

THE ASSOCIATION OF TAXATION TECHNICIANS

ATT PAPER 6 VAT

May 2023

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- A maximum of two marks will be awarded for the quality of presentation in Part II.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

PART I

1. Becky owns a small toy shop on the High Street in Exeter and has been accounting for VAT under the flat-rate scheme (FRS) for many years. For the quarter ended 31 March 2023, she has the following income and expenses:

	<u>VAT exclusive</u>	<u>VAT</u>	<u>VAT inclusive</u>
<u>Income</u>	£	£	£
Sale of toys	123,333	24,667	148,000
Bank interest	2,000	n/a	2,000
<u>Expenses</u>			
Electricity	1,500	300	1,800
Purchase of toys	800	160	960
Laptop (exclusively for business use)	2,200	440	2,640

Calculate, with supporting explanations, the VAT due for quarter ended 31 March 2023. The flat-rate percentage for this type of business is 7.5%. (4)

2. 'Fur Babies England' is a VAT-registered cat rescue charity which has recently opened a café and gift shop to raise funds for its cat rescue operation. It sells the following items:

- 1) Cat calendars.
- 2) Books about cats.
- 3) Gluten-free chocolate cake to take away.
- 4) Bottles of water to drink inside the café.
- 5) Cat magazines.
- 6) Greeting cards.
- 7) Cheese and tomato baguettes to eat inside the café.
- 8) Gingerbread cats covered in chocolate to take away.

State the VAT liability of each of the above items. (4)

3. Scandley Good manufactures and sells candles within the UK and is registered for VAT. It used to source all the raw materials for the candles from within the UK, but recently it has signed contracts with manufacturers overseas. Scandley Good will import large volumes of soy wax from China on a regular basis. It will be responsible for clearing the goods through Customs and paying any VAT and duties due. Scandley Good does not wish to pay VAT at the time of importation.

Explain the options available to Scandley Good for paying the import VAT due and how this may be recovered as input tax. (4)

4. Chris specialises in the sale of English sparkling wine and has business and private customers across the globe. All wine is dispatched from Chris's warehouse in High Wycombe (GB) to the customer under DAP (Delivered at Place) Incoterms.

Chris made the following supplies in the last VAT period:

- 1) 50 cases to a restaurant in the USA.
- 2) 24 bottles to an individual residing in France.
- 3) 50 cases to a retailer in Northern Ireland.
- 4) Wine consultancy services to a restaurant group in Norway (delivered by email).

State the UK VAT treatment of each of the supplies above. (4)

5. Sarah started a new dog walking and dog training business in March 2018. HMRC registered the business for VAT on a calendar quarterly submission stagger, with effect from 1 March 2021. The business was so successful that Sarah took on two more employees in April 2021. In April 2023 Sarah realised that she had accidentally omitted all the sales made by her two new employees in her quarterly turnover for VAT purposes. Sarah cannot adjust her current VAT return for the historic under-declared output VAT and will instead need to notify HMRC.

Sarah tried to look back through her records and old VAT returns to re-check all the figures that she had submitted to HMRC since the date of VAT registration, but realised that she had only saved her spreadsheets – documents such as purchase invoices had all been thrown away and not saved electronically.

Explain the process for Sarah to notify HMRC of the undeclared VAT, including the information to be provided. State the applicable time limits for notifying HMRC of the undeclared VAT and for retaining VAT records. (4)

6. Jacob obtained some tax advice relating to the VAT liability of his consultancy supplies. Unfortunately, this revealed that he has been erroneously treating his supplies as zero-rated when they were standard-rated. Jacob also omitted some purchases due to poor accounting systems. A week later he received a letter from HMRC announcing that they intend to carry out a VAT visit on his business. As it was clear that HMRC would discover this error during the visit Jacob sent a disclosure letter to HMRC before the scheduled visit. He then fully cooperated with all HMRC's subsequent information requests.

His income and expenditure for the years in question were as follows and none of the VAT on this was included on the VAT returns submitted to HMRC historically:

	<u>20/21</u>	<u>21/22</u>	<u>22/23</u>
	£	£	£
Sales	120,000	130,000	155,000
Purchases (exclusive of VAT at 20%)	15,000	5,000	18,000

Jacob is entitled to recover all the VAT incurred on his purchases.

Calculate the maximum and minimum penalty that HMRC could impose. (4)

7. Brexerton Hall is a VAT-registered country estate in Dundee comprising a large house with extensive gardens and a number of further buildings including holiday cottages. The whole estate extends to 200 acres. There is no option to tax on any of the land or buildings.

In the last VAT period, it received the following VAT-inclusive income:

	£
1) Letting holiday cottages for seven nights at a time to holidaymakers.	375,000
2) Admission to the House and Garden.	630,000
3) Pheasant shooting days including hospitality.	72,000
4) The grant of grazing rights (with no responsibility for the welfare of the animals) to local farmers.	12,000

Calculate the output tax due to HMRC for items 1) to 4) above. (4)

8. Zak received an input VAT assessment from HMRC for £10,000 on 1 May 2022. The letter states that Zak was not entitled to deduct this amount of input tax as it was not for business purposes. Zak disagrees with this.

Explain the options available to Zak to challenge HMRC's decision including applicable time limits. (4)

9. "ElectraCity" is a VAT-registered UK company specialising in the manufacture of air fryers.

The company has just received an order from a UK retailer for air fryers totalling £10 million. ElectraCity wants to offer the retailer a 2% prompt payment discount but is unsure whether it will be taken up. It has not yet raised the invoice to the retailer.

Explain the two methods ElectraCity could use to account for VAT, assuming the retailer does pay promptly and thereby takes advantage of the discount. (4)

10. Mohamed makes only standard-rated supplies for VAT purposes. He applied to cancel his VAT registration and HMRC duly sent him his final VAT return for the period 1 October – 15 December 2022.

In that period Mohamed made the following sales and purchases:

<u>Sales</u>	£
Sale of copyright	35,000
Sale of stock	5,000
<u>Purchases</u>	
10 boxes of luxury chocolates to loyal customers	1,800

There were also the following business assets on hand at the date of deregistration:

	<u>Market value</u>
	£
Patent	100,000
Computer (bought from a non VAT-registered business)	300
Unsold stock	8,000

All amounts are shown exclusive of VAT.

Calculate the VAT liability (box 5 figure) on Mohamed's final VAT return. Show your treatment of each item. (4)

PART II

Presentation skills – awarded for quality of presentation.

(2 marks)

11. Lisa has bought some land on which there is a farmhouse, an old farm worker's cottage and a barn which was used for storing farm equipment. The farmer lived in the farmhouse until just before the sale, but the cottage has been unoccupied for 15 years. Lisa will convert the farmhouse into two apartments which will then be sold as a freehold. The cottage, which is in a poor state of repair, will be restored and redecorated and then sold as a freehold. The barn will be converted into an office space from which she will run her business.

Lisa has appointed an architect to provide designs for the project and is about to appoint a building company to do the building work.

Lisa, who is currently renting an office, is worried that the builder may not complete the work on time. She is therefore going to add a liquidated damages clause to the contract. She is unsure whether to set the value of damages at an amount equal to the extra rent she will have to pay if the work is completed late or to set a much higher amount to ensure that there is enough incentive to complete the contract on time.

Requirements:

- 1) **Explain what the VAT liability will be of the services of the architect and the builder for the works done on each of the buildings.** (6)
- 2) **Explain whether Lisa will be able to reclaim any input tax on the services she buys.** (6)
- 3) **Explain what liquidated damages are and how the courts are likely to deal with the two alternative amounts, if the contract with the builder is disputed.** (3)

Total (15)

12. Riz owns an art gallery in Birmingham. His income comes from the sale or hire of artwork, entry fees to art exhibitions in the gallery and from providing customers with estimates of the value of pieces of art which they own. He has also just set up an online shop where it is possible to download digital copies of the artwork in the gallery.

Now that the online shop has been set up, Riz has found that there are a number of customers based outside the UK who are interested in his work and the valuation service he provides. As he is unsure of how to treat the VAT on these sales, he has provided you with a sample of transactions to advise on. These are the following:

- 1) Sale of digital downloads to private individuals and businesses.
- 2) Hire of a painting to a private customer who will show the painting in their home in Japan for six months and then for three months in their holiday home in the UK.
- 3) Sale of the service of valuing a painting to private customers and businesses which Riz does in his gallery in Birmingham.

In addition to the above, another gallery owner based in Spain has asked Riz if he would like to run an exhibition in Spain. Riz would hire space in the gallery and would then collect income by selling tickets to view the exhibition. Tickets are likely to be sold to a mixture of private individuals and businesses. Riz will eat in restaurants whilst he is in Spain and will hire a car for the two weeks that he is there.

The Spanish gallery owner has also asked if he can hire Riz's gallery so that he can run an exhibition in the UK. In return for this he will give Riz half of any income he gets from ticket sales.

Requirements:

- 1) **Explain what is the place of supply of the services provided by Riz including the digital downloads, hire, valuations, tickets sales for the exhibition in Spain and share of income from ticket sales in the UK.** (10)
- 2) **Explain what is the place of supply of catering and car hire provided to Riz while he is in Spain.** (2)

Total (12)

13. Trinkets and Tat is a VAT registered gift shop. All the items that it sells are liable to VAT at 20%. The owner has contacted you with the following email.

To: Adviser,T@vat.co.uk

Subject: New transactions

Hello tax adviser

The last quarter has been quite unusual and I have a number of new scenarios that I would like your advice on please.

Burglary

Last month there was a burglary at the shop. They stole £1,000 cash from the till and goods which cost £1,500 plus VAT but which would have sold for £3,000 plus VAT. The burglary caused quite a lot of damage. The insurance company have said that they will pay for lost income and also for the cost of fixing the damage. How should I deal with the stolen money and goods, and also the payment from the insurance company when it arrives?

Free gifts and promotions

One of my regular customers was so upset by the burglary that they collected some money and gave me a donation of £500. As a thank you I gave them a really nice necklace from the shop. It cost £80 plus VAT and would have sold for £100 plus VAT.

I had to close the shop for a week while the damage was repaired. When I re-opened, I gave the first 20 customers a mug. The mugs cost £3 plus VAT each and would have sold for £4 plus VAT.

The mugs were very popular and I have now decided that I will also give a free mug to anyone who spends more than £100 in the shop.

Do I need to make any VAT adjustments for any of the above items?

Vouchers

I have also started to sell £5 vouchers which can only be used to buy items in my shop. The vouchers sell for £4.80 each but can be used to buy £5 worth of goods. Do I need to declare VAT when I sell the vouchers or when they are exchanged for goods and what value should I declare?

Expenses

Finally, I recently visited Paris to look at some pottery I was thinking of buying for the shop. In the end I decided not to buy any. I may be able to find invoices for the cost of the hotel in London, where I stayed before I got the early train to Paris, train fares to London and Paris and the cost of the hotel in Paris. Can I reclaim the VAT on these items on my VAT return even though I did not buy any pottery to sell?

Please could you reply before the end of the week as I need to prepare the VAT return in good time. Your last advice was a little bit late and I do not want to have to make a complaint.

Best wishes

Chelle

Requirements:

- 1) **Write an email to Chelle answering the questions in each section of her email about the correct VAT treatment of the points she raises, which are:**
 - a) **the items described in the 'burglary' section;** (3)
 - b) **the donation and gifts;** (4)
 - c) **the timing and value of voucher transactions; and** (2)
 - d) **input VAT on the costs incurred on the Paris trip.** (3)
- 2) **State six key features of the client complaints procedure that you should have, as recommended by Professional Rules & Practice Guidelines (PRPG).** (3)

Total (15)

14. HJ Storage Ltd owns a building where people can store their goods. For additional charges, the company also offers services of transporting the goods to the storage facility and providing packaging materials. The charges for all of these are standard rated. HJ also offers optional insurance to customers, the details of which are set out in a brochure which HJ provides to potential customers. This is a separate supply of exempt insurance.

In the year ended 31 March 2023, HJ had taxable income of £937,000 (VAT exclusive) and exempt income of £63,000. It had the following costs:

	<u>Net</u> £	<u>VAT</u> £
Rental of building	400,000	80,000
Purchase and maintenance of vans for transporting goods to the store	120,000	24,000
Office running costs	40,000	8,000
Design fees for brochure about insurance product	40,000	8,000
Electricity	30,000	6,000
Packaging materials for sale to customers	12,000	2,400
Audit fees	10,000	2,000

The building is separated into two areas. The floor space of the largest part of the building, where the customers' goods are stored, is 90,000m² and that of the office space is 500m². It has been agreed with HMRC that the space relating to the storage of goods is wholly used for taxable activity and that the office space is used for both taxable and exempt activity.

HJ currently uses the standard method for its partial exemption calculation. HJ's advisers have suggested that HJ could use a special partial exemption method. Using this method, the amount of reclaimable non-attributable input tax would be determined using a two-step calculation.

In step 1, all non-attributable input tax would first be allocated to taxable use by the formula:

floorspace wholly used for taxable activity/total floorspace x non-attributable input tax.

In step 2, non-attributable input tax which has not been allocated to taxable use as calculated in step 1 would then be subject to a further calculation in which more of that input tax is allocated to taxable use by the formula:

taxable income/total income x remaining non-attributable input tax.

The total reclaimable VAT will be the amounts allocated to taxable use in step 1 and 2 plus any input tax directly attributed to taxable use.

Requirements:

- 1) Calculate how much input tax HJ can claim using the standard method. (Do not apply de minimis tests.) (5)
- 2) Calculate how much input tax HJ would claim if its special method was approved. (4)
- 3) Explain what HJ should do to apply for a new special partial exemption method and from what date this would normally be effective. (5)
- 4) Explain how HJ should show recoverable and irrecoverable input tax in its financial statements for operating costs and asset purchases. (2)

Total (16)