THE CHARTERED INSTITUTE OF TAXATION

The Chartered Tax Adviser Examination

November 2008

PAPER IID

INDIRECT TAXATION

TIME ALLOWED – 3 HOURS

- You should answer all of the questions.
- Start each answer on a new sheet of paper and write on one side of the paper only.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any relevant legal aspects in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of the answer folder.

1. One of your clients is planning to build a small eight megawatt hydroelectric plant next to a reservoir on his private estate. You are provided with the following information in relation to the construction of the hydroelectric plant and dam:

   1) The construction team is planning to use aggregate extracted from the site to mix with cement and other materials to create the concrete required for the dam.

   2) Tunnels and pipes will be excavated and installed to feed water to the generating plant.

   3) Access roads to the reservoir and generation plant will be constructed using aggregate excavated from the site in the building process without mixing it with any other materials.

   4) Any excess aggregate from the site not used in construction as described above, is going to be disposed of at a former quarry owned by the client.

   The client has also heard that he may be able to obtain more money for selling the output from the plant if he can also sell the energy with associated Levy Exemption Certificates. He would like to understand whether he is eligible for the Levy Exemption Certificates and is also unsure how many he will receive as in some situations the plant may artificially increase the flow rate, height or pressure of the water by pumping.

   You are required to prepare some notes for a meeting with the client to discuss:

   1) The Aggregates Levy and Landfill Tax implications of the construction.

   2) Eligibility for Levy Exemption Certificates.

(10)

2. You are the VAT specialist in a firm of Chartered Tax Advisers. The owner of the practice, Wendy North, specialises in direct tax and has asked for your assistance. You have previously sent her an outline of the current listed schemes and scheme hallmarks and she has now asked you to produce a summary document outlining the key provisions of the VAT Avoidance Disclosure Scheme and how it operates. You should not include details of the current listed schemes and specific scheme hallmarks.

   She has also referred to two live client scenarios that she has come across recently and asked you to comment on them.

   <u>Young Ltd</u>

   Young Ltd is a funeral parlour chain owned by Mr West. It has entered into a leasing agreement for hearses and digging machinery with Cesar Ltd, owned by Mr West's son. Cesar Ltd received a loan from Romero Ltd, a subsidiary of Young Ltd, to purchase the hearses and machinery. The loan was repaid before the first rental was due and the managing director of Young Ltd maintains that the loan was provided purely to assist Cesar Ltd out of a temporary unforeseen cashflow difficulty. Your boss thinks that, as there was no tax avoidance motive, this arrangement should not require disclosure.

Continued

2. *Continuation*

Sparrow plc

Sparrow plc is a betting business with annual turnover of £10 million. Under a deal with an advisory boutique who will share in any consequent VAT saving, it altered its contracts for marketing so that its supplier, Jamaica plc, invoiced an advertising consultancy service without VAT to Turner Ltd, a Guernsey subsidiary of Sparrow plc. Turner Ltd then provided an administration service to the UK parent. Wendy believes the scheme has not been properly implemented so that it does not achieve the desired result and thus does not require disclosure.

You are required to prepare a memo to Wendy North dealing with the above matters. (15)

3. One of your clients, Green Landfill Ltd operates a landfill site. It is registered for Landfill Tax and is up to date with its returns which it makes for calendar quarters. The company estimates that its Landfill Tax liability for the year ended 31 March 2009 will be £1.5 million.

Recently, it has received two requests for financial assistance from local organisations. The first is from an environmental charity, which wants to run a publicity campaign in the area promoting waste recycling in the community. The other is from a non-profit making local conservation group concerned with protection of the environment which plans to provide and maintain a park with free public access on some land two miles from the company's landfill site. Neither organisation has any connection with the company.

The directors consider that a contribution of this sort would enhance the reputation of the company and will discuss the two requests at their next board meeting. It is proposed that a contribution of £30,000 would be made immediately following the end of the company's financial year which is 31 March 2009 to one of the two organisations, provided the company meets its profit forecast.

Mr Brown, the finance director who is new to the industry has heard that there is a tax efficient way for landfill operators to make this type of donation in a way that can reduce the company's Landfill Tax payments. He has arranged a meeting with a tax partner in your office next week and this item will be on the agenda. Mr Brown wishes to be aware of the opportunities for any Landfill Tax relief in order that the Board can make an informed decision on the matter.

The tax partner has asked you to prepare a file note briefing him on the subject, in particular:

1) **Considering the potential for a claim to Landfill Tax credit in relation to the two requests for funding.** (6)

2) **Setting out the procedure the client should follow in respect of any possible claim.** (4)

3) **Calculating the potential amount and detailing the method of any claim, assuming the forecast Landfill Tax payment is correct.** (5)

You should refer to any relevant legislation in your file note.

Total (15)

4. ABC Tools Ltd is a manufacturer and supplier of tools to industrial companies. The company has production factories at sites in the UK and supplies UK, EU and non-EU customers. It holds proper export evidence and customer VAT numbers where necessary, in respect of its supplies to overseas customers. In addition, it has purchased some commercial properties on an industrial estate and now also operates a property rental business. It holds three properties in York, which are rented entirely to tenants. It also has a further property in Leeds, where the company uses the ground floor itself for storage and rents out the first floor to tenants.

The company is registered for VAT and makes VAT returns on calendar quarters. It has not elected to waive exemption in respect of any of its properties and does not have a special partial exemption method.

The company's sales and input tax for the year ended 31 March 2008 are as follows:

	UK Sales (excl VAT) £000	EU Sales £000	Non-EU Sales £000	Rents (York) £000	Rent (Leeds) £000
2007					
April	1,034	267	248	150	50
May	1,067	229	263	150	50
June	1,029	283	233	150	50
July	1,100	276	259	150	50
August	1,087	264	221	150	50
September	1,344	243	238	150	50
October	1,023	222	198	150	50
November	944	210	223	150	50
December	1,051	233	218	150	50
2008					
January	1,278	239	251	150	50
February	1,498	248	262	150	50
March	1,385	225	234	150	50
	£13,840	£2,939	£2,848	£1,800	£600

Input Tax

	Attributable to tool manufacture £000	Attributable to York properties £000	Attributable to Leeds property £000	Other non-attributable overheads £000
2007				
April	175	7	8	5
May	150	6	5	6
June	165	7	4	4
July	133	5	6	5
August	145	6	5	6
September	151	7	4	5
October	159	5	3	4
November	161	6	6	5
December	157	7	7	6
2008				
January	177	8	8	7
February	165	8	7	6
March	161	7	6	7
	£1,899	£79	£69	£66

Continued

4. *Continuation*

Recent input tax claims by the company are as follows:

	£
Quarter to 30 June 2007	518,480
Quarter to 30 September 2007	456,900
Quarter to 31 December 2007	504,280

You can assume that the provisional input tax claims for the quarters ended 30 June 2007 to 31 December 2007 are correct.

In February 2008, the company sold a surplus production factory. This had been acquired in January 2001 at a cost of £2,750,000 plus VAT. The factory had been used entirely for tool production. No VAT was charged on the sale.

The company has also been awarded a substantial contract for 2008/09, which involves the supply and installation of a large item of machinery in a factory in France for a French company. Costs will be incurred in the UK as well as France in relation to this contract.

You are required to:

1) Calculate the company's recoverable input tax for the quarter ended 31 March 2008 and the company's partial exemption annual adjustment (if any) for the year ended 31 March 2008. (4)

2) Calculate any other adjustments you consider necessary in respect of the year ended 31 March 2008 and advise when and how any such adjustments should be made. (13)

3) Make a brief note concerning the recovery position in relation to UK VAT on costs of the supply and installation project in France for 2008/09 partial exemption purposes. (3)

Total (20)

5. A client of your firm in the retail sector is planning to set up a new venture involving the sale of a range of leisure and sports clothing via an internet site. The proposed structure will involve the setting up of a new UK incorporated purchasing company (P Ltd) based in the group's present head office in London, which will source clothing mainly from Portugal and Italy. The goods will be delivered directly to the warehouse of a new UK incorporated retail company (R Ltd) in the Midlands.

P Ltd will sell the clothing to R Ltd as required to fulfil retail orders and will invoice R Ltd for the clothing on a monthly basis. The clothing will then be sold by R Ltd through an internet site and delivered direct to retail customers. The site will calculate the price in local currency and debit or credit card details will be taken at the time of the order, although payment will not be taken until the goods are despatched. A delivery note will accompany the goods and there will also be a delivery charge. Customers can return the clothing for a full refund within 28 days.

It is expected the main sales areas will be the UK, France, Holland and the USA. The budgeted first year turnover is £5 million with around £2 million of this arising from UK sales, a further £2 million from Europe and the balance from the USA.

Both new companies will be wholly owned subsidiaries of the existing group holding company.

The group finance director, Rupert Red, has asked you to write to him setting out the main VAT consequences of the proposed structure. (20)

6. Your client, Green Ltd, has recently undergone a statutory accounts review by your firm's audit team. The team are unsure whether UK Corporation Tax might apply to all the companies in which Green Ltd holds an interest and have referred to you for an explanation of how to determine this. The details they have provided for each relevant company are as follows:

Brown Inc

A US-incorporated company based in Delaware is a 100% subsidiary of Green Ltd. It has an operational office with staff in the US but all directors are UK-resident and meet in London.

Red Ltd

A UK-incorporated 100% subsidiary with a head office in Toronto. All decisions about the company's business are taken in Canada with no interference from the UK parent company.

Yellow Ltd

A Guernsey-incorporated company with sales staff and a storage area for product samples located in Green Ltd's London office. All board meetings take place in Guernsey. Green Ltd owns 24% of Yellow Ltd while the rest is owned by an unconnected French company.

All the above companies were incorporated in 1994.

Green Ltd has an ongoing dispute with HM Revenue & Customs on two imports and one supply of goods which took place in the period.

Import of Machine Parts from Morocco

Nil duty was paid as the goods originated from a country eligible for EC preference arrangements. Green Ltd knows that its competitor holds a Binding Origin Information decision for the goods, but HM Revenue & Customs are claiming that the goods did not originate from Morocco and that £1.5 million of duty is therefore payable.

Import of Machine Parts from China

These were flown into Heathrow and then delivered by road and rail. HM Revenue & Customs claim that the value of the goods (calculated by reference to the price paid) is incorrect and has not taken into account delivery costs. £0.3 million of additional duty is claimed based on the cost of the air, road and rail transport.

Dispatch of Folding Bicycles to Spain

The goods were sold zero rated to an unconnected third party client with a genuine Spanish VAT registration number who was to arrange their removal from the UK to Spain. However, the airwaybill and other freight documentation turned out to have been falsified and HM Revenue & Customs are claiming that £0.5 million of VAT is due as the zero rating conditions have not been met.

Green Ltd is denying that any amounts are due and so the audit partner has asked you to explain how likely it is that HM Revenue & Customs are correct in each case and on what basis.

Continued

6. *Continuation*

You are required to prepare a memo to the audit partner which:

1) **Explains whether UK Corporation Tax may apply to the various companies in which Green Ltd holds an interest.** (10)

2) **Explains whether HM Revenue & Customs are correct in relation to the three areas of dispute.** (10)

Total (20)