Institution **CIOT - CTA**
Course **APS Taxation of Individuals**

Event **NA**

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Answer-to-Question-_1_

REPORT

TO: Stephen Hooper
From: Tax Advisor
Date: 10 May 2023
Subject:

INTRODUCTION

This report has been prepared following the email receieved from Stephen Hooper on 24 April 2023, and the follow up meeting with Anna Pearce on 1 May 2023.

The information for this report has been taken from these sources, along with the historic information we hold on file.

The report will look to discuss the tax position of the following:

- Section A: Consultancy work proposition

- Section B: Employent with King Enterprises

- Section C: 12 Valerie Close

This report has been prepared solely for use by you, the firm will not be liable for any reliance on this report by any other parties.

The following reference have been used in the this report:

IT - Income Tax

CGT - CGT

HICBC - High Income Child benefit Charge

PRR: Private Residence Relief

EXECUTIVE SUMMARY

- If the consultancy work is undertaken care should be taken to ensure this does not fall under the deemed employment rules.

- The contract being undertaken will result in the distributions from Hooper Ltd being classed as dividend income which will result in an additional tax liability of £15,706.93 over 2 tax years. You will also become subject to the HICBC.

- While net income of 16,060 can be achieved from the contract, it is recommended that this is ot undertaken as overall you will loose net cash of £1,447

- Due to the optional remuneration legislation, you will be taxed on the £10,000 regardless of which option is taken regarding the car / travel allowance.

- The car benefit will however result in a net better position of £762 and therefore should be opted for on the promotion.

- If an additional mortgage is taken out on 12 Valerie Close, interest will be restricted on this to a tax reducer of £2,000 as the loan is not for the purposes of the business.

- If the property is transferred to the company you will incur CGT of £3,715 and the company will be liable for £22,000 in SDLT.

- The property should be kept in your name personally for additional net annual income of £1,360

Section A: Consultancy work proposition

(A1) Employed or Self-Employed

You have been offered a 6 month consultancy contract which would be undertaken via a limited company.

Where a close company is owned by a sole shareholder, HMRC will review the position of this to check whether the deemed employment rules apply.

Deemed employment occurs where, if it wasn't for an intermediatry, would the individal be classed an employee of the organisation.

In this instance, a company being set up for a single contract. HMRC will consider, if the contract was not in place would it be an employment.

If the deemed employment rules apply, the income earnt under the engagement would be subject to IT under PAYE and Class 1 National Insurance.

When reviewing the position, HMRC will also look at things such as:

- Whether the contract is required to provide work
- How the company is paid
- Whether a personal service is required by you
- who provide equipment

- Whether there is a business operation in place.

To determine whether the legislation would apply, would require more facts about the engagement.

Based on the work under the contract being subcontracted and there being no personal service, will will assume the rules do not apply and the income will not be subject to the deemed employment rules.

(A2) Liquidation of Hooper Ltd

Where a company is formally liquidated, the funds following this are distributed as capital and subject to CGT. This allows for beneficial rates of tax to be applied, along with the CGT annual exemption.

As you meet the qualifying conditions, as noted in your 2022/23 tax return, you qualify for Business Asset Disposal Relief on the capital distributions which allows the taxable distribution to be liable at a flat rate of 10%.

Where a company has been wound up and the following conditions are met, the capital conditions will fail and the distirbutions will be taxed as dividend income.

The conditions are as follows:

- the company is a close company
- the person owns at least a 5% holding in the company
- the main reason of the company beig wound up is to avoid tax
- within 2 years of the final distribution the individual undertakes work, whether this be a trade, partnership or under a LTD in which they have a 5% holding, in the the field of work

If the consultancy work is undertaken, you will meet this criteria and the distributions will instead be taxed as dividend income.

As a result of this, your 2022/23 tax return will need to be amended to remove the capital distribtion and instead include an additional dividend of £39,800.

This will result in additional tax due of £13,074.43 for 22/23. We are within the time frame for amending your tax return so this can be done without implication.

Further to the above, when a tax payer or a partner they live with are in receipt of child benefit, should one of the partners income breach £50,000, the higher earner will be subject to the HICBC.

For the HICBC, for every £100 thh taxpayer income is above £50,000. 1% of the child benefit recieved is repayable. Once income exceed £60,000 the full amount of child beenfit recieved is repayable.

With the additional income your total income will exceed the £60,000 and therefore you will be due to pay back 100% of the Child benefit recieved by your partner. This must be incldued in your self-assessment tax return

The distribution recieved on 10 April 2023 will also no longer qualify and will alos be taxable as a dividend. This additional IT due of £2,632.50 in 2023/24.

Overall, taking the contract will result in additional tax due of £15,706.93 over the 2 tax years, plus an additional estimated £1,800 for the HICBC.

(A3) Income from the Consultancy Work

After corporation tax you expect to make a profit of £17,000 from the consultancy work.

As you will be employed by King Enterprises, both a salary and dividends will be subject to higher rate tax.

As you will not intend to udnertake work in a similar field again following the cessation of the contract, the funds could be withdrawn from the company on wind up and the rules discussed in Section A2 will not apply.

As the funds retained in the company will be below £25,000 a formal liquidation will not be required, which will save on costs. Should this route be taken we can discuss the information liquidation route further at a later time.

The £17,000 would be avaliable as a capital distribution. As this is expected to take place in December 2023 no other distributions would have occured in the year the annual exempt amount will be avaliable.

BADR will not be avaliable on this distribution as the shares have not been held for 2 years.

You will have a CGT libaility as follows:

£17,000 - £12,300 = £4,700

As you will be a higher Rate taxpayer in 2022/23 the gain will be taxed at 20% = £940

Net income will be (£17,000 - £940) £16,060.

(A4) Summary

If the consultancy work is undertaken, care would need to be taken to ensure this does not fall under the deemed employment rules.

You would realise net income of £16,060 from the contract, however the previously distributions recieved on the liquidation of Hooper Ltd would fail as capital and instead be taxable as dividends.

As a result of this, additional tax of £15,706.93 will be due, along with an estimated HICBC of £1,800. There would also be additional admin fees incurred to amend the 2022/23 tax return.

Overall, it is recommended that the consultancy work is not udnertaken as you will be end up with an estimated overall net loss of £1,447 £(16,060 - 15,707 - 1,800).

Section B: Employent with King Enterprises

You are currently working for King Enterprises plc, they have offered you a new contract which you wish to better understand the tax implications of.

This contract will not be effected by either the decision made on the contracting role, or buy to let property position.

(B1) Current position

You have been working for King Enterprises plc since September 2022 in their office in Nottingham. You recieve a gross salary of £50,000 and you recieve a tax free employer pension contribution of £4,000 (£50,000x 8%).

Overall the your current employment has a gross worth of £54,000.

With property income will be above £60,000 so will be liable to HICBC charge - unless this is moved to company.

Could make personal pension conts to reduce liability.

(B2) Promotion

In your new position you will recieve a salary of £60,000, a tax free employer pension contribution of £4,800 (£60,000x 8%) and either a car benefit or travel allowance.

Your net position will be £74,800 following the promotion. This higher income will be taxable at 40% plus teh HICBC.

(B2.1) Car v Travel Allowance

Where a car is provided to an employee and this is avaliable for personal use, a taxable benefit will arise. It does not matter whether the car is used personally, the avaliability of this will result in a benefit arising.

The taxable benefit is calculated based on the vehciles co2 emissions and based on the details provided you will have a taxable benefit of £8,223 (Appendix 2).

Where fuel is provided by the employer for business use only, no taxable benefit will arise. As you will not be using the car for personal journeys this will be the case.

To ensure this, should this option be taken, you may wish to request the offer be amended to state fuel will only be provided for business journeys only.

As you will be a higher rate taxpayer this will be subject to tax at 40% resulting in an additional liability of £3,289.

Alternatively, you have been offered a travel allowance of £10,000. As this is cash recieved this will be subject to both IT and Class 1 National Insurance via payrol.

If taken, you will incur the cost of a lease vehicle at an annual cost of £5,148 (£429 x 12), plus fuel costs of £2,000. Resulting in net expenses of £7,148.

Following the promotion you will work at home 2 days a week, and travel to 3 locations in Sheffield for the remaining 3 days.

Where an employee is required to travel to a temporary workplace, travel to the location is a deductible expense if the conditions are met.

To be deductible, the place of work must be for a duration of under 24 months and less than 40% of the employees time is spent at this location.

You will be working on 3 different sites, within 7 miles of each other. Where a workplace may consist of several locations in close proximity, HMRC will deem the 'area' as the work place.

As you will be spending 60% of your week in an area of Sheffield for at least 3 years, the temporary workplace rules will not apply and travel will not be allowed.

If you are requiresd to work at home by your employer on the days spent in Nottigham, you may be able to claim the work from home allowance, however we would need further information to determine this.

As the travel costs will not be dedcutible from the allowance, you will be subject to Tax on NIC on the full £10,000, resulting in laibilities as follows:

£10,000 @ 40% = £4,000
£10,000 @3.25% = £325

Your net position of the allowance would be a loss of £1,473 £(10,000 - 4,000 - 325 - 5,148 - 2,000).

You would therefore be in a better postion by accepting the compnay car and requesting the contract be adjusted to disallow personal fuel.

Where a cash sum is offered in place of a benefit, the optional remuneration rules are triggered which will result in the cash amount being taxed on your over the benefit. You will therefore be subject to tax on the full £10,000.

Thsi will however still result in a better net position as the additional tax will be £711 which is less than the £1,473 loss.

Section C: 12 Valerie Close

You are considering borrowing additional funds on 12 Valerie close and are considering incorporating a property business to hold the rental property in an attempt to minimise the tax exposure.

(C1) Retaining property personally

As the proeprty currently stands you have an outstanding mortgage of £250,000 with a rate of 3.5% which equates to annual interest of £8,750.

Your are intending to take a further mortgage of £100,000 which will result in the interest rate increasing to 4% if kept in your name. This will result in the annual interest increasing to £14,000 (£350,000 x 4%).

The mortgage interest allowed against a rental property is resricted to the lower of:

- the interest amount
- the property income
- Net adjusted income

Further to the above, mortgage interest is further restricted to the value of the property when this was brought into the letting business.

When first let the property was worth £350,000. Therefore a mortgage up to this amount would usually be allowable.

However, where a further mortgage is taken after the property business has commenced, any further loans on the property must be used 'wholly and exclusively' for the purpose of the property business.

As you are intending to use the further mortgage to fund your personal expenses, the 'wholly and exclusively' condition will not be let and interest charged on the additional loan will not be allowable for tax purposes.

As an additional loan is being taken this will however increase the interest on the current mortgage to 4% resulting in annual interest of £10,000 (£250,000 x 4%).

As £10,000 will be the lower of the 3 restrictions above, this will be allowed for tax purposes.

On an individual, mortgage interest is allowed as a tax reducer and relief is restricted to 20% of the interest paid. This will therefore not reduce your taxable income, but it will result in a tax deduction of £2,000 (£10,000 x 20%).

If the property is kept in your name personally, due to your other income this will be taxed at 40%, resulting in a liability of £4,400 (£11,100 x 40%). After the the tax reducer of £2,000, you will recieve net income of £8,660 on the rental property.

(C2) Transfer Property into a company

You are proposing incorporating a limited company to hold the rental property as a property business.

If the property is transferred to a company the mortgage interest will increase on the outstanding loan of £350,000 to 4.5% resulting in annual interest of £15,750.

Once in the company, due to additional admin expenses, profits on the property are expected to be £10,000. As the mortgage is on the property when this is brought into the letting company, the full interest of £15,750 will be an allowable expenses.

Companies are also not restricted to the interest being a tax reducer and therefore this will be deductible from profits resulting in a loss of £5,750.

The company will be a seperate legal entity and the loss will be that of the company's. As the company has no other trade, the loss will be wasted. No corporation tax will be due on the income.

The retained income in the company will then need to be withdrawn. As you are recieving a salary from King Enterprises plc, it would be more efficient to recieve the funds as dividends, this will reduce the tax rate from 40% to 33.75%, along with the £2,000 dividend allowance.

As you will not be receiving any other dividend income in the year, you will pay tax on the dividend as follows:

£2,000 @ 0% = 0
£8,000 @33.75% = 2,700

Overall, you would have net icnome of £7,300 (£10,000 - £2,700).

(C3) Further Tax Implications of Transfer

The transfer of the property into a company will be a disposal for CGT.

Where a property has been lived in as a main residence PRR is avaliabale, this exempts the period of main residence from CGT. Where the property ceases to be a main residence and is not reoccupied prior to sale, the last 9 months will also qualify for PRR as deemed occupancy.

The property was your main residence up to 1 June 2020 and as a result this part of the gain, along with the final 9 months will result in 89.7% of the gain being exempt from CGT.

A gain of £25,568 will remain chargeable. As you are a higher rate taxpayer, this will be subject to CGT at 28% resulting in a tax liability due of £3,715.

As the rate of tax on residential property is higher than that on the share disposal, the above considers that your annual exempt

exempt would be offset against the transfer instead of the capital distribution from your company. As a result of this, an additional amount of £980 will also become due on the capital distribution recieevd on 10 April 2023.

The additional tax of £980 can be avoided if you wait until the 2024/25 tax year to transfer the property into the company.

As this would be a disposal of UK residential property and a gain is being made, you would need to report the disposal on a 'CGT on UK Property return' and this would need to be filed within 60 days of the transfer. The tax of £3,715 would be due within the 60 days also.

As the property is not a business asset, no further CGT relief are avaliable on the transfer of the property.

As the property will be an aquistion of residential property by a company Stamp Duty Land tax (SDLT) will be payable on the market value of the transfer, even though no consideration is paid.

Companies subject to 3% surcharge on residential property.

This will be due as follows:

£125,000 @3%= £3,750
£125,000 @5%= £6,250
£150,000 @8%= £12,0000

Total SDLT = £22,000

This would be payable by the company within 30 days of the tansfer.

Lastly, the property is also currently valued at £400,000. If owned by company and the value increased to over £500,000, this will be subject to the annual ATED charge.

(C4) Summary

If the property is transferred into a company in the current tax year there will be CGT to pay of £4,695 (£3,715 + £980), along with SDLT of £22,000.

By leaving the property out of the company you will have annual net income of £8,660, whereas this will be reduced to £7,300 by transferring the property into the company.

You will again incur the HICB in full should the property be retained personally, however this be be incurred regardless following your promotion so should not be considered in this circumstance.

APPENDIX 1

Review of Tax liability should the distributions be treated as dividends:

2022/23 Tax year

Salary	29,548			

Property Income	11,100			
Dividends	9,000			
Additional Dividends*	39,200			
Total income	88,848			
Less: personal allowance	(12,570)			
taxable Income	76,278			
28,078 @20%	5615.60			
2,000 @0%	0			
7,622 @8.75%	666.93			
38,578 @33.75%	13,020			
Total tax	19,302.53			
Less relief on Finance Costs*	(1,750)			
Less: PAYE	(2,484.20)			
Total Tax	15,068.33			
Current 22/23 Tax	1,993.90			
Additional Tax due	13,074.43			

*relief restricted to 20%. £8,750 x 20% = £1,750

HICB charge will also be applicable for 22/23. As income over £60,000, full recoevery will be due. Estmated £1,800.

23/24 Tax Year

As Capital the payment will fall under the CGT Annual Exemption and no tax will be due.

As a dividend, due to the increase in salary income the full dividend will be taxable at the higher rate, after dividend allowance:

£10,000 - £200 = £9,800

£			

2,000	@0%	0	
7,800	@33.75%	2,632.50	
Total		2,632.50	

Appendix 2

Car Benefit: 8,223

List Price - 26,525 x 31% = 8,223

Co2 emissions - 130g/km - 75 = 55 / 5 = 11

20%+ 11% = 31%

Appendix 3

Gain on Transfer of Property:

	£		
Market value	400,000		
Cost	(150,000)		
Gain	250,000		
PRR	(224,432)		
Net	25,568		
Annual Exemption	(£12,300)		
Taxable Gain	13,268		
Tax @28%	3,715		

PRR:

Purchase - 01/06/2001
Transfer - 01/06/2023
Owned - 22 years

Lived in 01/06/2001 - 01/06/2020 - 19 years

Last 9 months deemed occupancy - 0.75 years

19.75 / 22 = 89.7% PRR

250,000 x 89.7% = £224,432

Additional tax due on Capital distribution due to Annual Exemption being removed:

£9,800 @ 10% = £980