostensibly separate businesses when they are closely bound to one another by organisational, financial and economic links, and HMRC conclude that they have been artificially separated. Such a direction, if issued, would take effect from the date it is issued (or a future date) and would require the VAT accounting of the relevant activities to be combined.

Of more concern is the possibility that HMRC could argue that you and Anne are in partnership and that the VAT registration should reflect that. The facts that you are sharing premises, staff and other assets might support the proposition that you and Anne are in business together and that the VAT accounting should follow that. A similar outcome might follow if HMRC were to conclude that the two business strands had been artificially separated for VAT planning reasons (to avoid VAT on the food takings) and that, following case law in the UK and Europe, that strategy was "abusive" (on the basis that the outcome – no VAT on the food sales – ran counter to the intentions of UK and EU VAT law). Either contention could result in arrears of VAT as well as making the future food sales subject to VAT. On the figures that you have provided, this could cost as much as £30,000 - £35,000 (based on your figures for Anne's turnover and allowing for the current year to date) and HMRC might seek to apply a penalty of up to 100% plus interest.

I would suggest that we meet as soon as possible to explore:

1. the rationale behind the separation of the bar and "catering" businesses,
2. the extent to which the accounts for them are separated,
3. the bank accounts that you and your wife use for your businesses, and
4. any charges made for the use of "shared" facilities, staff, etc.

From this we will be able to determine the strength of a potential appeal should HMRC issue a direction or assess for Anne's takings to be included in the VAT registration.

We should also discuss the officer's suggestion that the margins achieved on the declared bar sales are insufficient. We should consider whether the period chosen for the comparison of your purchases and sales is a representative one, and if proper allowances have been made for wastage, etc, to ensure that any potential VAT assessment is made to "best judgement" and does not overstate the projected takings.

Unfortunately, if temporary staff were stealing from the till while you were dealing with your father's death, you would still be liable to account for VAT on the cash taken.

Yours sincerely

Bill Dodds

MARKING GUIDE

TOPIC	**MARKS**
Annual Accounting	
Outline of workings of the scheme	1
Conditions for admission	1
Late Filing/Payment	
Possibility of arguing for "reasonable" excuse for lateness for some periods	1
Acknowledgement that a late submission of this sort might not be well received	1
Escaping from the default surcharge regime after 12 months of compliance	1
Combination of catering and "Wet" trades	
Outline of HMRC aggregation direction power	1
Effective date of direction	1
Recognition of "partnership" contention	1
Recognition of "abuse" argument	1
Outline of consequences of a finding of "partnership" or "abuse" including likely assessment and potential penalty	1
Potential under-declaration on bar sales	2
Consider basics of mark-up exercise, whether period used properly representative, allowances made, etc.,	1
Confirm VAT due on any stolen cash	1
PHS	1
TOTAL	**15**

QUESTION 6

Mr A Smythe,
Provodit plc,
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Arnold Bloggs & Co LLP,
Sunshine House,
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1 November 2019

Dear Albert,

Group Reorganisation – VAT, Stamp Duty Land Tax and Stamp Duty

VAT

I recommend that the three new wholly owned subsidiaries are added to the Provodit VAT group and that the properties are transferred after they are VAT grouped. Future supplies between them, including the transfers, will then be disregarded for VAT purposes. Grouping is likely to simplify administration and reduce VAT costs. Also, there is then no need for a separate notification of an option to tax by Provodit Developments Ltd over the two properties that have been redeveloped already, as it will be bound by the election previously made by Provodit Manufacturing Ltd. It is probable that the group should opt to tax over the other development properties, but I would need details of the location and likely use of them before I could confirm this.

We should consider the locations and likely future use of properties to be transferred to Provodit (Sales) Ltd. It is likely to be advisable to opt to tax at least some of them, in order to avoid VAT costs on the upkeep of the properties, security, and so forth and on things like planning applications.

We could VAT group the JV company, but Provodit plc would then have responsibility for its VAT compliance. A separate registration could avoid this and might also enable it to benefit from a cash flow advantage by placing it on monthly VAT returns. However, this may not be worthwhile as the construction costs should be zero-rated, so the amount of VAT it will incur may be relatively small.

If JV Co Ltd is not VAT grouped, the transfer of the properties to it will need to be recognised for VAT purposes, either as an exempt supply if there is no option to tax over them (which may lead to VAT costs on transfer expenses, etc.,) or as a taxable supply (if the properties are "opted"), which would lead to additional Stamp Duty Land Tax (SDLT) being payable. Before a conclusion is reached on this, we should consider the VAT costs that might be incurred if an exempt supply of the properties takes place and also SDLT issues (see below)

I recommend that we review the likely future position to see if we should consider applying for HMRC's approval of a special partial exemption method, perhaps "ringfencing" input tax referable to individual properties and using a transaction count, rather than a values-based apportionment to compute the recoverable element of overhead costs and the like. A special method would avoid the potentially distortive effect of high value property transactions under the standard (values based) method.

Stamp Duty

Unlike sales of existing shares (which are subject to stamp duty at 0.5%), the issue of new shares in the new companies and JV Co Ltd will not be subject to Stamp Duty.

Any sale of Provodit (Sales) Ltd will attract Stamp Duty at 0.5% but this will be a matter for the purchaser to deal with.

SDLT

Generally, conveyances of freehold land and the grant of leases are subject to SDLT.

There is an SDLT relief for most land transactions between members of a group where one of the companies concerned owns 75% of the ordinary share capital of the other, or all are 75% owned by another. All the group companies apart from JV Co would satisfy this test and it follows that property transfers between them would qualify for group relief and so would not be subject to SDLT.

Even though no duty will be due, it is still necessary to report the intra-group transactions to HMRC and to claim group relief.

The effect of SDLT group relief can be reversed by a later event, such as when the purchaser or the vendor leaves the stamp duty group. A denial of group relief would also follow from “arrangements” for a loss of 75% control. If the triggering event happens within 3 years of the initial transfers, (e.g. if Provodit (Sales) Ltd is sold within this timescale), this would result in a loss of group relief on transferred properties still held at that point. That could cost as much as £127,500 if none of the transferred properties have been sold when Provodit (Sales) Ltd leaves the group. In that event, a further return must be made to HMRC and the group relief would be clawed back, unless a further property transfer means that the properties remain in the group.

JV Co Ltd will not qualify for group relief as it will be only 60% owned by Provodit plc, so the transfer of properties to it will be subject to duty in the normal way. JV Co Ltd will need to report the transactions and will incur duty totalling £141,500 if the property transfers take place within a VAT group or are exempt. That figure would increase to £174,000 if the properties transferred are subject to VAT (even though the VAT should be recoverable as input tax by JV Co Ltd). I suspect that the balance of advantage will lie with VAT grouping (or possibly with making an exempt supply of the properties) but we need to consider this further before reaching a conclusion.

I will contact you shortly to discuss this.

Yours sincerely

Charles Fotherington

SDLT Calculations

Provodit (Sales) Ltd

	Transfer Price £	SDLT at 0% on first £150,000 £	SDLT at 2% on next £100,000 £	SDLT at 5% on balance of transfer Price £	Total SDLT £
Property 1	1,250,000	0	2,000	50,000	52,000
Property 2	350,000	0	2,000	5,000	7,000
Property 3	650,000	0	2,000	20,000	22,000
Property 4	850,000	0	2,000	30,000	32,000
Property 5	150,000	0	N/A	N/A	0
Property 6	500,000	0	2,000	12,500	14,500
					127,500

JV Co Ltd

	Transfer Price £	Transfer Price if subject to VAT £	SDLT at 0% on first £150,000 £	SDLT at 2% on next £100,000 £	SDLT at 5% on balance of transfer Price £	Total SDLT £
Property 1	2,500,000		0	2,000	112,500	114,500
Property 2	750,000		0	2,000	25,000	27,000
						141,500
Property 1		3,000,000	0	2,000	137,500	139,500
Property 2		900,000	0	2,000	32,500	34,500
						174,000

MARKING GUIDE

TOPIC	**MARKS**
VAT:	
VAT grouping of Newcos	1
Ensure property transfers happen after VAT grouping	1
Option to tax by Provodit Manufacturing Ltd binds Provodit (Developments) Ltd if they are VAT grouped	1
Consider options to tax on properties going to Provodit (Sales) Ltd	1
Pros and Cons of VAT grouping JV Co	1
Possible partial exemption issue for Provodit VAT group	1
Effects of separate VAT registrations for Newcos and JV Co	1
Stamp Duty:	
No duty on the issue of new shares	1
Stamp Duty Land Tax	
Eligibility for SDLT group relief	1
Newcos 1,2 and 3 eligible for relief	1
JV Co not in SDLT group	1
Provodit companies need to report transactions on SDLT1 and claim group relief even though no duty due	1
Issue of possible post transaction loss of group relief if purchaser leaves group	2
Calculate potential loss of group relief clawed back	1
JV Co required to pay duty and report on SDLT1	1
Calculate amount of duty if no VAT on transfers to JV Co	1
Calculate amount of duty if VAT due on transfers to JV Co	1
PHS	2
TOTAL	**20**