

**IIT 2009/10 ASSOCIATE EXAMINATION
PAPER II VAT ROUTE – POTENTIAL SOLUTION**

Question 1

- 1) 5%
- 2) “Hot food” means food which, as any part of which, has been heated for the purpose of enabling it to be consumed at a temperature above the ambient air temperature and is above that temperature at the time it is provided to the customer.
- 3) “Major interest” in relation to land, means the fee simple or a tenancy for a term certain exceeding 21 years.
- 4) Liable to UK VAT (@ 15%).
- 5) £1,000,000
- 6) Within 30 days of the event.
- 7) £2,000
- 8) Entering: £1,350,000
Leaving: £1,600,000
- 9) Bad Debt Relief is calculated by applying the VAT fraction to the “outstanding amount” of the invoice, which in this case would be the VAT element.
- 10) £600,000
- 11) £2,000,000
- 12) £1,600,000
- 13) The total of the exempt input-tax must be:
 - a. Less than 50% of all input-tax; and
 - b. Less than £625 per calendar month on average.
- 14) Six months.
- 15) Six years.
- 16) £500
- 17) Taxable: £150,000
Total: £187,000
- 18) Six months.
- 19) £50
- 20) 28 days

Question 2

Capital Goods Scheme

Building A

This is a capital item under regulation 113(b) of the VAT Regulations 1995. The first interval commences on its purchase and ends on 31/3/04 at the end of the tax year in which it was purchased (reg 114(4)(a)).

An annual adjustment is required at the end of this tax year:

Annual percentage recovery 45% of 140,000 = 63,000

Deducted in period 09/03 was 56,000 (40%)

Adjustment due from HMRC = **7,000 claimable in period 06/04**

The baseline percentage for the capital goods scheme is 45%.

Adjustments are required under the capital goods scheme for subsequent intervals as follows:

Tax year ending 31/03/05 – recovery percentage 50%

$\frac{140,000}{10} \times (50 - 45)\% = \mathbf{700 \text{ due from HMRC on the 09/05 return}}$

Tax year ending 31/03/06 – recovery percentage 55%

$\frac{140,000}{10} \times (55 - 45)\% = \mathbf{1,400 \text{ due from HMRC on the 09/06 return}}$

Tax year ending 31/03/07 – recovery percentage 60%

$\frac{140,000}{10} \times (60 - 45)\% = \mathbf{2,100 \text{ due from HMRC on the 09/07 return}}$

Tax year ending 31/03/08 – recovery percentage 40%

$\frac{140,000}{10} \times (40 - 45)\% = \mathbf{700 \text{ due to HMRC on the 09/08 return}}$

On its exempt disposal on 1/05/07, there were 5 complete intervals remaining. A further adjustment is therefore needed to treat its use over these 5 intervals as exempt:

$\frac{140,000}{10} \times 5 \times (0 - 45)\% = \mathbf{31,500 \text{ due to HMRC, also on the 09/08 return}}$

Building B

This is also a capital item under regulation 113(b). The first interval commences on its purchase in November 2004 and ends on 31/3/05 at the end of the tax year.

There is no difference between the initial deduction percentage and the tax year percentage and so the deduction of 50% is not affected by the annual adjustment.

The baseline for the capital goods scheme is therefore 50%

Adjustments are required under the capital goods scheme for subsequent intervals as follows:

Tax year ending 31/03/06 – recovery percentage 55%

$\frac{105,000}{10} \times (55 - 50)\% = \mathbf{525 \text{ due from HMRC on the 09/06 return}}$

Tax year ending 31/03/07 – recovery percentage 60%

$\frac{105,000}{10} \times (60 - 50)\% = \mathbf{1050 \text{ due from HMRC on the 09/07 return}}$

As the building was totally destroyed during this period, no further adjustments are due (reg 115(4))

Building C

This is a capital item under regulation 113(e) and the first interval commences on its first use on 1/06/06 and ends on 31/03/07 at the end of the tax year. However, the VAT incurred is deductible as input tax when charged to X Ltd, giving recovery as follows:-

Tax period 12/05 – 50% of 105,000 = 52,500

Tax period 03/06 – 45% of 52,500 = 23,625

Annual adjustment tax year ending 31/03/06 gives 55% recovery of 105,000 + 52,500

157,500 X 55% = 86,625 less 76,125 deducted = **adjustment of 10,500 due from HMRC on the 06/06 return**

Tax period 06/06 – 60% of 52,500 = 31,500

An adjustment is due under the capital goods scheme in the subsequent intervals following the first interval, therefore the first adjustment is due for tax year ending 31/03/08. There are 2 alternative ways of doing this either by using the 2 different initial baseline percentages or combining them:-

Method 1

$\frac{157,500}{10} \times (40 - 55)\% = 2,362.50$ due to HMRC **plus**

$\frac{52,500}{10} \times (40 - 60)\% = 1,050$ due to HMRC

giving a total **3,412.50 due to HMRC on the 09/08 return**

Method 2

Total input tax incurred on capital item 210,000 of which 118,125 deducted = 56.25%

$\frac{210,000}{10} \times (40 - 56.25)\% = 3,412.50$ due to HMRC on the 09/08 return

Question 3

Fred Sheet

(Date)
Mr F Sheet
(Address)

Dear Mr Sheet

VAT Registration

Thank you for your letter dated 10 April 2009. I am writing as requested to explain the VAT registration implications for the clients referred to in your letter. For ease of reference I will comment on each case in separately headed paragraphs.

Ms Val Avon

Ms Avon is liable to register at the end of any month if the value of taxable supplies in the past 12 months has exceeded £67,000 (Para1(1) Sch 1 VATA 1994). Clearly the value of taxable supplies has not exceeded the threshold to date. If current levels of turnover are maintained, the threshold will not be exceeded at the end of June (when deposit paid) but will be exceeded at the end of July.

I understand that the air show will not be held again until 2011 and there is no guarantee that Ms Avon will be awarded future contracts. Ms Avon could apply for exception from registration which is available provided HM Revenue & Customs are satisfied that the turnover for the 12 months starting 1 August 2009 will be less than the deregistration threshold, currently £65,000.(Para1(3) Sch 1 VATA 1994).

Ms Avon should notify her liability for registration within 30 days of 31 July 2009 and submit an application for exception from registration (unless it is thought that registration will be worthwhile). Full details of turnover for the previous 12 months and expected turnover in the next 12 months should be provided to HMRC.

If the contract is obtained in 2011, it may be possible to successfully apply again for exception from registration.

Mr Mark Aroni

Mr Aroni can register voluntarily and does not have to wait until the turnover threshold is breached. (VATA 1994 Sch 1, para 9). He currently has no obligation to notify and register for VAT. Although the VAT registration rules are different when a business is taken over as a going concern, the rules only apply when the vendor is a taxable person. The previous owners were not and were not required to be registered for VAT and therefore were not taxable persons.

If Mr Aroni does not wish to register voluntarily, the liability to register arises at the end of the month in which the total of his turnover reaches £67,000. He then has another 30 days (the notification period). The effective date of registration will be the first day of the month after the notification period, e.g. if the threshold is exceeded at the end of May, the effective date of registration will be 1 July 2009.

VAT can be recovered on costs of goods on hand at the date of registration and on services received in the 6 months prior to the effective date. If Mr Aroni registers now with a current date it would appear most of the VAT incurred on costs will be recoverable. If however services were received more than six months prior to registration, the VAT on such services will be irrecoverable. Mr Aroni could consider applying for a retrospective effective date of registration but the disadvantage is he will have to account for VAT on sales made from the effective date.

Where voluntary registration is concerned, the effective date has to be agreed with HMRC at the time of making the application or at least before registration takes effect.

Mr Ian Dear

Your assumption that Mr Dear can ignore the fees for work performed for his German business client when calculating the turnover for VAT registration purposes is correct. The fees are outside the scope of UK VAT. As such the fees are not taxable supplies. It is the value of taxable supplies which determines registration liability. Unfortunately notwithstanding the VAT liability of the German fees, Mr Dear does have an obligation to register now and an application for VAT registration will need to be submitted prior to 30 April 2009. The effective date will be 1 May 2009.

The liability for registration arises because the costs of certain services received from abroad (including legal fees) are deemed to be taxable supplies (s8(1) VATA 1994) and have to be included in taxable turnover when determining whether or not the VAT registration threshold has been exceeded. From the information provided the turnover for the 12 months ended 31 March and the German legal fee totals £70,000. This is in excess of the current threshold, £67,000. You mention that the turnover is increasing slowly therefore exception from registration (see above) is not an option.

I hope this letter is helpful. If you require clarification or I can be of further assistance please do not hesitate to contact me.

Yours sincerely

A Advisor

Question 4

VAT Liability

Part 1

- A** Relevant legislation re intra EU haulage SI 1992/3121 Art 10, Art 14
The place of supply of intra EU transport is, primarily, the place of the departure of the goods.

(i) In this instance the place of supply is Germany. As Yeti Ltd has a German VAT registration, Ernie Stoppard can zero rate the supply of the intra EU freight services when quoting Yeti's DE VAT number, and should also make some reference on the invoice either to the relevant legislation or give some indication that the supply is one where the customer is liable to account for the VAT in his member state via the reverse charge provisions. Documentary evidence should also be retained to support the intra EU transportation, examples might be, bills of lading, consignment notes, certificates of shipment, etc.

(ii) The place of departure, and therefore supply, is France, but the customer is not registered for VAT in France. In this instance Yeti can ask that Ernie Stoppard use either its GB or DE VAT registration number. If the DE VAT number is chosen, zero rate the supply (as Yeti is 'established for VAT purposes' in both EU countries). The place of supply is then the EU country of the customer, the customer's EU VAT number should be shown on the invoice and some indication that the supply is one where the customer is liable to account for the VAT in his member state via the reverse charge provisions.

Alternatively, Yeti could ask for the supply to be taxed in the UK, and be treated as a UK domestic supply.

(iii) In this instance again, the place of supply is Germany. Ernie Stoppard can zero rate the supply of the intra EU freight services when quoting Yeti's DE VAT number, and should also make some reference on the invoice either to the relevant legislation or give some indication that the supply is one where the customer is liable to account for the VAT in his member state via the reverse charge provisions. Documentary evidence should also be retained to support the intra EU transportation, examples might be, bills of lading, consignment notes, certificates of shipment.

- B** Relevant legislation re international haulage SI 1992/3121 Art 6, and (VAT Act 1994, Sch 8, Group 8 Item 5)

This is international freight transport (between EU and non-EU), and the place of supply of international freight transport is the country where the transport takes place to the extent that it takes place in that country. The VAT liability is therefore zero rated in the UK, and outside the scope of UK and EU VAT to the extent that it takes place outside the EU. The invoice should note the reason for zero rating, and documentary evidence should also be retained to support the zero rating, examples might be, bills of lading, consignment notes, airway bills, certificates of shipment

Part 2.

Relevant legislation is SI 1992/3121 Art 5, and VAT Act 1994 Sch 5 Para 1-8

(i) The place of supply of legal services relating to specific areas of land is where the land itself is located, irrespective of where the customer belongs. So in this instance, although the supply is made to a company based in France, UK VAT should be charged on the services.

(ii) Due diligence services would fall within Sch 5 Para 1-8 VAT Act 1994 and in this case the recipient of the supply is in France. The place of supply is treated as taking place in the EU country of the customer if the services are supplied to him for business purposes. Doolittles can zero rate their supply to Moonstruck when quoting Moonstrucks FR VAT number and should also make some reference on the invoice either to the relevant legislation or give some indication that the supply is one where the customer is liable to account for the VAT in his member state via the reverse charge provisions.

Part 3

Relevant legislation is SI 1992/3121 Art 17 & 18

The supplier, Wotbat Ltd, belongs in the UK, and the customer in France, but is not VAT registered. Normally the supply would then be taxable in the UK, but the services were actually "used and enjoyed" in South Africa. So, the use and enjoyment provisions can be applied if the customer can prove that the racquets were only used in South Africa, and the supply will be outside the scope of UK and EU VAT. Wotbat Ltd should obtain some kind of proof/evidence that the racquets were only used in South Africa, if they wish to treat the supply as outside the scope of VAT.

Question 5

Butterfly Insurance Plc

The Annual Adjustment is required under Regulation 107 to SI 1995/2518, and its purpose is to even out fluctuations between VAT quarters, either in the percentage of taxable supplies to total supplies and/or the level of input tax incurred in a specific quarter.

From an initial review of your figures, I note that your highest recovery percentage occurred in the quarter to December. Since this quarter also recorded a significantly higher amount of input tax, it is inevitable that the Annual Adjustment, when calculated, will result in a repayment to HM Revenue & Customs, to be accounted for on your June return.

I have calculated your Annual Adjustment using the figures you supplied, and you will see that the overall percentage for the year is around 27% - this results in a repayment of approximately £35,700.

As regards the imminent purchase of the risk consulting business, this very much looks like it will constitute a Transfer of a Going Concern (TOGC) under Article 5 of the VAT (Special provisions) Order 1995. This means that there should be no VAT charged to you on the purchase of the business, but you should nevertheless check the contracts to confirm this.

However, as you are a partly exempt group that is acquiring a business by way of a TOGC, you are required to consider and apply s.44 of the VAT Act 1994, which is an anti-avoidance provision aimed at preventing a partly exempt business from acquiring assets that would otherwise bear VAT.

This section requires you to charge yourself VAT on the open market value of the assets (s.44(7) and (8)). This constitutes both output and input tax, but you will only be able to reclaim input tax depending on to how much taxable usage to which you will be putting the assets under your partial exemption method. However, under s.44(3) you do not need to include assets that are over 3 years old.

If the vendor has not reclaimed input VAT on his original purchase of the assets then, to the extent that it has been restricted, you do not have to apply the s.44 charge to such items.

In addition, assets that fall within the Capital Goods Scheme (CGS) do not need to be included. The CGS applies to property, including refurbishments, where VAT was incurred on expenditure exceeding £250,000 within the last 10 years. In addition, IT hardware and other assets acquired for over £50,000 within the last 5 years by the previous owner also fall within the CGS. You will, in effect, inherit any existing CGS items, and will have to continue with the adjustments required under the CGS until it ends.

It is critical that you find out from the vendor information relating to each of these assets in order to establish the extent of any s.44 charge and CGS adjustments.

We should also take the opportunity to consider your partial exemption method, and decide whether it would be possible to apply to use a Special Method under Regulation 102, rather than the Standard Method you are currently using. It seems that you will be separating your risk management and insurance businesses, so in principle it may be possible to attribute input tax more accurately to each of these under a sector-based method.

You will have to agree a mechanism for dealing with input tax incurred by the service company for use by both sectors of your business – typically this can be by reference to headcount or floor space, but it will need the written approval of HM Revenue & Customs, as it must be fair and reasonable. As Finance Director, you will have to sign a declaration to this effect in any case.