



ICAS TAX PROFESSIONAL (ITP)

SAMPLE MATERIAL 2013/14

ITP training provider

Tolley® Exam Training

ITP



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Sample chapter from Taxation of Companies

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Introduction

The ICAS Tax Professional (ITP) is designed to deliver deep technical tax knowledge to candidates across a range of taxes, with a focus on using this knowledge in a client situation to deliver appropriate tax advice. Full details of the learning objectives and the structure of the qualification can be found in the syllabus document available on the website.

Every candidate embarking on the qualification will be supplied with the same material, prepared by ICAS and Tolley Tax Training. ITP is therefore able to offer consistency from start to finish, with ICAS setting the syllabus and learning objectives, creating the material in partnership with Tolley, and setting examinations based on this syllabus and material. The material will be used both as correspondence material and in the classroom and includes all the knowledge required to pass the examinations. Sample examination papers are available on the ICAS website.

The notes are enhanced with illustrative examples and diagrams to assist understanding. In addition, short examples are provided in most chapters allowing candidates to work through new concepts themselves and check their answers. All programmes include the provision of progress tests and mock examinations for marking.

Recognising that the use of source legislation is vital in practice, all material includes full cross-references to the tax legislation, which can be used in the examinations, and also to case law where appropriate. Legislative references are clearly identified throughout the material.

Every pack of material is supported with a full question bank covering the topics on the course, and a revision pack of exam standard questions. Candidates are also provided with access to Tolley's Online Academy and Tolley's Performance Tracker. The Online Academy houses all of the candidate material – both manuals and question banks. It allows access to audio visual lectures which supplement the manuals and allows for the audio from these to be downloaded as MP3 files to listen to another time. Additionally, the Student Forum allows candidates to share experiences, ask questions and help each other in their studies. Tolley's Performance Tracker allows candidates and firms to track their test results.

This booklet includes sample material from each of the Level 2 papers within the qualification, demonstrating the straightforward, clear style of writing used in the material and the focus on illustrations, examples and legislative references.

GROUP CONSORTIUM COMPANIES

22.1 Introduction

This chapter looks further at consortium companies in particular consortium members who are also group members and consortium companies who are also group members.

22.2 Objectives

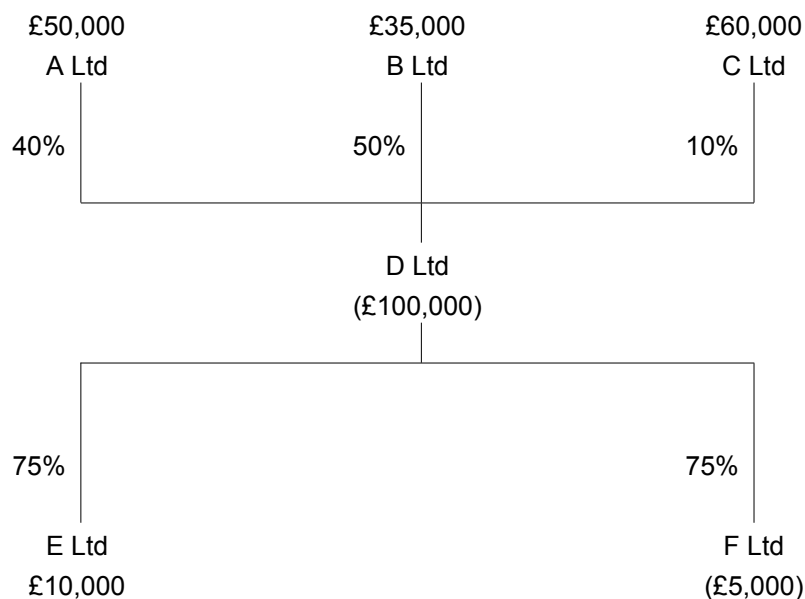
By the end of this chapter you should be able to:

- Define a group consortium company
- Advise of the effect of a group relief claim in the group consortium company
- Describe a consortium holding company
- Describe a link company

22.3 Definition and effect

A “group consortium company” is a consortium company which has its own 75% group. When computing consortium relief available to the consortium members, it is deemed that any group relief claims that the consortium company could make within the consortium group have been made. It is therefore the net loss of the group in simple terms, which is available to the members. [CTA 2010, s.148 & s.149](#)

Notes

 **Illustration 1**


£10,000 of D Ltd's loss will be deemed to have been transferred by way of group relief to E Ltd, reducing D Ltd's loss available for consortium relief to just £90,000.

Given this information, the amount of D Ltd's loss that A Ltd, B Ltd and C Ltd will be entitled to is as follows:

A Ltd will be entitled to £36,000, which is 40% of £90,000.

B Ltd will be entitled to 50% of £90,000 which is £45,000 but this will be restricted to the amount of profit of B Ltd, reducing the claim to just £35,000.

C Ltd will be due 10% of the loss, which is £9,000.

22.4 Group relief claims made

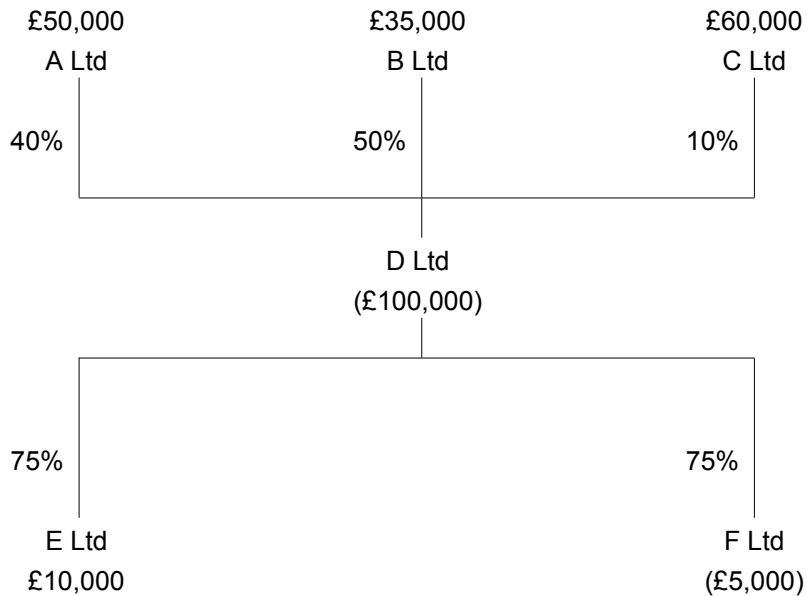
Where an actual group relief claim has been made between the subsidiaries of the group consortium company, it can be taken into account when computing the deemed claim. This can increase the amount of loss available to the consortium members.

CTA 2010, s.148(6) & s.149



Illustration 2

Notes



An actual group relief claim is made between E Ltd and F Ltd, which transfers the £5,000 loss in F Ltd to E Ltd, reducing E Ltd's profit down to just £5,000.

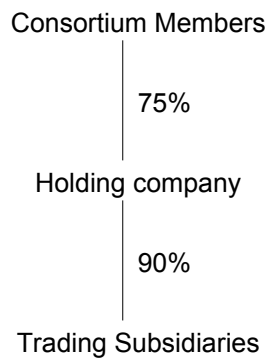
This reduces the deemed group relief claim between D Ltd and E Ltd to just £5,000 and therefore the amount of loss available to the consortium members is increased to £95,000.

A Ltd is entitled to 40% of this, which is £38,000.

B Ltd is entitled to 50%, which is £47,500 but this will be restricted to B's profit of £35,000.

C Ltd will be entitled to 10%, which is £9,500.

22.5 Consortium holding companies



Notes

The definition of a “**holding company**” for consortium relief purposes is a company whose activity is wholly or mainly in the holding of shares in **90% trading subsidiaries**. [CTA 2010, s.153\(3\)](#)

When a consortium company is a ‘holding company’ **losses can flow directly between the trading subsidiaries and the consortium members**, based on the amount of the trading subsidiary's loss, multiplied by the consortium member's interest in the consortium company, on the proviso that the trading subsidiaries are UK resident. Where the subsidiaries are not UK resident no losses can flow.

Losses can also flow to or from the consortium members and the holding company as usual.

22.6 Link companies

A **link company** is a company which is a **member of a consortium and a member of a group relief group**. A link company can be established in the EEA. [CTA 2010, s.133](#)

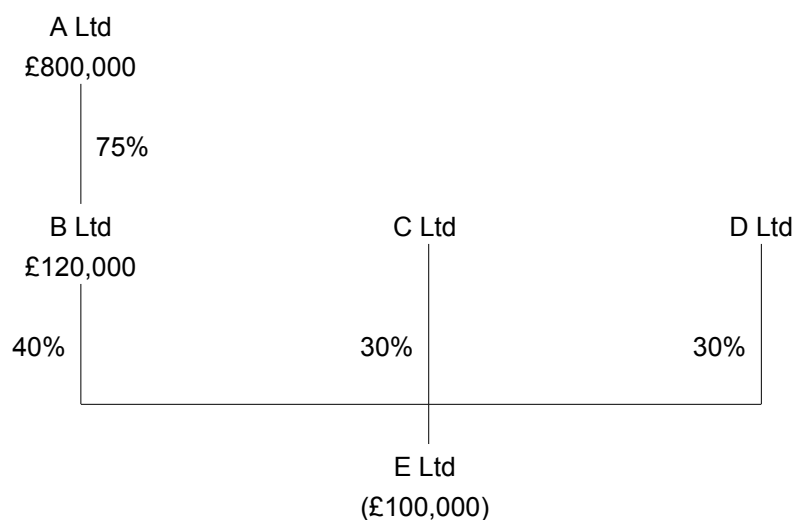
Losses in the consortium company can **flow through the link company** to members of its 75% group. Equally, losses of fellow group companies can flow through the link company to the consortium company. The amounts are based on the consortium member's interest in the consortium company's result.

Consortium condition 2 in the legislation is met where the claimant company is a member of the link company's group.

Consortium condition 3 in the legislation is met where the surrendering company is a member of the link company's group.



Illustration 3



B Ltd is a link company here.

Assuming a year end of 31 March 2014, A Ltd has a marginal rate of tax of 23% and B Ltd has a marginal rate of tax of 20%.

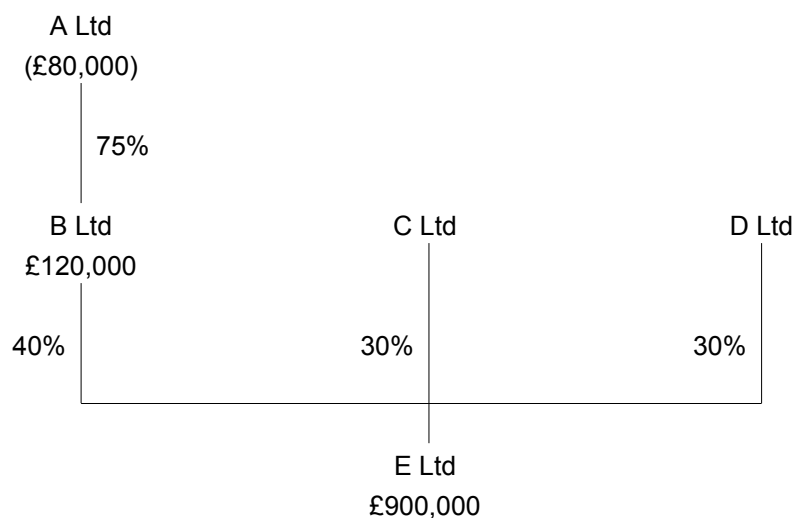
Therefore, if any losses are to flow it would be better that they go to A Ltd rather than B Ltd – that is the advantage of the link company rules.

B Ltd's share of E Ltd's loss, which at 40% is £40,000, can flow through B Ltd and straight to A Ltd under the link company principle.

So a consortium company's loss can be used by the consortium member, or any other member of the consortium member's group relief group.

 **Illustration 4**

All companies have a year end of 31 March 2014.



E Ltd has a marginal rate of tax of 23.75% and B Ltd has a marginal rate of tax of 20%. Under the link company principle it would be better for A Ltd's loss to flow to E Ltd to take advantage of the higher marginal rate of tax.

The maximum loss that E Ltd could accept from B Ltd and its group, is a total of £360,000 (being 40% × £900,000) but as A Ltd's loss is only £80,000 the claim will be restricted to just £80,000.

We would actually need to look further at the arrangements within the consortium here in practice. A Ltd owns 75% of B Ltd, so therefore is going to benefit to the extent of 100% (under the group relief rules) of any losses flowing between A Ltd and B Ltd, whereas the group only owns 40% of E Ltd. The consortium arrangements may allow the tax saving as a result of the consortium relief claim to be passed to the A Ltd

group. If this is not the case however, it would probably be worth only transferring the loss between A Ltd and B Ltd. This would need to be taken into account when deciding the final claim to make.

22.7 Anti-avoidance provisions

There are some anti-avoidance provisions in place to prevent manipulation of the consortium relief rules. S.155 CTA 2010 provides that a trading company is deemed **not** to be owned by a consortium (so no relief is available) where arrangements are in place which mean a person, or persons, who have less than 50% of the ordinary share capital of the trading company have, or together have, or could obtain, control of the company. Further anti-avoidance provisions have been introduced, which build on this position, it is assumed because schemes have come to light which try to get around the provisions of s.155. [CTA 2010, s.155](#)

Therefore new legislation was introduced to counter such schemes which aimed to manipulate control of the consortium company, in order to give rise to a tax advantage. The amendments restrict consortium relief to 50% of what it would normally be where: [CTA 2010, s.146A & s.146B](#)

- i arrangements are in place which prevent a consortium member either alone or with other members, from controlling the consortium company (where they otherwise would have such control); and
- ii the arrangements are part of a scheme the main purpose, or one of the main purposes of which is to enable the claimant company (be it the consortium member or the consortium company) to obtain a tax advantage.

The legislation is effective for accounting periods beginning on or after 12 July 2010.

SUMMARY & REVIEW – GROUP CONSORTIUM COMPANIES

If a consortium member is also a member of a group relief group then it is a **link company**. Link companies can be UK resident and also EEA based.

Losses can flow through the link company in both directions.

Where a **consortium member is also a member of a group relief group** there is no order of priority for group relief consortium claims.

If the **consortium company is a holding company of a group relief group** then group relief always takes priority. If actual group relief claims are made we can take account of these. (CTA 2010, s.148, S149)

If the **consortium company is a consortium holding company** then losses can flow between its 90% trading subsidiaries and the consortium members. (CTA 2010, s.153)

VALUE OF THE SUPPLY

8.1 Introduction

In this chapter we shall look at how you value a supply. The chapter will cover the definition of consideration, special rules for valuing supplies in certain situations, prompt payment discount as well as mixed and composite supplies.

The general rules for determining the value of a supply of goods or services are to be found in

- VATA 1994, s 19(2) where the consideration for the supply is wholly in money; and
- VATA 1994, s 19(3) where the consideration is not wholly in money.

These general rules are, however, subject to any special valuation rules made by or under VATA 1994. These special rules are considered in 10.4 below.

VATA 1994, s.19(1)

8.2 Objectives

By the end of this chapter you should be able to:

- Compare the difference in treatment between consideration wholly or not wholly in money
- Summarise the Naturally Yours Cosmetics Ltd case
- Describe the treatment for supplies between connected persons
- Advise of the implications of offering a prompt payment discount
- Distinguish between mixed and composite supplies using case law

8.3 Consideration Wholly in Money

The gross value of the supply is the value of the consideration that is given for it. Therefore the starting point for VAT is what a trader receives for a supply rather than what the trader actually supplies. VATA 1994, s.19 (2)

Consideration = Price of the item + the VAT

Trade prices and contracts usually state that the price is VAT exclusive so this would mean that the price being quoted is the value of the supply and that VAT will be added

Notes

on top of this price at the standard rate. (*Hostgitt Ltd v Megahart Ltd*) However, in practice, this procedure is actually the opposite of the VAT rules because the VAT rules say that where a contract says nothing about VAT then the starting point is the consideration so, in other words, if you are quoted a certain price and VAT is not mentioned, that price is VAT inclusive and hence is the consideration. This is what happens when people go shopping in supermarkets and shops, the price they see, which never mentions VAT, is the price including VAT.



Example 1

Outlined below are three items or services being sold in 2013.

You have to calculate the tax to the nearest penny, assuming a standard VAT rate of 20% where appropriate.

- a) Marks & Spencer sells a ladies coat at £99.00

VAT due is £

- b) A plumber charges £250 plus VAT to repair a leaky tap

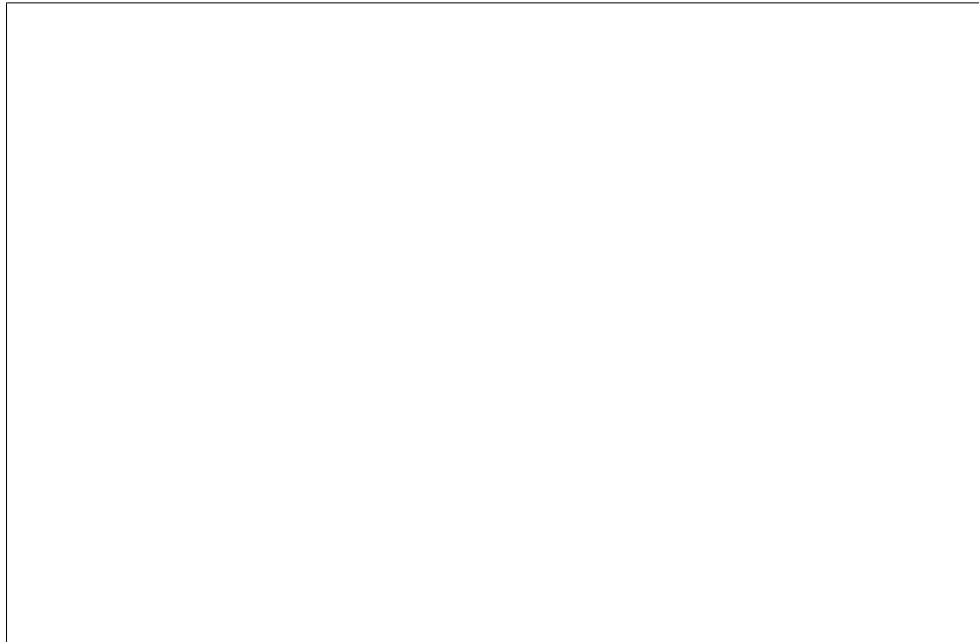
VAT due is £

- c) A book costs £12.00 in Waterstone's Book Shop

VAT due is £

✔ Solution to Example 1

Notes



However, rather unusually, with effect from 17 March 2005, the consideration payable to an overseas supplier of natural gas and electricity is the value on which VAT is to be accounted for. This follows the changes in the place of supply rules relating to these services which were introduced from 1 January 2005.

8.4 Consideration Not Wholly in Money

If a supply is for a consideration not consisting, or not wholly consisting, of money, subject to the special valuation rules in 10.4 below, its value is to be taken to be such amount in money as, with addition of the VAT chargeable, is equivalent to the consideration. In other words, it is necessary to [VATA 1994, s.19\(3\)](#)

- determine the amount that would have been given in money for the supply if goods or services had not instead been used for all or part of the payment; and then
- multiply that amount by the VAT fraction to establish how much VAT is due.

It is important to distinguish between non-monetary consideration and no consideration. Non-monetary consideration exists when a supply is made in return for payment in the form of goods or services. Where there is only non-monetary consideration, a barter transaction takes place. In some cases there may be both a monetary consideration and a non-monetary consideration.

Notes

When goods or services are provided for no payment in any form (monetary or non-monetary), there has been no consideration. It is then only necessary to value such a provision of goods or services where *VATA 1994* **deems** a taxable supply to have taken place. The commonest cases are

- private or non-business use of business assets for no consideration;
- private or non-business use of services supplied to the business;
- supplies of business goods/assets for no consideration; and
- deemed supplies of business goods/assets on hand at the time of deregistration.

8.5 Special Rules

Schedule 6 of VATA 1994 contains special rules for valuing supplies in certain situations. HMRC can direct that an **open market value is used for supplies between certain connected persons**. This will normally apply where the purchaser cannot recover all of the input tax being charged (for example, an exempt or a partially exempt trader). For the rule to apply the consideration must be **wholly** in money for **less** than open market value. There must therefore be some consideration for the open market value to be applied between connected persons. If there is no consideration, for example, it is some sort of barter transaction, this rule cannot be applied. [VATA 1994, Sch 6 Para 1](#)

If a mail order company sells goods using unregistered agents, then that **mail order company can be forced by HMRC to account for VAT on the full retail price of those goods**. If this was not the case, then the margin of profit given to the agent would escape a charge of VAT and the VAT being paid would not be based on the actual amount paid by the customer. [VATA 1994, Sch 6 Para 2](#)

Open market value can also be used when fuel is provided for private use for consideration. [VATA 1994, Sch 6 Para 2A](#)

Where there is a supply of goods by virtue of

- a Treasury order under *VATA 1994, s 5(5)* (self-supply of goods),
- *VATA 1994, Sch 4 para 5(1)* (gifts of business assets),
- *VATA 1994, Sch 4 para 6* (removal of business assets from one EC country to another), or
- *VATA 1994, Sch 4 para 8* (deemed supply on deregistration and termination of business),

then, (subject to exception in Sch 6 para 10) the value of the supply is

- a) such consideration in money (excluding any VAT) as would be payable by the person making the supply if he were, at the time of the supply, to purchase goods **identical** in every respect (including age and condition) to the goods concerned;
- b) where the value cannot be determined as under (a) above, such consideration in money (excluding any VAT) as would be payable by that person if he were, at that time, to purchase goods **similar** to, and of the same age and condition as, the goods concerned; and
- c) Where the value cannot be determined as under (a) or (b) above, the **cost of producing** the goods concerned if they were produced at that time.
[VATA 1994, Sch 6 Para 6](#)

Where an employer makes a supply of goods or services to his employees consisting of

- food or beverages supplied in the course of catering, or
- accommodation in a hotel, inn, boarding house or similar establishment,

the value of that supply is to be taken to be the monetary consideration, if any, paid by the employee (i.e. the consideration is nil where there is no consideration or any consideration other than money). [VATA 1994, Sch 6 Para 10](#)

Where accommodation in a hotel, inn, boarding house or similar establishment is

- provided to an individual for a period exceeding four weeks, and
- throughout that period the accommodation is provided for the use of the individual either alone or together with one or more persons who occupy the accommodation with him otherwise than at their own expense,

after the initial four weeks the value of the supply is reduced to that part attributable to facilities other than the right to occupy the accommodation (subject to a minimum of 20%). [VATA 1994, Sch 6 Para 9](#)

If a supply is invoiced in a foreign currency, then that supply is valued at the appropriate exchange rate in force on the day the supply is made.
[VATA 1994, Sch 6 Para 11](#)

8.6 Prompt Payment Discount

Some traders offer a prompt payment discount to encourage customers to pay on a timely basis. When valuing goods for VAT always **assume** that if a prompt payment discount is offered, the **discount will be taken up** by the customer. Thus the VAT is always charged on the discounted price whether or not the discount was actually taken. **VATA 1994, Sch 6 Para 4**



Illustration 1

Let us say that a trader sells goods in September 2013 for £500 exclusive of VAT. This trader offers a 10% discount if payment is made within 7 days. The goods are £500 if you pay late, or £500 less a 10% discount, so £450, if you pay early.

Because a prompt payment discount is offered, whether it is taken or not, VAT is calculated on the discounted amount. Thus the VAT is calculated on the £450 value of goods, which at 20% gives £90.00 of VAT. This is added on to £500 worth of goods if the goods are paid for after 7 days, (£590.00) or it is added on to the £450 worth of goods if the goods are paid for within 7 days (£540.00).



Example 2

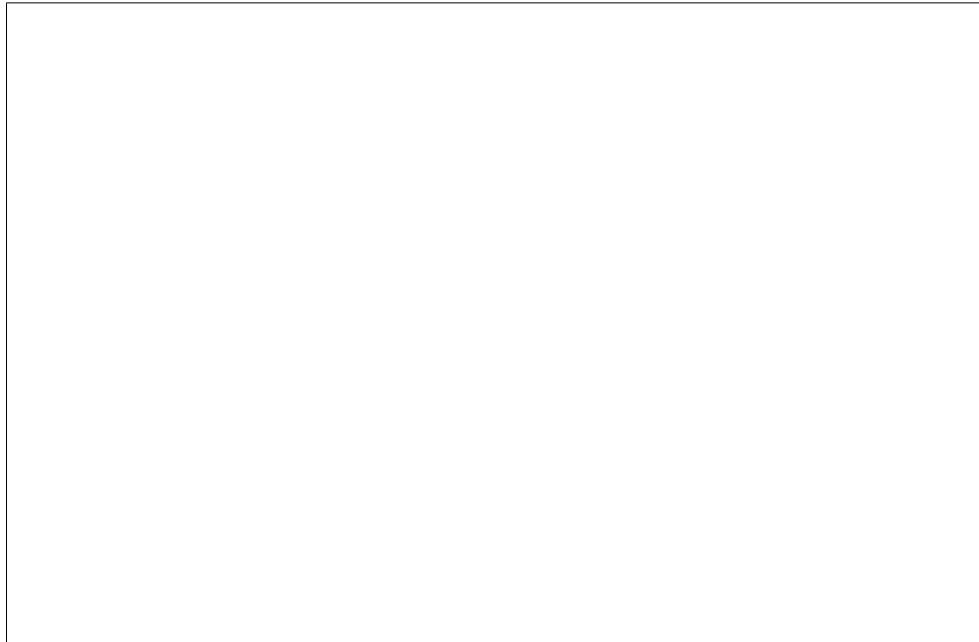
Joe sells goods in March 2013 for £1,000 exclusive of VAT to ABC Limited. Joe offers a 2% discount for payment within 10 days.

Calculate the VAT due if ABC Limited pays 30 days later.



Solution to Example 2

Notes



8.7 Further Points

The next item to consider is a gift. A gift is where goods are given over to one person but **no consideration** is given back for the goods. For VAT you must value the goods and you value them at their replacement cost. **VAT is then charged on a consideration which equals the replacement cost** of those goods.

VATA 1994, Sch 6 Para 6(1)

For a barter transaction, (i.e. I give you goods and in return you give me something back, but not money), we are effectively looking at non-monetary consideration. The legislation states that this **non-monetary consideration must be valued** and this value is what the output tax is calculated in respect of. In the case of *Tron Theatre Ltd* a charity issued a brochure requesting potential supporters to sponsor seats in its theatre by paying £150. In return sponsors were entitled to priority bookings for two gala evenings and their sponsorship acknowledged by brass plaques on the seats and an acknowledgement board in the foyer. The company did not account for VAT on the sponsorship payments. HMRC assessed for VAT on the sponsorship sum and the assessment was upheld on the basis that the sponsorship was consideration for a supply by the charity. **VATA 1994, s.19(3)**

8.8 Single and Multiple Supplies

There are two different types of supply. The single and the multiple supply.

Notes

A **multiple** supply is where there are **individual elements** within the supply that are **treated separately for VAT**. An example of this would be where a student goes on a course and has to purchase some books as part of the course. A course is standard-rated and books are zero-rated. They are effectively treated as separate supplies, even though the student might purchase them together. The individual elements are being treated separately for VAT.

This is contrasted to the **single** supply where there is just a **one supply** although it might be made up of lots of different things. An example of this is a plane ticket to fly to New York. The traveller will also be provided with a meal on the flight. Air transport is zero-rated and catering is standard-rated. However the traveller is buying a complete package and it is difficult to separate the two elements plus, of course, the meal is just a small insignificant piece of the overall flight to New York. In such a case, this single supply would just be treated as a zero-rated supply of a plane ticket to New York.

With a multiple supply, there is the need to perform an apportionment calculation to split the individual elements of the supply in order to calculate the VAT due. With a single supply only a single rate of VAT applies to the whole supply.

VATA 1994, s.19(4)

The leading case in determining whether a supply is single or multiple is *Card Protection Plan*. This is primarily because the ECJ gave useful guidance on what to use as a basis for these decisions. They were:

- Since it is not possible to give guidance that would cover all cases of single/multiple supplies, when you are considering a transaction that consists of a number of components regard must be given to all the circumstances in which that transaction takes place.
- Each supply of a service must normally be regarded as distinct and independent
- A supply that comprises a single service from an economic point of view should not be artificially split - the essential features of the transaction must be ascertained to decide if the supply to a typical customer comprises several distinct principal services or a single service
- There is a single supply in cases where one or elements are to be regarded as ancillary services. An ancillary service is defined as something that does not constitute for customers an aim in itself but is a means of better enjoying the principal service supplied
- The fact that a single price is charged is not decisive. If the circumstances indicate that customers intend to purchase two or more distinct services a single

price will not prevent these being treated as separate supplies with different liabilities applying, if appropriate, to those services

This guidance was then applied by HMRC when considering company formation services with ancillary printed matter in Business Brief 1/06. When considering the ECJ guidance HMRC were of the view that there was a single standard rated supply of company formation services rather than a standard rated supply of formation services and a separate zero-rated supply of printed matter. [Business Brief 1/06](#)

Illustration 2

In 2013 a training company offers a lecture course and study materials for £2,000 plus VAT. The cost to the training company for the manuals is £100 and the cost of the course is £500.

The manuals are a zero-rated supply of printed matter and the course a standard-rated supply. This is a multiple supply.

Notice 700 published by HMRC suggests using either the cost of each element or the selling price of each element to apportion total consideration. In our illustration we shall use cost to apportion this mixed supply. The total cost of £500 and £100 is £600.

100/600	× 2,000	= zero-rated output	333
500/600	× 2,000	= standard-rated output	<u>1,667</u>
			<u>2,000</u>

Assuming a standard rate of 20% the VAT due is:

333 @ 0%	Nil
1,667 @ 20%	<u>333.40</u>
Total VAT due	<u>333.40</u>

8.9 Single/Multiple Supply Cases

There is an absolute wealth of case law on the topic of single and multiple supplies.

HMRC v Weight Watchers (UK) Ltd (2008)

The company enrolled customers on a programme in which they attempt to lose weight, encouraged by attending regular meetings. Enrolment costs £9 and meetings cost £4.95, and each includes the provision of some printed matter. In 2004 HMRC issued a ruling that this was a multiple supply with some zero-rated printed matter in it, but in 2005 they changed the ruling to a single standard-rated supply of a weight watching programme.

Notes

The Tribunal allowed the company's appeal – there was a multiple supply. In doing so, it placed significant reliance on the ECJ's decision in *Levob* (2006) as being more directly relevant than *CPP* (1999) – *CPP* dealt only with services, while *Levob* dealt with a bundle of goods and services.

HMRC appealed to the High Court, arguing that the Tribunal had either applied the wrong legal test, or else had reached the wrong legal conclusion on the basis of the primary facts of the case. The judge did not think that the test was wrong, but allowed HMRC's appeal in part; as a matter of law, it was necessary to consider whether a package of supplies formed, objectively, a single economic supply that was indivisible, and that should be applied to the weekly meetings. It appears therefore that the initial package on joining Weight Watchers may include some zero-rated material, but after that everything is standard-rated.

The company appealed against the first part of the judge's decision and HMRC cross-appealed against the second. The Court of Appeal has found for HMRC on both points. The reality of the supply was the reinforcing effect of the regular meetings. Enrolment was a necessary preliminary to receiving the subsequent supplies, and was no different in principle from them. There might be some value in the printed matter on its own, but that was not what the customers were signing up for: they were in reality (and as HMRC argued) buying a weight loss programme, not separate materials.

HMRC v David Baxendale Ltd (2009)

L Ltd offered a programme for rapid weight loss for those who were seriously overweight. The physical aspect of the programme was the total replacement of normal food with its food packs, accompanied by counselling and advice. L Ltd licensed its trademarks to counsellors such as the taxpayer, who they supplied and trained. The taxpayer was one of approximately 300 other taxpayers in similar factual circumstances, namely, each counsellor purchased food packs from L Ltd at a price below the price they charged for their sale. L Ltd also provided printed materials and other items to the counsellors for them to sell or provide to the participants as well as detailed course materials. An issue arose concerning the correct VAT treatment of the supply, or supplies, made by the taxpayer to persons who participated in the programme. In determining the issue, the VAT and duties tribunal directed itself that it was appropriate to analyse a transaction as a single supply in a case where there was a close link from an economic perspective or from a physical perspective. It held that, in the instant case, there were two supplies, one of food and the other of support services. The tribunal found that the amount paid for the food packs also provided consideration for counselling services and that there was therefore more than one supply. In the event, the tribunal found that the support services and the food packs constituted separate supplies. The Revenue appealed against the tribunal's decision. The appeal was allowed by the judge who held, *inter alia*, that there was a single supply of standard-rated services. The taxpayer appealed.

It submitted, inter alia, that the tribunal had been correct to find that it made separate supplies of food and support services.

The proper functioning of the VAT system required that single transactions should not be artificially split into separate supplies where to do so would not reflect the economic reality of the transaction. The test was therefore that of economic indivisibility based on an objective view of the transaction from the consumer's perspective.

In all the circumstances, the judge's conclusion was supportable. It was unrealistic to regard the support services as other than part of a continuous programme of dieting and weight stabilisation designed to achieve the permanent reduction of the customer's weight. The inclusion of the support service in the price paid for the food packs, whilst not conclusive in itself, was consistent with that being what the taxpayer offered and, more particularly, what the consumer wished and intended to purchase and receive. The support services were integral to the achievement of the customer's needs. The tribunal had not adequately addressed the question whether the supplies were so closely linked as to form a single and indivisible economic supply. On the facts, what the typical customer purchased was a single package of food packs and support services which he wished to use in combination with each other and which, in the context of the transaction, were not economically divisible. The food packs and support services were intended to re-enforce each other, and were therefore to be taken together, and purchased on that basis. In all the circumstances, it would be artificial to split up the supply of food and support services. They had to be regarded as a single economic supply. The appeal would be dismissed.

Telewest Communications plc (2005)

A group of companies (T) supplied cable broadcasting services to subscribers. It provided the subscribers with a monthly magazine providing details of the programmes which it broadcast. Until 1999, it treated part of the subscriptions as attributable to zero-rated supplies of the magazines. Following the decision in *British Sky Broadcasting Group plc*, the Commissioners issued a ruling that the whole of the subscriptions were for standard-rated supplies of broadcasting services. T then incorporated a separate company (P) with the intention that T should supply the standard-rated broadcasting services and that P should supply the magazines. P registered for VAT, and treated its supplies of the magazines as zero-rated. The Commissioners issued a ruling that in reality the magazines were still being supplied by T (and were part of a single standard-rated supply). T and P appealed. The Court of Appeal allowed their appeals, holding on the evidence that there had been a partial novation and that the customers had become contractually bound to P. Arden LJ held that the supply of television services and the supply of a magazine could not be treated as a single supply, merely because the customer could not enter into one transaction without the other. There was no authority for the proposition that the concept of 'principal and ancillary contracts', as propounded in *Card Protection Plan*

Notes

Ltd, could apply where there was more than one supplier. The principle of 'economic neutrality' did not require the court to treat two separate supplies as a single supply simply because the suppliers were related parties and their supplies were linked.

Provided the arrangements are at an open market value and the customer is made aware of whom he is contracting with, the courts have regularly supported the viability of such structures.

Changes to the Telewest decision

Following a number of cases which seek to split supplies and benefit from zero-rating HMRC issued legislation in 2011. The purpose of the legislation is to prevent zero-rating where an item of printed matter is connected with a supply of services made by a different supplier. This seeks to break the approach confirmed by the Court of Appeal in *Telewest*, by preventing zero-rating where the supply would be regarded as a single supply if it were supplied by the same person.

The law only applies if the supply of printed matter is connected to a supply of services; it will **not** apply if it is connected with a supply of goods. This means that a supply which would, on a single basis, be treated as goods (because the printed matter is the predominant element) will not be caught by the new rules.

VATA 1994, s.8 Group 3, Note 2

 **Example 3**

For each of these supplies decide whether there is a mixed / multiple supply or a compound / composite supply.

	Multiple Supply	Single Supply
a) A box of Earl Grey Tea comes with a china teapot as a special Christmas promotion	<input type="checkbox"/>	<input type="checkbox"/>
b) A language school sells courses and books for a total fee of £500.	<input type="checkbox"/>	<input type="checkbox"/>
c) Ticket to fly to Rome includes a standard lunch	<input type="checkbox"/>	<input type="checkbox"/>

SUMMARY & REVIEW – VALUE OF THE SUPPLY

VAT is 1/6ths of the consideration when the standard rate is 20%.

Where a contract specifies that the price quoted is exclusive of VAT then any VAT must be added to the contract price.

Consideration not wholly in money is valued from the point of view of the person receiving the consideration where they are aware of the retail price of the goods or services received. Where they are unaware of the retail value, consideration is valued at cost to the supplier of the goods.

If there was a **prompt payment discount** offered, always deduct it when calculating VAT even if the discount is not actually taken up by the customer.

A **gift** needs to have a value for consideration in order to work out VAT and we would use replacement value in such a case.

If we are looking at a **barter transaction** then the value of consideration is the value of the non-monetary consideration we are receiving.

A **multiple supply** is a supply that you can apportion into its individual elements and then charge VAT upon each element accordingly.

A **single supply** is really just one supply with a single VAT liability. If there are separate elements then there must be a main supply with the other element or elements just being incidental to that main supply. The main case being, of course, *Card Protection Plan*. Other cases include *Weight Watchers and David Baxendale Ltd*.

It was possible to split “single” supplies if they were supplied by different entities; *Telewest*.

VATA 1994, Schedule 8, Group 3, Note 2 now prevents zero rating where an item of printed matter is connected with a supply of services made by a different supplier.

Appendix 1 – Solutions to Chapter Examples

Solution to Chapter Example 1

a) £16.50

The first item is for sale in Marks & Spencer and the price shown will be the consideration, i.e. the VAT inclusive price. Thus $1/6$ of £99 gives us £16.50.

b) £50.00

The second item is a plumber charging £250 plus VAT for services, so the price being shown is not the consideration because the VAT is not included and has to be added on top to get to consideration. To work out the VAT we charge 20% of £250 and get £50.00.

c) Nil

The third item is a book being sold for £12. It is a shop, just like the Marks & Spencer example, so the price being shown is the consideration. Normally we would take $1/6$ for the VAT except books are zero-rated supplies so it is actually 0% VAT added on to this price paid to give us both a price paid and a consideration of £12 and zero VAT.

Solution to Chapter Example 2

The correct answer calculates VAT on the discounted amount even though the discount was not taken because the company paid late. £1,000 less 2% discount is £980, which at 20%, gives us £196.00 of VAT. The company will pay £1,000 plus £196.00 of VAT (i.e. £1,196.00).

Solution to Chapter Example 3

A box of Earl Grey tea is the main supply here. The china teapot, which probably costs a lot more than the tea, is just a promotional incidental supply. This is very similar to the case with the biscuit tin in United Biscuits Limited. This is a single supply, a compound / composite supply, of Earl Grey tea which will be zero-rated.

A language school selling a course and books will probably be making a mixed / multiple supply because you will be able to apportion VAT between the two elements provided, i.e. the course and the books.

CLASS 1 NATIONAL INSURANCE CONTRIBUTIONS

12.1 Introduction

In this chapter you will learn about class 1 NIC including an overview of the six classes of NIC, the definition of earnings, class 1 primary contributions, the difference in rules for directors, class 1 secondary contributions and the implications of contracting out of the state second pension.

NIC is a very important money-raising tool for the Treasury and, year on year, National Insurance Contributions bring in around 23% of total Government revenue. Collection of NIC is administered by the National Insurance Contributions Office (NICO) which is now part of the HM Revenue and Customs. Other parts of the HMRC assist NICO in the collection of National Insurance Contributions, particularly via the PAYE system.

The purpose of National Insurance Contributions is to provide certain retirement benefits such as the State Pension, as well as to fund certain Social Security benefits such as Job Seekers Allowance and Employment and Support Allowance. If the amount raised by NICO by way of National Insurance Contributions is insufficient to cover these benefits, any deficit is made up by a grant from the Treasury.

At present there are six classes of National Insurance:

- a) Class 1 - paid by both employees and employers on earnings from employment.
SSCBA 1992, s.1
- b) Class 1A – paid by employers only on benefits awarded to certain employees.
- c) Class 1B - paid by employers only on Pay As You Earn Settlement Agreements (PSAs).
- d) Class 2 - a flat rate weekly amount paid by self-employed persons.
- e) Class 3 - voluntary contributions paid by taxpayers who wish to top-up their contribution record in order to preserve their entitlement to State benefits.
- f) Class 4 - paid by self-employed persons on the profits from their trade.

This gives us an overview of National Insurance. In this chapter we shall concentrate solely on Class 1 NIC.

12.2 Objectives

By the end of this chapter you should be able to:

- Compare the different classes of NIC
- Define earnings for Class 1 NIC purposes
- Calculate Class 1 NIC for both the employee and employer
- Show the difference in calculation if the employee is a director
- Explain how the regional class 1 NIC holiday can help a business
- Describe how NIC will change if the employee has contracted out of the state second pension

12.3 Class 1 NIC

Class 1 National Insurance Contributions are broken down into **primary** contributions or **secondary** contributions. **Primary** contributions are paid by **employees** whilst **secondary** contributions are paid by **employers**.

Class 1 NICs are paid on earnings from the employment. If an employee receives earnings, that employee will pay Class 1 primary contributions whilst if an employer pays earnings to an employee, the employer makes a secondary Class 1 contribution.

Both primary and secondary contributions are accounted for under the PAYE system and are paid over to HMRC, along with income tax, on the **19th of each month or 22nd where payment is made electronically**.

Every time an employer makes a payment of earnings to an employee, that employer will have to account for Class 1 secondary NICs currently at a rate of 13.8%. This is a very substantial additional cost borne by employers and the majority of NICs raised by the Treasury are collected from employers rather than employees.

12.4 Earnings

Class 1 contributions are paid on “earnings”. It is very important that we establish what constitutes “**earnings**” for National Insurance purposes. **Any cash payment** made by an employer to an employee is likely to be earnings for NIC purposes. This will include salaries and bonuses, but does not include the taxable element of termination payments taxed under s.401 ITEPA 2003. It will not include the reimbursement of genuine business expenses. **SSCBA 1992, s.3**

If an **employer settles an employee's personal liability**, this payment will also constitute earnings for Class 1 National Insurance. For example, if an employee makes a visit to a shop and spends £100 which is not a business expense and that £100 is subsequently paid by the employer, the employer has paid for an employee's personal bill. That payment will constitute earnings for NIC (but not PAYE). As such, the £100 will be charged to Class 1 National Insurance. Of course, if the employee paid the bill and was subsequently reimbursed by the employer, the amount reimbursed would be subject to Class 1 NIC and also PAYE. If the supply of the goods was arranged by the employer directly with the supplier, Class 1 NIC (and PAYE) is not due on the payment but Class 1A will be due from the employer.

If an employer makes a non-cash payment to an employee – i.e. some form of payment in kind – and that **payment in kind** can be **surrendered for cash**, that payment will **also be earnings** for NIC purposes, just as it is for PAYE purposes. For example, if the employer provides the employee with a bonus in the form of premium bonds, the employee has the legal right to exchange or surrender the premium bonds for cash. The payment in premium bonds will therefore be subject to Class 1 NIC. Contrast this with the employer giving the employee, say, a television. The only way the employee can obtain cash for the TV is if he sells the asset, not simply by surrender. The payment by way of the TV is therefore not subject to Class 1 NIC. Instead, it will be subject to Class 1A.

Payments in the form of “**readily convertible assets**” are earnings for NIC purposes. You will recall from the PAYE chapter, that a readily convertible asset is an asset that is traded on a recognised Stock, or Commodities Exchange, or an asset for which trading arrangements exist. The definition of a readily convertible asset for NIC is exactly the same as the definition we looked at for PAYE. The readily convertible assets legislation was introduced as many employers had thought up imaginative NIC avoidance schemes to reduce their NIC liabilities. [ITEPA 2003, s.702](#)

Vouchers are earnings for NIC, regardless of whether they are cash or non-cash vouchers. Childcare vouchers given to employees are specifically excluded to the extent that they do not exceed the exempt amount, being £55, £28 or £25 per week and are not earnings for Class 1 NIC. Class 1 NIC is charged on any excess amount over the allowable amount.

Mileage payments are not earnings for Class 1 NIC purposes if they do not exceed 45p per mile (irrespective of the number of miles reimbursed). If an employer pays more than this then the excess over 45p per mile will be subject to Class 1 NIC.

So, if an employee travels 15,000 miles on company business in a year and is reimbursed 50p per mile, the excess of 5p per mile i.e. £750 will be subject to Class 1 NIC. Remember that the excess reimbursement for tax purposes will not be subject to PAYE.

Notes

The vast majority of common benefits will not be earnings for Class 1 NIC purposes. For instance, if an employee is given use of a company car, or has a taxable cheap loan, that benefit will be charged to income tax, but it will not then be charged to Class 1 National Insurance Contributions in the hands of the employee. Again, Class 1A will be payable by the employer.

12.5 Class 1 Primary contributions

Primary contributions are paid by employees on earnings in an “earnings period”. Most UK employees have a monthly earnings period – i.e. we receive our salary etc on a monthly basis. Some employees, typically in manufacturing industries, still receive their earnings weekly.

The current rates of National Insurance are given in the tax tables. For employees who receive their remuneration **weekly**, **no National Insurance is charged on the first £149 per week** of an employee's earnings. This is called the “primary earnings threshold” (PET). On **earnings between £149 per week and £797 per week**, the main rate of Class 1 NIC is **12%**. The weekly limit of £797 is called the “upper earnings limit” (UEL).

Employees also pay Class 1 NICs at the additional rate of **2% on earnings in excess of the upper earnings limit i.e. above £797 per week**.

The tables also give us the monthly and annual limits. For employees with a **monthly earnings period**, for earnings up to £646 per month, NIC is charged at zero percent. For earnings between £646 and £3,454 per month, the rate is 12% and there is a further NIC liability of 2% on earnings in excess of £3,454 per month. **SSCBA 1992, s.8**

This is illustrated by the diagram below:

	Nil	PET	12%	UEL	2%
£0		£149 pw		£797 pw	
		£646 pm		£3,454 pm	
		£7,755 pa		£41,450 pa	

An employee will start to pay Class 1 primary contributions with effect from his 16th birthday and will stop paying NIC at the date of retirement, which for a man is currently 65. For women born before 6 April 1950, the retirement age is 60. For women born after 6 April 1950, the retirement age is increasing to 65 between 2010 and 2018. Between these dates, retirement age for a woman born on or after 6 April 1950 will depend on her exact date of birth. **SSCBA 1992, s.6**

From December 2018, the retirement age for both men and women will start to increase to reach 66 in October 2020. Further increases are planned after this date.

NICs are calculated for earnings periods. An employee who is paid monthly will have 12 earnings periods in any particular tax year, so to calculate his NIC for the year, we do 12 separate NIC calculations and add them together.



Example 1

An employee has a salary of £18,000 per annum in 2013/14 which is paid monthly. The employee has use of a company car giving rise to a benefit of £2,500. The employee gets a cash bonus at Christmas of £5,000.

Calculate the employee's NIC for 2013/14.



Solution to Example 1

12.6 Directors

The above rules do not apply to directors. **All directors** have an **annual earnings period**. This means to calculate a director's NIC we look at their earnings in the whole of the tax year, irrespective of whether the director was paid on a weekly or monthly basis. This is to prevent a company director from manipulating the NIC rules by paying himself in such a way as to minimise his NIC for the year.

 **Example 2**

Take the figures in the previous example, but this time assume that the salary, the car benefit and the Christmas bonus are accruing to a director rather than a normal employee.

Calculate the employee's NIC for 2013/14.

 *Solution to Example 2*

12.7 Class 1 Secondary contributions

Class 1 secondary contributions are paid by employers on any earnings paid to employees. The current rate of Class 1 secondary contributions is zero percent on earnings up to the secondary earnings threshold and 13.8% on the excess.

Note that there is a slight difference between the primary earnings threshold and the secondary earnings threshold. Employers start to pay Class 1 secondary contributions when an employee's earnings exceed £148 per week (£641 per month £7,696 per annum) whereas the employee does not start to pay Class 1 primary contributions until earnings exceed £149 per week (£646 per month/£7,755 per annum).

SSCBA 1992, s.9

£0	Nil	SET	13.8%
		£148 pw	
		£641 pm	
		£7,696 pa	

You will also note two other things here. The first is that the **rate of NIC is higher for employers than for employees – i.e. 13.8% as opposed to 12%**. The second thing to note is that there is **no upper earnings limit** for employer's contributions, i.e. the 2% rate does not apply for employers. So for every one pound of earnings paid to an employee above the secondary earnings threshold, the employer will have to pay 13.8 pence in National Insurance Contributions.

This is a substantial cost for employers to have to bear and effectively, adds nearly another 13.8% to their total wages bill.

In the case of an employee or director earning £23,000 per year, the secondary liability to be paid by the employer is:

$$(23,000 - 7,696) @ 13.8\% = £2,112$$

Employer secondary contributions begin with effect from the employee's 16th birthday, but there is no upper age limit. So if a salary is paid to an employee who is 68 years old, the employee will have no Class 1 primary liability, but the employer will still have to pay Class 1 secondary contributions at 13.8%.

Class 1 secondary NIC contributions paid by the employer in respect of an employee, along with Class 1A and 1B contributions, are deductible by the employer in arriving at taxable profits.

12.8 Regional Class 1 NIC Holiday

A Class 1 NIC 'holiday' is available to new businesses which start up during the period 22 June 2010 – 5 September 2013. [NICA 2011, Part 2](#)

The scheme applies to new businesses with a principal place of business in Scotland, Wales and Northern Ireland. It will apply to businesses set up in England, apart from London, the South East and the East. The aim is to help new businesses in areas of the UK that most require assistance.

Under the scheme, an employer will not be required to pay secondary Class 1 NIC for **the first 52 weeks** of an employee's employment, where the employee is taken on by the employer **in the first year of business**. The relief applies in respect of the **first 10 employees hired**, but is capped at **a maximum of £5,000 per employee**. Once the £5,000 limit has been reached for an employee, secondary Class 1 NICs will have to be paid as normal.

After 5 September 2013, Class 1 NIC is payable in full as normal, even if full relief has not been obtained. So, if a business starts on 1 June 2013, the holiday will only apply for 3 months.

Remember that **primary Class 1 NICs payable by the employee will continue to be paid in full as normal.**

12.9 State Second Pension

When we calculated the employee's Class 1 NIC liability in the previous illustrations, we did so on the assumption that the employee had not “contracted out” of the State Second Pension.

The State Second Pension provides individuals with an Additional State Pension. The amount of the pension relates to the earnings of the employee, but is more generous for the low paid.

It is possible for an **employee who is a member of a salary related occupational pension scheme to contract out of the State Second Pension** and if he does so, he is informing the Government that he will make his own pension arrangements. There are certain advantages from an NIC point of view of contracting out of the State Second Pension.

If an employee is contracted out of the State Second Pension, that employee will get a 1.4% rebate on his National Insurance Contributions.

The employee will pay Class 1 NIC at a reduced rate of 10.6% on earnings between the primary earnings threshold and the upper accruals point. Earnings between the upper accruals point and the upper earnings limit will remain liable to NIC at 12%. Earnings in excess of the upper earnings limit are subject to NIC at the 2% rate.

In addition, a rebate of 1.4% is given on earnings between the lower earnings limit and the primary earnings threshold. This is deducted from the total NIC liability.

Where an employer operates a salary related occupational pension scheme which is contracted out, employer's secondary contributions between the secondary earnings threshold and the upper accruals point will be 10.4% as opposed to 13.8%. A 3.4% rebate is given on earnings between the lower earnings limit and the secondary earnings threshold.

Remember that, for examination purposes, all the limits and rates are clearly set out in the tax tables!

Note that it is not possible to contract out where an individual has a personal pension or is a member of a defined contribution occupational pension scheme.

12.10 NIC administration

Notes

NICs are dealt with on a day to day basis by the **National Insurance Contributions Office (NICO)**.

The collection and payment of Class 1 NICs is the responsibility of the employer under the PAYE regulations. If an employer fails to comply with the regulations, notices under Sch 4 SI 2001/1004 can be issued to recover any NICs underpaid.

[SI 2001/1004 Reg 67](#)

Class 1 NICs are due for payment along with income tax collected under PAYE. The payment, interest and late payment penalty provisions we looked at in respect of PAYE apply equally to NIC due, as well as tax. [SI 2001/1004 Reg 67A & 67B](#)

Details of Class 1 primary and secondary NICs payable must be included on the employer's Full Payment Submissions. Penalties for incorrect submissions are calculated based on the liability to tax and NIC.

Taxpayers have a right of appeal against any assessment of national insurance contributions. The NIC appeals procedure follows that for income tax.

SUMMARY & REVIEW – CLASS 1 NATIONAL INSURANCE

Class 1 contributions are paid by both employees (primary contributions) and employers (secondary contributions) on earnings from employment.

Earnings include:

- Cash payments (other than reimbursement of genuine business expenses)
- Payments in kind that can be surrendered for cash
- Readily convertible assets
- Settlement of employee's personal liability
- Vouchers (except childcare to the extent it does not exceed the exempt amounts)

The calculation of **Class 1 primary** contributions is done for an earnings period for employees. The weekly limits are:

First £149	No NIC
£149 – £797	12%
Above £797	2%

The contributions start at age 16 and stop at retirement age.

For a **director an annual earnings period** must be used.

Class 1 secondary contributions are at 13.8% on the excess above the secondary earnings threshold (£148 p/w in 2013/14).

The contributions start at 16 but there is no upper age limit.

If the employee is a member of a salary related occupational pension scheme which is **contracted out** of the Second State Pension, a lower rate of NIC will be payable by both the employee and the employer.

NICO is part of HM Revenue and Customs and is responsible for the administration of NIC. The due dates, interest and penalty position essentially mirrors that for PAYE.

SUMMARY & REVIEW – TREATMENT OF EMPLOYMENT INCOME

	PAYE income?	Class 1 NIC?
Cash payments including salary, bonuses	Yes	Yes
Termination payments taxed under s.401 ITEPA 2003		
• 1 st £30,000	No	No
• excess over £30,000	Yes	No
Payment/reimbursement of genuine business expenses	No	No
Private expenses (including non-qualifying relocation payments and the full amount of incidental expenses where payment exceeds the limits)		
• reimbursed to employee	Yes	Yes
• paid to supplier but arranged by employee	No	Yes
• paid to supplier and arranged by employer	No	No
Round sum allowances	Yes (unless HMRC agree it does no more than reimburse business expenses)	Yes (unless specific and distinct business expense identified)
Readily convertible assets	Yes	Yes
Vouchers		
• cash vouchers	Yes	Yes
• non-cash vouchers	No (unless can be exchanged for readily convertible asset)	Yes (ignore exempt amount of childcare vouchers)
Asset surrenderable for cash	Yes	Yes
Qualifying relocation payments in excess of £8,000	No	No
General benefits eg		
• assets made available for private use	No	No
• car and fuel benefit	No	No

Notes

• loan benefit	No	No
• loan written off	No	Yes
Approved mileage allowance payments		
• not exceed authorised amount	No	No
• exceeding authorised amount	No	Yes (excess)

Appendix 1 – Additional Examples

Additional Example 1

Which of the following forms of remuneration are earnings for Class 1 NIC purposes?

- a) Interest free loan
- b) £5,000 of premium bonds
- c) £20,000 of gold bullion
- d) John Lewis store voucher
- e) Reimbursement of home telephone calls
- f) Reimbursement of business expenses

Additional Example 2

Harry is an employee earning £26,000 per year. He is paid weekly and in March 2014 he received a bonus of £1,000.

Calculate his Class 1 NIC due for 2013/14.

Appendix 2 – Solutions to Chapter Examples

Solution to Chapter Example 1

The salary and the Christmas bonus constitute earnings for Class 1 NIC, but the company car benefit does not.

The monthly limits are:

	£
Primary earnings threshold:	646
Upper earnings limit:	3,454

For 11 months of the year his earnings will be $18,000/12 = £1,500$.

In December his earnings will be $1,500 + 5,000 = £6,500$.

The calculation will therefore be as follows:

Class 1 primary NIC	£
11 months with earnings of £1,500	
$(1,500 - 646) \times 12\% \times 11$ months	1,127
1 month with earnings of £6,500	
$(3,454 - 646) \times 12\% \times 1$ month	337
$(6,500 - 3,454) \times 2\% \times 1$ month	<u>61</u>
NIC payable	<u>1,525</u>

The effect of this is that part of the £5,000 bonus paid in December 2013, will only have been charged to NIC at 2%.

Solution to Chapter Example 2

To calculate the director's NIC we need to aggregate his earnings for the whole of the tax year and compare to the annual limits.

Annual earnings
 $(18,000 + 5,000) = £23,000$

Class 1 primary NIC
 $(23,000 - 7,755) @ 12\%$ £1,829

Notes

We see here that, unlike as with the employee in the previous illustration, none of the director's earnings will attract the 2% rate of NICs and for this reason it tends to be more expensive from an NIC perspective to be a director rather than a normal employee.

Appendix 3 – Solutions to Additional Examples

Notes

Solution to Additional Example 1

Earnings

a.	Interest free loan	No	(No NICs on benefits)
b.	£5,000 of premium bonds	Yes	(Surrenderable for cash)
c.	£20,000 of gold bullion	Yes	(Readily convertible asset)
d.	John Lewis store voucher	Yes	
e.	Home telephone bill	Yes	(Settlement of employee's liability)
f.	Reimbursed business expenses	No	

Solution to Additional Example 2

Earnings:

51 weeks @ £500

1 week @ £1,500

NIC:

(500 – 149) @ 12% × 51	£
	2,148
(797 – 149) @ 12% × 1	78
(1,500 – 797) @ 2% × 1	14
Total	<u>2,240</u>



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