



## **May 2023 Examination**

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### **PAPER 6**

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### **VAT**

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#### **Part I Suggested Answers**

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*Candidates will be given credit for relevant points not on the mark scheme.*

1. Flat-rate turnover is the VAT inclusive amount of £148,000, as bank interest is excluded (1/2)

When calculating 'relevant goods' the laptop is excluded. Electricity and purchases of toys are regarded as relevant goods and their VAT-inclusive total is £2,760 (1/2). This is less than 2% of flat-rate turnover (being £2,960) so Becky is regarded as a limited cost trader (1/2). The flat-rate percentage is therefore 16.5% and not 7.5% (1/2).

Output VAT: £24,420 (148,000 x 16.5%) (1/2)

As the VAT inclusive cost of the laptop exceeds £2,000 the input tax can be reclaimed (1/2)

Input VAT: £440 (1/2)

VAT liability = £23,980 (1/2)

2.

- 1) Cat calendars are standard-rated (1/2)
- 2) Books about cats are zero-rated (1/2)
- 3) Gluten-free chocolate cake to take away is zero-rated (1/2)
- 4) Bottles of water to take away are standard-rated (1/2)
- 5) Cat magazines are zero-rated (1/2)
- 6) Greeting cards are standard-rated (1/2)
- 7) Cheese and tomato baguettes to eat inside the cafe are standard-rated (1/2)
- 8) Gingerbread cats covered in chocolate to take away are standard-rated (1/2)

3. 4 marks (4.5 marks available)

There are two options for Scandley Good to defer the import VAT:

- I) Postponed VAT accounting (PVA), and (1/2)
- II) Payment using a deferment account (1/2)

PVA operates by including the import VAT as output tax (1/2) and including the same as input VAT on the same VAT return, subject to the usual rules for input VAT recovery (1/2). The monthly postponed import VAT statement is the supporting evidence for input VAT recovery (1/2).

Alternatively, a regular importer such as Scandley Good can defer the import VAT and duty until the 15th of the following month by setting up a deferment account (1/2). This will require a bank guarantee (1/2) which can be reduced if the company qualifies for Simplified VAT accounting (SIVA) (1/2). The C79 certificate, issued by HMRC, is needed to support input VAT recovery. (1/2)

4.

- 1) Zero-rated (1)
- 2) Zero-rated (1)
- 3) Standard-rated (1)
- 4) Outside the scope of UK VAT (1)

5. Max 2 marks from the first section below (3 marks available)

Sarah will need to submit an 'error correction notification' or 'voluntary disclosure' or VAT 652 (1/2) to HMRC.

Sarah should provide a description of the inaccuracy (1/2), the full amount of the inaccuracy (1/2) and explaining how and why the inaccuracy arose (1/2).

The disclosure should detail the VAT accounting period in which the error occurred (1/2) and show the under-declared output VAT for each VAT period (1/2).

Other relevant details will also be given credit.

1 mark

The disclosure should be made immediately after discovered but within 4 years of the end of the prescribed accounting period in which the under-declared output VAT occurred (1) i.e. 30 June 2025.

1 mark

VAT records should be retained for 6 years (1).

6. VAT due on income = £67,500 ( $1/6 \times 405,000$ ) (1/2) or £81,000 ( $20\% \times 405,000$ ) (1/2)

Less input tax = £7,600

Potential Lost Revenue (PLR) = £59,900 (1/2) or £73,400 (1/2)

This was a prompted disclosure (1/2) of a failure to take reasonable care (1/2)

Maximum penalty is 30% of PLR (1/2) which is £17,970 (1/2) or £22,020 (1/2)

Minimum penalty is 15% of PLR (1/2) which is £8,985 (1/2) or £11,010 (1/2)

Any sensible points arguing that the disclosure was actually unprompted, with the correct applicable penalty percentages, will also be given credit.

7.

1. £375,000  $\times$  1/6 = £62,500 (1) (standard-rated supply)
2. £630,000  $\times$  1/6 = £105,000 (1) (standard-rated supply)
3. £72,000  $\times$  1/6 = £12,000 (1) (standard-rated supply)
4. £0 (1) (zero-rated supply)

8. Zak can request HMRC for a review (1) of its decision. This should be done within 30 days of receiving the assessment (the appealable decision) (1/2). HMRC then have 45 days to respond (1/2). If Zak is not happy with the outcome then he can appeal to the First-tier Tribunal within 30 days of HMRC's response. (1/2)

Alternatively, Zak can appeal directly to the First-tier Tribunal (1) within 30 days of receiving the assessment (1/2).

Credit will also be given if candidates mention that costs are not normally awarded at First-tier Tribunal so it may be better for him to request the HMRC review first.

9. ElectraCity does not know whether the retailer will take up the discount so the invoice must show the full amount i.e. £10 million plus VAT (1/2).

If the retailer does pay promptly ElectraCity could:

- 1) issue a credit note to evidence the reduction in consideration (1); or
- 2) include on the original invoice the terms of the prompt payment discount (1/2), the time by which the discounted price must be paid (1/2) and a statement that the customer can only recover as input tax the VAT paid to the supplier. (1/2)

If the discounted price is paid in accordance with the prompt payment discount ElectraCity must account for VAT on the amount actually received. (1)

10.

**Output VAT on sales**

Copyright: VAT = £7,000 (20% x 35,000) (1/2)

Sale of stock: VAT = £1,000 (20% x 5,000) (1/2)

Total = £8,000

**Input VAT on purchases**

Input VAT = £0; chocolates exceed the £50 gift limit so no input tax should be deducted. Credit will be given if input tax is deducted but with a corresponding output tax charge (1/2)

**VAT on assets on hand**

Patent - intangible assets are services and no VAT is due (1/2)

Computer - no input VAT was recovered on the purchase so no output VAT due (1/2)

Stock - VAT = 1,600 (20% x 8,000) (1/2)

Box 5 = £9,600 (8,000 + 1,600) (1)



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#### **Part II Suggested Answers**

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*Candidates will be given credit for relevant points not on the mark scheme.*

## 11. (15 marks)

### 1) (6 marks)

The services of the architect will be subject to VAT at the standard rate for all the buildings (1 mark).

For the builder, the construction works for the farmhouse will be charged at the lower rate of VAT (5%) (1 mark) as there is a changed number of dwellings (1 mark). The renovation of the cottage will also be charged at the lower rate of VAT (1 mark) as the house has been empty for more than 2 years (1 mark) and therefore qualifies as the renovation of empty residential premises (1/2 mark). Construction works for the barn which will be used as an office will be subject to VAT at 20% (1/2 mark).

### 2) (6 marks)

The sale of the apartments in the farmhouse will be exempt from VAT (1 mark) and any input tax attributed to these works will not be recoverable (1/2 mark). The sale of the cottage will be zero rated as the first grant of a non-residential conversion (1 mark) as the building was empty for 10 years (1 mark) before the building was renovated. Any input tax attributable to these works will be recoverable (1/2 mark). Any input tax attributable to the barn conversion will be recoverable subject to the input tax recovery available to the business (1 mark). Non-attributable input tax will need to be apportioned using a partial exemption calculation. (1 mark).

### 3) (3 marks)

Liquidated damages are an amount of damages agreed between parties to a contract as a term of the contract. (1 mark) If Lisa bases the amount on an estimate of likely loss such as any additional rent due, then they are likely to be upheld if the contract is disputed (1 mark). However, if they have no basis of calculation and bear no relation to losses suffered, then they may be considered to be punitive and are much less likely to be upheld in court (1 mark).

## 12. (12 marks)

### 1) (11 marks available – 10 marks max)

The sale of digital downloads is an electronically supplied service. (1 mark) Where this is provided to an individual the place of supply is where the customer is based (1 mark). If supplied to an overseas business, then it is outside the scope of VAT unless used and enjoyed in the UK.. (1 mark)

The hire of goods is supplied where the goods are used and enjoyed (1 mark). The hire of the painting to the customer in Japan will be supplied in Japan whilst they are shown in the residence there (1/2 mark) and in the UK whilst shown in the holiday home (1/2 mark).

The supply of valuation services falls under the general rule for services for supplies to businesses so the place of supply will be where the business belongs (1 mark). If the customer is a private individual, the supply is regarded as work on goods and takes place where the work is physically carried out which will be the UK. (1 mark)

Ticket sales for the exhibition will be regarded as admission to an event (1 mark) and will be supplied in Spain where the exhibition takes place regardless of whether the customer is a business (1/2 mark) or an individual (1/2 mark).

Income from a share of the ticket sales in the UK is payment by the Spanish gallery owner for use of the gallery in Birmingham. This is a land related supply of services (1 mark) and the place of supply is therefore where the land is situated which is the UK (1 mark).

### 2) (2 marks)

The provision of catering services is where the catering is physically carried out in Spain (1 mark) and the short-term hire of a car is supplied where the vehicle is put at the disposal of the customer, also in Spain (1 mark).

### 13. (15 marks)

To: Chelle@tat.co.uk

Subject: VAT advice

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Dear Chelle,

Thank you for your e-mail. I am responding below to your questions in the order you have raised them.

#### 1) (a) (3 marks)

Burglary

When you have sold items and the cash from the sale is subsequently stolen, you do still need to account for the VAT on the cash in the till as you have (before the theft) made a supply for consideration. **(1 mark)** Where goods are stolen prior to a sale being made, you do not need to account for VAT as no supply has been made. **(1 mark)** The payment from the insurance company is outside the scope of VAT as it is a compensation payment. **(1 mark)**

#### 1) (b) (4 marks)

Free gifts and promotions

The donation of £500 is not consideration for any supply as it was not given in expectation that the necklace would be given in return **(1/2 mark)** and is therefore outside the scope of VAT. **(1/2 mark)** The necklace should be treated as a business gift and as its value exceeds £50 **(1/2 mark)**, then output tax should be declared on the £80 cost of the vase **(1/2 mark)**.

The free mugs given to returning customers are also business gifts. However, no output tax is due as the cost of each item is less than £50. **(1 mark)**.

Mugs given to customers spending more than £100 are treated as being part of the supply alongside the other items purchased by the customer **(1/2 mark)**. No additional output tax is due **(1/2 mark)**.

#### 1) (c) (2 marks)

Vouchers

As all the items for sale in the shop are subject to VAT at 20%, the vouchers are described as single purpose vouchers **(1/2 mark)**. VAT is due on the selling price of the voucher ie £4.80 at the time it is sold **(1 mark)**. No further adjustment is needed when the voucher is exchanged for goods as you are the seller of the voucher and know at what price it was sold **(1/2 mark)**.

#### 1) (d) (4 marks available, 3 marks max)

Expenses

Input tax can be reclaimed even if a project does not result in making taxable supplies provided that there was an intention to make taxable supplies **(1 mark)**. Input tax can be reclaimed on the hotel stay in London, **(1/2 mark)** provided you hold sufficient evidence **(1/2 mark)**, but there is no VAT on train fares **(1/2 mark)**. and French VAT from the Paris hotel cannot be reclaimed on a UK VAT return **(1/2 mark)**. There is a process for claiming overseas VAT **(1/2 mark)**. but this generally excludes costs such as hotels and is unlikely to be worth the amount involved **(1/2 mark)**.



**2) (3 marks)**

A complaints procedure should include the following features:

Setting out details of how to complain in an engagement letter;

Advising new clients in writing of the name and status of the person to be contacted in the event of the client wishing to complain about the services provided;

Advising of the ability to complain to the Tax Disciplinary Board or an alternative form of dispute resolution;

Acknowledging each complaint promptly in writing;

Investigating each complaint thoroughly and without delay.

Conducting investigations by a person of sufficient experience, seniority and competence who preferably was not directly involved in the act or omission giving rise to the complaint;

Advising the client about the investigation;

Taking appropriate action if the investigation finds that the complaint is justified in whole or in part;

Considering whether to inform the firm's professional indemnity insurers. **(1/2 mark each – max 3)**

14.

1) Standard method calculation

Taxable sales/Total sales = £937,000/£1,000,000 (1/2 mark) = 93.7% (1/2 mark) rounded to 94% (1/2 mark)

Taxable input tax	Exempt input tax	Non-attributable
24,000 (vans)	8,000 (brochure design)	80,000 (rent)
2,400 (packaging)		8,000 (office costs)
		6,000 (electricity)
		2,000 (audit)
26,400 (1/2 mark)	8,000 (1/2 mark)	96,000 (1 mark)

Non-attributable input tax allocated to taxable use = £96,000 x 94% = £90,240(1/2 mark)

Total reclaimable = £90,240 + £26,400 (1/2 mark)= £116,640 (1/2 mark)

2) (4 marks)

Special method calculation

Non-attributable input tax = £96,000 (see previous calc) (1/2 mark)

Taxable floor space/ total floor space = 90,000 m<sup>2</sup> / 90,500 m<sup>2</sup> (1/2 mark) = 99.45% (1/2 mark)

Rounding to the nearest whole number is not available in a special method. (1/2 mark)

Step 1 first allocation of non-attributable tax to taxable = £96,000 x 99.45% = £95,472 (1/2 mark)

Step 2 second allocation of non-attributable tax to taxable = (£96,000 – £95,472) x £937,000/£1,000,000 = 528 x 93.7% (1/2 mark)= £495 (1/2 mark)

Total reclaimable input tax = £26,400 + £95,472 + £495 = £122,377 (1/2 mark)

3) (5 marks)

To apply for a new partial exemption special method, HJ will need to write to HMRC or use the online application to ask for approval for the new method (1 mark). The application will need to include a clear explanation of how the method will work (1 mark) and a declaration that the method is fair and reasonable (1 mark). HJ will need to provide a worked example of how the method will work (1 mark). A method will normally be approved from any of the date of the application, the start of the tax year or a future date. (1 mark).

4) (2 marks)

Reclaimable VAT for both operating costs and asset purchases is posted to the VAT control account as a debtor.(1 mark) For operating costs, the irrecoverable VAT is shown as an expense in the Profit and Loss Statement (1/2 mark) whereas for assets, the irrecoverable VAT is added to the asset value (1/2 mark).