



November 2020 Examination

PAPER 6

VAT

Part I Suggested Answers

1.

- 1) The following conditions must be met for Oscar to be eligible to join the annual accounting scheme:

Taxable supplies within the next 12 months are not expected to exceed £1,350,000. (1/2)

- VAT registration is not in the name of a group (1/2)
- The business is not registered as a divisional registration (1/2)
- The business has not ceased to operate the scheme in the 12 months preceding the date of application (1/2)
- The business is not insolvent and does not have a rising VAT debt (1/2)

Oscar has met the conditions above so he is entitled to join the scheme. (1/2)

(Maximum 2 marks)

- 2) The main advantages of the scheme are:

- Cash flow certainty - the trader knows the exact amount to pay each month or quarter; (1/2)
- Ability to make additional payments as and when they can be afforded; (1/2)
- Only having to complete one VAT return each year, instead of the normal four; (1/2)
- Two months to complete and send in the annual VAT return and any balancing payment, instead of the usual one month; (1/2)
- Being able to align the VAT year with the end of the business tax year; (1/2)
- Less chance of financial penalties for late filing as there is only one VAT return to file per year. (1/2)

(Maximum 2 marks, 1/2 mark each)

Total (4)

2.

1)	Children's colouring book	Zero-rated (1/2)
2)	Folded map of Birmingham	Zero-rated (1/2)
3)	2021 Diary (blank for completion)	Standard-rated (1/2)
4)	Exercise Books (lined, blank)	Standard-rated (1/2)
5)	English Dictionary	Zero-rated (1/2)
6)	Cycling Magazine	Zero-rated (1/2)
7)	Newspaper	Zero-rated (1/2)
8)	Wrapping paper	Standard-rated (1/2)

(4 marks, 1/2 mark each)

3. It is important for Carbon ReNew to determine whether a particular activity is a 'business' or 'non-business' activity because:

- VAT must be charged on standard-rated 'business' income; (1/2)
- No VAT is due on 'non-business' income; (1/2)
- No VAT can be recovered on purchases relating to 'non-business' income; (1/2)
- Input VAT can be recovered on purchases relating to 'business' income, subject to the normal rules; (1/2)
- Reliefs are available on certain purchases for 'non-business' activity e.g. construction of new buildings. (1/2)

(Maximum 2 marks, 1/2 mark each)

4.

1) Greta's Fashions Ltd is not obliged to register for MTD for VAT for returns as its turnover is below the threshold of £85,000. (1)

Greta's Fashions Ltd may also in some circumstances be able to apply for exemption from MTD for VAT (for example on religious grounds). (1)

(2 marks)

2) A spreadsheet is likely to meet one of the requirements of MTD, namely to record and preserve digital records. (1) However, in its standard form it is unlikely to meet the other two requirements: (1) to provide to HMRC information and returns from data held in those digital records by using the API platform and (2) to receive information from HMRC using the API platform. (1)

Therefore, a business will need to buy or develop bridging software in order to transmit the final VAT return figures, and to communicate, to HMRC, or use an API-enabled spreadsheet. (1)

Any transfer or exchange of data must be 'digitally-linked'. A digital link includes linked cells in spreadsheets so if there is a formula in one sheet that mirrors the source's value in another cell, then the cells are considered to be linked. (1)

(Maximum 2 marks, 1 mark each)

Total (4)

5. The most advantageous VAT accounting period for Markus is 'monthly' rather than 'quarterly'. (1)

As Markus will always be in a repayment VAT position and so requesting to be on monthly VAT returns will enable him to recover his VAT much earlier than if he was on quarterly VAT returns. (1)

(2 marks)

6. The basic tax point for services is the time when the work is completed (1/2).

The actual tax point amends this if, before the basic tax point, the supplier issues a VAT invoice or receives payment in respect of the supply. In that case the tax point is the time the invoice is issued (1/2) or payment is received. (1/2) So Anna's tax point is 29 September as payment was received in advance of the supply (actual tax point). (1)

However if the supplier issues a VAT invoice within 14 days after the basic tax point (assuming no advance payment has been made) the tax point becomes the date of the invoice. (1/2) So Rachelle's tax point is 8 October under this 14 day rule (actual tax point). (1)

(4 marks)

7. Tanya should include the following sources of income:

	£	
Photograph sales (£20,000 x 120%)	24,000	(1)
Rent on sub-let of property (not opted to tax)	4,500	(1)

Tanya should recover the VAT of £360 (£1,800 x 20%) on the camera being a capital item costing over £2,000 including VAT. (1)

Output tax: $(24,000 + 4,500) \times (11\% - 1\%) = 2,850$ (1)

Less input tax: 360

VAT liability = £2,490

Tutorial note: it is possible that limited cost trader rules may apply (depending on the content of miscellaneous expenses) equal credit was awarded for starting with 11% or 16.5% in the calculation of output tax.

(4 marks)

8. HMRC is entitled to levy default interest if the Exchequer has been deprived of an amount of VAT for a period of time. This is known as 'commercial restitution'. (1/2)

HMRC would not generally levy interest if the amount of VAT underdeclared by Sindon Ltd would have been immediately reclaimable as input tax by Grandol Ltd but has not been reclaimed. i.e. if there is no overall loss to the Exchequer. (1) However, if Grandol Ltd would not have been entitled to recover all or some of the VAT as input tax (e.g. if it is partly exempt) then HMRC may levy interest as commercial restitution. (1)

(Maximum 2 marks)

9. Crimple Ltd must write to HMRC to seek permission to use a special method, giving precise details of how the proposed method will work (1). Crimple Ltd must also submit a signed declaration to the effect that, to the best of its knowledge and belief, the method fairly and reasonably represents the extent to which goods or services are used in making taxable supplies (1)

(2 marks)

Common methods are:

- Floor space apportionment: ratio of floor-space occupied by income-generating staff involved exclusively in making taxable supplies to total floor space of income-generating staff (1)
- Staff time and headcount apportionment: ratio of staff time spent on taxable activity to total staff time (1)
- Transaction-based apportionment: ratio of taxable transactions to total transactions (1)

(Maximum 2 marks, 1 mark each)

Any other reasonable methods will also be awarded the marks.

Total (4)

10. News Alert's VAT-inclusive income for the period was as follows:

	£
Confectionery	6,000 (standard rated)
Newspapers, magazines and books	5,000 (zero rated)
Potato crisps	3,000 (standard rated)

Output VAT on standard rated sales = $1/6 \times (6,000 + 3,000) = \text{£}1,500$ (1/2)

No output VAT due on newspapers, magazines and books as they are zero-rated (1/2)

The standard rated VAT-inclusive expenses for the period were as follows:

Rent (landlord has opted to tax) 3,000

Input VAT = $1/6 \times 3,000 = \text{£}500$. (1/2)

The zero rated expenses for the period were as follows:

Newspapers and magazines 3,000 (zero rated so no input VAT to reclaim)

News Alert had the following goods on hand at the date of deregistration:

	<u>Market value (excluding VAT)</u>
	£
Unsold stock of confectionery	2,300
Unsold stock of recipe books	5,000
Point of sale system	4,000 (cost £5,000 + VAT)
Computer	1,500 (bought from an unregistered business)

Goods on which VAT was recovered: $\text{£}2,300$ (1/2) + $\text{£}4,000$ (1/2); VAT thereon = $\text{£}1,260$ ($20\% \times 6,300$). As VAT was greater than $\text{£}1,000$ News Alert needed to account for output VAT of $\text{£}1,260$ on these deemed supplies. (1/2)

Recipe books are zero-rated so News Alert would not have claimed any input VAT; the same applies to the computer as it was purchased from an unregistered business.

Therefore:

	£
Output tax	2,760 (1,500 + 1,260)
Less input tax	<u>500</u>
VAT liability	<u>2,260</u> (1)

(4 marks)

11. Lashmi Ltd can charge VAT on the subletting if:

- 1) Firstly, the decision to opt to tax must be made (1). HMRC recommend that a written record (such as board minutes or in an email) is kept showing clear details of the building and the date the decision is made (1/2)
- 2) Secondly, HMRC must be notified of the decision within 30 days of the decision being made (1). Notification must be made in writing (using Form 1614A (1/2) and clearly state which building is covered and the date from which the option has effect. (1/2)

HMRC will normally acknowledge receipt of notification within 15 working days (1/2) but Lakshmi Ltd should charge VAT from the date it opted to tax the building. (1/2)

(Maximum 3 marks)

12.

- 1) A large candle worth £45 (excluding VAT) to their top-performing staff member for the month. The same person has won this award for three months in a row.

The cost to the spa of gifting the three candles to the same person was £135 (excluding VAT). As these candles were gifted within a 12 month period, were more than £50 and the spa had recovered the input tax thereon, it would need to repay the input tax recovered or make an output tax charge for the same amount. (1)

- 2) Samples of face cream to all guests at the spa. The spa bought these for 10p (excluding VAT) a sachet and has given out approximately 1000 sachets.

There are no VAT implications of the samples as the gifting of these is not a taxable supply - the spa is entitled to recover the input tax with no output tax charge. (1)

- 3) A back massage (worth £85 including VAT) to a guest who won a competition. The massage was performed by in-house staff.

A gift of services from own resources (i.e. not bought in) is generally not a taxable supply and no output VAT is due. (1)

(3 marks)



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PAPER 6

VAT

Part II Suggested Answers

Q13.

1) Plot A

The first cost on the site will be the demolition of the existing building. As there is planning permission to construct new houses, the demolition costs will be zero rated as services received in the course of construction of dwellings. (1 mark) The cost of constructing the houses will be zero rated. (1 mark) The construction of the new road and connection to the water mains will also be zero rated. (1 mark) The purchase of the domestic appliances will be subject to VAT at 20%. (1 mark)

Plot B

The costs of converting the building from non-residential to residential use will qualify for reduced rating at 5% as the conversion of premises, to a different residential use; this includes a property that has never been lived being converted to residential use. (1 mark) However the lower rating will not apply to the part of the building which is to be used as a shop therefore this will be subject to 20% VAT. (1 mark)

Plot C

The costs of converting the house will qualify for reduced rating at 5% as the conversion of a single occupancy dwelling into a multi occupancy dwelling. (1 mark)

Plot D

The conversion of the existing house will be subject to VAT at 20% as there is no change in the number of dwellings. (1 mark)

Professional services for each plot will be subject to VAT at 20%. (1 mark)

(Maximum 8 marks)

2) Income from the sale of houses on plot A will be zero rated as the first grant of a major interest in a new dwelling (1 mark)

Income from the rental of the flats on plot B will be exempt from VAT. (1 mark) The rental of the shop will also be exempt (½ mark) unless the company opts to tax the land, in which case the rental income will be taxable at 20%. (½ mark)

The sale of the flats on plot C will be exempt as the sale of a dwelling. (1 mark) (Note zero rating not available for change in number of dwellings conversion.)

The sale of the house on plot D will be exempt as this is not the first grant of an interest in that building. (1 mark)

(5 marks)

- 3) The company will be able to reclaim input tax which relates to the taxable supplies i.e. being the zero rated sale of the Plot A new houses, and the Plot B shop and flats if the option to tax is made. (1 mark)

The input tax which relates to the exempt supplies being the Plot B shop and flats, the Plot C flats and the Plot D house will not be reclaimable (1 mark)

A partial reclaim will be possible for the professional fees which relate to the whole site as they are attributable to making both taxable and exempt supplies. (1 mark)

Input tax on the domestic goods will be blocked from an input tax reclaim. (1 mark)

(4 marks)

- 4) The letter to the client advising that you will cease to act for them should cover the following topics:

- A summary of services provided up to the date of ceasing to act;
- A note of any further action to be taken by you;
- A note of any outstanding matters that either the ex-client or the new advisers will need to address;
- Details of any impending deadlines and the action required;
- Your willingness or otherwise to assist the new advisers to resolve outstanding issues with HMRC or others and provide copy papers to the new advisers;
- Details of any outstanding fees; and
- A note indicating whether you or your successor is to advise HMRC of the change.

(Maximum 3 marks - 1 mark each)

Total (20)

Q14

- 1) The sale of kits and equipment (whether to the US businesses or private US customers) will be zero rated as exports (1 mark) provided that the company holds evidence of export (1 mark) and the goods are exported within 3 months of the tax point for the sale of the goods. (1 mark)

If any of the above conditions is not met, the sale of goods is subject to 20% VAT. (1 mark)

(4 marks)

- 2) For 'indirect exports', where the customer collects the goods there is a risk that the customer does not provide the required evidence of export. To protect against this, the company could make it part of the contract that the buyer provides evidence of export within 3 months. (1 mark) It may also be advisable to collect a deposit equivalent to the VAT which can be refunded once the evidence has been provided. (1 mark)

(2 marks)

- 3) Any of the following will be acceptable as evidence of export:

Official evidence such as:
the Goods Departed Message (GDM); or
the HMRC-endorsed SAD.

Commercial evidence such as:

sea waybills
air waybills
International consignment notes
master air waybills or bills of lading
certificates of shipment

Supplementary evidence is also acceptable such as:

customer's order
sales contract
inter-company correspondence
copy of export sales invoice
advice note
consignment note
packing list
insurance and freight charges documentation
evidence of payment
evidence of the receipt of the goods abroad

(Maximum 2 marks, ½ mark each,)

- 4) The sale of the helpline services will be outside the scope of VAT under the general place of supply rule when provided to a business customer. (1 mark) When provided to an individual, the helpline will be outside the scope of VAT as a variation to the general rule for intangible services provided to a consumer outside of the EU. (1 mark)

The charge for the 'app' will fall under the general rule for business customers and will be outside the scope of VAT. (1 mark) For private individuals, the supply will be an electronically supplied service which will also be outside the scope as an intangible service. (1 mark)

The repair of goods intended for export is zero rated. (1 mark)

(5 marks)

- 5) The accounting entries for the purchase invoice will be as follows:

	Dr	Cr	
	£	£	
Expenses	£10,000		(½ mark)
VAT control account	£2,000		(½ mark)
Bank		£12,000	(1 mark)

(2 marks)

Total (15)

Q15.

1) To: apartner@afirm.com 2/11/2020
Subject: Errors on VAT returns and Failure to prevent offence (1 mark format)

Hi,

Errors on VAT returns

Sharon

HMRC may classify Sharon's error as having been made in spite of reasonable care being taken. If so there will be no penalty due. (1 mark)

However Sharon's error is likely to be classed as 'careless' (½ mark) i.e. an error made due to lack of reasonable care.

The maximum penalty that may be applied by HMRC is 30% (½ mark) of potential lost revenue. (½ mark)

Penalties can be reduced by:

1. Disclosing the error to HMRC; (½ mark)
2. Helping HMRC to calculate the value of the error; and (½ mark)
3. Giving HMRC access to check the figures. (½ mark)

So if Sharon makes an unprompted disclosure to HMRC (as suggested by wanting to rectify this as soon as possible) then the penalty may be reduced to 0% (½ mark) (or 15% (½ mark) if HMRC prompt the disclosure e.g. via a compliance check).

Marney Ltd

The implication is that the errors may be deliberate (½ mark), with the amended invoice also being a 'concealed' (½ mark) error. The minimum and maximum penalties (as a percentage of potential lost revenue) for these are as follows:

Type of error	Minimum penalty (unprompted)	Minimum penalty (prompted)	Maximum penalty
Deliberate error (twice processed invoices)	20% (½ mark)	35% (½ mark)	70% (½ mark)
Deliberate and concealed error (amended invoice)	30% (½ mark)	50% (½ mark)	100% (½ mark)

It appears that the directors of Marney Ltd will only disclose the errors if prompted by an HMRC visit so the minimum penalties will be 35% for the twice processed invoices, and 50% for the amended invoice.

(Maximum 9 marks)

2) Notes of Criminal Finances Act 2017

The offence of failing to prevent the facilitation of tax evasion occurs when:

- Criminal tax evasion (by any person) has taken place (in relation to any UK or foreign tax) (1 mark)
- A person associated with the entity has criminally facilitated the tax evasion while performing services for that entity; and (1 mark)
- The entity has failed to put in place (and document) reasonable, proportionate procedures to prevent an associated person from committing the tax evasion facilitation offence. (1 mark)

The offence is punishable by unlimited fines and the publication of the conviction. (1 mark)

(4 marks)

Total (13)

16.

1) Option 1

Omit from calculation:

- £3,000 monthly salary; (½ mark)
- £20,000 loan income; (½ mark)
- £15,000 receipt from capital equipment. (½ mark)

Registration date:

Income for 12 months to end of October 2021 = £48,000 (£4,000 per month x 12)
For each subsequent month deduct £4,000 and add £9,000.

Cumulative income at end of:

November	=	£53,000
December	=	£58,000
January	=	£63,000
February	=	£68,000
March	=	£73,000
April	=	£78,000
May	=	£83,000
June	=	£88,000 (1 mark)

Registration limit exceeded by 30 June 2022 and therefore registration required from 1 August 2022. (½ mark)

Option 2

Omit from calculation:

- £15,000 start-up grant. (½ mark)

Registration date:

Income for 6 months to end of April 2021 = £36,000 (£6,000 per month x 6)
For each subsequent month add £9,000.

Cumulative income at end of:

May	=	£45,000
June	=	£54,000
July	=	£63,000
August	=	£72,000
September	=	£81,000
October	=	£90,000 (1 mark)

Registration limit exceeded by 31 October 2021 and therefore registration required from 1 December 2021. (½ mark)

Option 3

Forward look test.

At 1 November 2020, Stella expects to receive £100,000 within the next 30 days, (1 mark) therefore registration required from start of 30 day period (1 mark) which is 1 November 2020. (1 mark)

Option 4

Omit from calculation:

-£50,000 share sale. (½ mark)

Income is then £12,000 per month. Income after 7 months is £84,000 and after 8 months is £96,000.

Therefore registration limit is exceeded after 8 months which is 30 June 2021 (1 mark) and registration is required from 1 August 2021. (½ mark)

(10 marks)

2) Advantages of voluntary registration:

You avoid accidentally exceeding the registration date later and/or have no need to monitor monthly income. (½ mark)

You can reclaim input tax on purchases. (½ mark)

A VAT registration can give the appearance that there is substance to your business. (½ mark)

Disadvantages of voluntary registration:

You have to complete VAT returns and comply with deadlines. (½ mark)

You may need to pay someone to complete the returns for you. (½ mark)

Your products will be more expensive if you are selling direct to private consumers. (½ mark)

(Maximum 2 marks, ½ mark each)

(Maximum 12 marks)