



## **May 2018 Examination**

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**PAPER 6**

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**VAT**

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Part I Suggested Answers

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Q1 (3 marks)

The first return paid late will receive no penalty, but a default will be recorded. **(1 mark)**

The second late payment will be subject to a surcharge of 2% **(½ mark)** and the third will be subject to a surcharge of 5% **(½ mark)**.

The surcharge penalty due on the late payment of the April 2018 return will be £10,000 - £4,000 = £6,000 x 10% = £600. **(1 mark)**

Q2 (4 marks)

Refer to paragraph 4, Schedule 1, VATA 1994

1) A taxpayer can deregister for VAT if they can demonstrate that their taxable turnover in the next 12 months will not exceed £83,000. **(1 mark)**

Expected turnover for the 12 months following each of the first few months in 2018 is as follows:

Month	January	February	March	April	May
Expected income in next 12 months (£)	114,000	104,000	94,000	84,000	77,000

**(1 mark)**

Therefore Ben could deregister from 1 May 2018. **(1 mark)**

2) If Ben intends to cease trading altogether then he will be unable to deregister until he has ceased trading. **(1 mark)**

Q3 (4 marks ½ mark each)

Refer to Group 1, Schedule 8, VATA 1994

- 1) Sandwiches for consumption on the premises                      Standard rated (catering) **(½ mark)**
- 2) Cups of hot soup for take away                                      Standard rated (hot take away food) **(½ mark)**
- 3) Sandwiches for take away    Zero rated (cold take away food) **(½ mark)**
- 4) Chocolate bars    Standard rated (excepted item) **(½ mark)**
- 5) Bottled water    Standard rated (excepted item) **(½ mark)**
- 6) Canned pet food     Standard rated (pet food) **(½ mark)**
- 7) Hay for horses and ponies    Zero rated (animal food) **(½ mark)**
- 8) Vegetable plants     Zero rated (live plants producing food) **(½ mark)**

Q4 (4 marks)

Output tax due is

$£25,800 \times 1/6 = £4,300$  (½ mark)

$£400 \times 1/6 = £67$  (1 mark) (output tax remains due because the items were supplied for consideration even if the cash was later stolen) (½ mark)

$£4,600 \times 1/6 = £767$  (1 mark)

(VAT is due on the gross amount; the deduction by the credit card company represents a separate supply by them). (½ mark)

Total output VAT = £5,134 (½ mark)

Q5 (4 marks)

1) VAT due under flat rate scheme =  $£12,000 + £6,300 + £8,000 = £26,300$  (1 mark)  $\times 9.5\% = £2,498$  (½ mark)

VAT due under normal accounting rules =  $£2,000 + £300 - £1,200 = £1,100$  (1 mark)

Therefore no financial benefit is gained from using the scheme in this quarter. (½ mark)

2) Where a business undertakes two different activities, the appropriate flat rate scheme is the one which is correct for the activity with the largest turnover. (1 mark)

Q6 (4 marks)

Refer to s43 VAT 1994

Problema S.R.L. cannot be included in any group registration as it is not based in the UK. (1 mark)

Conundrum Ltd and Dilemma Ltd cannot form a VAT group as the registrable entity would have no taxable supplies. (1 mark)

Conundrum Ltd, Dilemma Ltd and Complication Ltd could form a group as they are all controlled by the same entity. (1 mark)

Dilemma Ltd and Complication Ltd could form a VAT group as they are both controlled by the same entity. (1 mark)

Conundrum and Complication Ltd could form a VAT group as one controls the other. (1 mark)

**(Maximum 4 marks)**

Q7 (3 marks)

The vacuum cleaner used to clean the shop is put to taxable business use and no VAT adjustment is therefore required. **(1 mark)**

The wholly owned company is a connected party which cannot reclaim input tax in full. Therefore VAT should be declared on the open market value of the cleaner which, based on the other sales made, would be £150. **(1 mark)**

Where a business asset is transferred for no consideration, VAT should be declared on the cost of acquiring the asset and the vacuum cleaner given as a gift should therefore have a VAT charge calculated on the purchase price of £100. **(1 mark)**

Q8 (3 marks)

Where a company car has private mileage, a fuel scale charge, based on the CO<sub>2</sub> emissions of the car is used to calculate the output tax due in respect of the private use of the car. This output tax due would be calculated as follows:

Car A:	£211	<b>(½ mark)</b>
Car B:	$£252 \times 1/3 =$	<b>£84 (½ mark)</b>
Car C:	$£295 \times 2/3 =$	<b><u>£197</u> (½ mark)</b>
Total due	$£492 \times 1/6$	<b>(½ mark) = £82</b>

½ mark for not apportioning re business/private mileage.

½ for not adjusting the input tax recovery.

Q9 (3 marks)

- 1) For the computer imported from the United States, VAT will be payable by the importer (William Doors) at the point of entry into the UK. **(1 mark)**

For the computer purchased from France, VAT will be payable via an acquisition tax charge which William Doors will need to declare in Box 2 of his VAT return. **(1 mark)**

- 2) In order to reclaim input tax on the import, William will need a C79 form. **(1 mark)**

Q10 (3 marks)

Refer to Group 15, Schedule 8, VATA 1994

The design fees and magazine/newspaper charges both fall within the zero rating for charity advertising. **(1 mark)**

The management of the advertising campaign does not qualify as it is neither an advert nor the design/production of one. **(1 mark)**

The advert to existing supporters does not qualify for zero rating as adverts sent to selected individuals or groups are excluded from the relief. **(1 mark)**

Q11 (3 marks)

Refer to Group 6, Schedule 7A, VATA 1994

The construction services relating to the ground floor will be standard rated as the number of dwellings on this floor remains the same. **(1 mark)**

As the number of dwellings on the second and third floor will change, the construction services relating to these parts of the building will be subject to reduced rate VAT. **(1 mark)**

Fees such as architects are excluded from the definition of construction services and will therefore be subject to VAT at the standard rate. **(1 mark)**

Q12 (2 marks)

The Principal VAT Directive is the VAT legislation of the European Union. **(1 mark)**

It establishes a framework of rules which member states must implement into their own legislation. **(1 mark)**

A taxpayer is entitled to rely on the direct effect of the Directive where the rule established by the directive is clear and a member state has failed to reflect that in its own implementing legislation. **(1 mark)**

**(Maximum 2 marks)**



## **May 2018 Examination**

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Part II Suggested Answers

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1.

Accountant Firm  
Road  
Town

Siobhan Smith  
Cookery School  
Road  
Town

Date **(1 mark – presentation, including sign off)**

Dear Ms Smith

Further to my conversation with Sarah Lynn I write to provide you with some background on how to calculate her recoverable input tax.

### Principles

VAT incurred on costs which are wholly attributable to making a taxable supply, such as sales of books and equipment from the shop, is called 'taxable input tax' **(1 mark)**. VAT incurred on costs which are wholly attributable to making an exempt supply, such as the cookery courses, is called exempt input tax **(1 mark)**.

VAT incurred on costs which cannot be wholly attributed to either a taxable or an exempt supply is 'residual input tax' and this must be apportioned between the taxable and exempt elements **(1 mark)**. The default apportionment is based on the standard method. Under the standard method the apportionment is based upon the ratio of taxable to taxable plus exempt income. The recovery percentage is always rounded up to the next whole number **(1 mark)**.

Taxable input tax (i.e. VAT wholly attributable to taxable supplies and the taxable part of the residual input tax) is recoverable in full **(1 mark)**.

Exempt input tax (i.e. VAT wholly attributable to exempt supplies and the exempt portion of the residual input tax) cannot be recovered unless it is de minimis **(1 mark)**. The exempt input tax will be de minimis if it is no more than £625 per month on average and no more than 50% of the total amount of VAT incurred **(1 mark)**.

VAT recovery is calculated each quarter and then, on the final VAT return of the year, an annual adjustment calculation is done **(1 mark)**. The effect of the annual adjustment is to smooth out VAT recovery and ensure that fluctuations in income throughout the year do not distort input tax recovery **(1 mark)**. I have explained how the annual adjustment on the April 2018 return should be done below.

### Annual Adjustment calculation

$$\begin{aligned} \text{Annual Recovery \%} &= \frac{(\pounds 5,000 + \pounds 6,250 + \pounds 4,000 + \pounds 10,000)}{(\pounds 5,000 + \pounds 6,250 + \pounds 4,000 + \pounds 10,000 + 15,000 + 25,000)} \\ &= \frac{\pounds 25,250}{\pounds 65,250} \\ &= 39\% \quad \mathbf{(1 \text{ mark})} \end{aligned}$$

Recoverable input tax for year:

Equipment purchases in April quarter	£600	(1/2 mark)	
Equipment purchase year to date	£2,000	(1/2 mark)	
Total VAT on building costs * 39%	£2,496	(1/2 mark)	(£1,600 + £4,800) * 39%
Total taxable input tax	£5,096	(1/2 mark)	
Total exempt input tax*	£3,904	(1/2 mark)	(£1,600 + £4,800) - £2,496
Total claimable input tax	£9,000	(1/2 mark)	
VAT recovered to date	(£7,500)	(1/2 mark)	
VAT claimable on April return	£1,500	(1/2 mark)	

\*Total exempt input tax is de minimis because it is no more than £625 per month on average and £3,904 is no more than 50% of the total amount of input tax incurred in the year. **(1 mark)**

If you have any questions regarding the above, please do not hesitate to contact me,

Kind regards

Advisor

2.

1)

The tax point will be the earlier of the date a VAT invoice is issued and the date of payment, so the tax point for IT Support Ltd's services will be the date invoices are issued to clients **(1 mark)**.

2)

VAT is payable to HMRC on the tax point of a supply, even if the customer has not yet paid for the supply **(1 mark)**. A bad debt relief claim enables a business to recover VAT paid to HMRC if the invoice is unpaid and certain conditions are met. The conditions for making a claim are:

- VAT must already have been accounted for on the supplies and paid to HM Revenue & Customs **(1 mark)**;
- The debt must have been written off in the day to day VAT accounts and transferred to a separate bad debt account **(1 mark)**;
- The value of the supply must not be more than the customary selling price **(1 mark)**;
- The debt must not have been paid, sold or factored under a valid legal assignment **(1 mark)**;
- Six months must have elapsed since the later of the time payment was due and the date of the supply **(1 mark)**;
- and
- The claim must be made within a period of four years and six months after the later of the time payment was due and the date of the supply. **(1 mark)**

**Max 6 marks**

3)

Under the cash accounting scheme output VAT is only payable to HMRC on sales when invoices are paid rather than according to the normal tax point rules **(1 mark)**. Similarly, VAT can only be recovered on purchases when they are paid for **(1 mark)**. This may benefit IT Support Ltd because it will receive automatic relief for VAT on bad debts **(1 mark)**.

A business is entitled to use cash accounting if it expects that the value of taxable supplies in the next 12 months will be £1.35 million or less **(1 mark)**. As James has this expectation IT Support Ltd would be entitled to use the scheme assuming that other conditions, such as it being up to date with its VAT returns are met **(1 mark)**.



3.

1)

The place of supply of legal services in connection with the sale of the house in Switzerland is Switzerland (**1 mark**). This is a service relating to land and it is supplied where the land is situated (**1 mark**).

The place of supply of legal services in connection with the will of Edward McKenna is Canada (**1 mark**). The place of supply of legal services to a non-business customer based outside the EU is where the customer is resident (**1 mark**).

The place of supply of legal services in connection with Elizabeth McKenna's divorce is the UK (**1 mark**). The place of supply of legal services to a non-business customer based in the EU is where the supplier is established (**1 mark**).

2)

DR Equipment purchase £50,000

DR VAT Control account £10,000

CR Cash/bank £60,000

**2 marks - lose ½ for each mistake**

3)

The engagement letter is used to manage client expectations, provides significant protection to the practitioner and is an important document in any dispute (**1 mark**).

The letter should set out clearly:

- The basis on which fees are charged (**1 mark**)
- The scope and nature of the assignment (**1 mark**)
- And invite the client to agree to this in writing. (**1 mark**)

4)

The two aims of the Data Protection Act 1998 are as follows:

- To give data subject rights over the retention and use of personal data (**1 mark**);
- To ensure that personal data is handled correctly. (**1 mark**)

The principles of data protection seek to ensure that data is (**1/2 mark each to a maximum of 2**):

- Fairly and lawfully processed;
- Only held and processed for limited, specific purposes;
- Adequate, relevant and not excessive for the purpose;
- Accurate and up to date;
- Not kept for longer than necessary;
- Processed in line with the individual's rights;
- Stored confidentially and securely, with systems in place to confirm what data is held about a person if asked; and
- Not transferred outside Europe without adequate protection.

4.

1) The construction of a new residential house is zero rated for VAT purposes **(1 mark)**. Thus, Mr & Mrs Wain do not need to add VAT to the invoices they issue to Mr Littner and, similarly, the labourers they engage to undertake construction work do not need to add VAT to their invoices **(1 mark)**.

2)

Expense	VAT claimable	Reason
Materials for Mr & Mrs Wain's new home	Nil <b>(1/2 mark)</b>	VAT incurred on a non-business expense cannot be recovered through the VAT return. <b>(1 mark)</b>
Materials for Mr Littner's new home (£140,000)	£28,000 <b>(1/2 mark)</b>	VAT incurred on building materials is recoverable because it is a cost component of a zero rated supply. <b>(1 mark)</b>
Kitchen units for Mr Littner's new home (£7,000)	£1,400 <b>(1/2 mark)</b>	Kitchen units are building materials and VAT is recoverable. <b>(1 mark)</b>
Kitchen appliances for Mr Littner's new home	Nil <b>(1/2 mark)</b>	Kitchen appliances are not building materials and are subject to a specific input tax block. <b>(1 mark)</b>
Wardrobes for Mr Littner's new home.	Nil <b>(1/2 mark)</b>	Fitted furniture (other than kitchen units) is not a building material and is subject to a specific input tax block. <b>(1 mark)</b>
Total VAT recoverable	£29,400	
Total VAT recovered	£80,000	
Total VAT repayable to HMRC	£50,600	<b>1/2 mark</b>

3)

HMRC will issue a VAT assessment to recover the £50,600 overclaimed VAT **(1 mark)**. They will also consider assessing for a penalty **(1 mark)**. Mr & Mrs Wain's error would be viewed as a careless error because it arose out of ignorance of the VAT rules not a deliberate attempt to overclaim VAT **(1 mark)**.

As the error has come to light as a result of an inspection visit the penalty percentage applied to the error would be 15-30% **(1 mark)**. Where the penalty sits in this range will depend upon the quality of Mr & Mrs Wain's disclosure to HMRC and their cooperation with the inspection **(1 mark)**. Reductions in the penalty percentage from the maximum are based upon telling HMRC about the errors, helping HMRC work out what extra tax is due and giving HMRC access to records to check the figures **(1 mark)**.

*Comment on Mark Scheme – In line with ATT policy candidates will be given credit for all relevant points made which are not on the mark scheme. In particular, candidates who note that Mr & Mrs Wain could have claimed the VAT incurred on materials for their own home via the DIY housebuilder's scheme will receive marks. However, in order to achieve full marks candidates must recognise that the VAT is not claimable via the VAT return and that penalties for errors like this would be due.*