



The Chartered Tax Adviser Examination

November 2020

Human Capital Taxes

Suggested Solutions

ANSWER 1

From Tax Manager
To martina.cowley@ola.gov.uk
Date 23 November 2020
Subject Customer care training

Martina,

As agreed, I have noted below the Income Tax and National Insurance Contributions (NIC) considerations of engaging the trainers.

Off payroll working in the Public Sector

Overbridge Local Authority (the 'Authority') is considered to be a public authority body and special rules covering worker's services supplied through intermediaries have applied to public authority bodies from April 2017. For these rules to apply there must be:

1. An individual who personally performs or is under an obligation to perform services for a public authority;
2. The services are provided under arrangements involving a third party and are not provided under a direct contract between the public authority and the individual; and
3. If the services had been provided under a contract directly between the public authority and the individual, the individual would have been considered as an employee of the public authority.

This potentially applies to all the trainers. However, Michelle Dennis will be covered by the agency rules because she personally provides services to the Authority, there is a contract in place between the Authority and a third person (Coach.com Ltd) under which the Authority pays for her services and the Authority has supervision, direction and control over the way Michelle's work is performed. As such, Coach.com Ltd will be required to operate PAYE and NIC as if Michelle were an employee and, as the agency rules take priority, the Authority has no further obligations in relation to Michelle.

. However, the agency rules do not apply to the other trainers as Coach.com Ltd does not contract with them directly as individuals. Therefore, the Public Sector rules must be considered in relation to the arrangements with Sanjit Khula and June and Oscar Cox.

Employment Status

Based on the facts presented, the arrangements with Sanjit Khula June and Oscar Cox would appear to create employment relationships. This is based on the following main indicators:

- a) There is mutuality of obligation created between the Authority and each trainer, as it is for the Authority to decide who performs the training and each individual is required to provide their own services.
- b) The services were performed on the Authority's premises and were overseen and determined by the Authority;
- c) The trainers did not provide their own materials and equipment;
- d) The trainers did not take financial risk, as they were paid fixed fees;
- e) Supervision is applied over the trainers' course content and performance. The Authority could say who, how, what or when the work is performed, and crucially required the personal service of each specified trainer.

You should have retained evidence so that you can show that you took all reasonable care when determining the workers' status.

Use of employment agency

Where a public sector body does not contract directly with the intermediary providing the services of the worker, but does so through an agency, this is referred to as a 'chain'. The public sector body must inform the next link down in the chain (the party with whom it has a contract) what its decision is regarding the employment status of the worker.

You were therefore required to inform the next person in the chain (i.e. Coach.com Ltd) that you consider the trainers employment status is such that they would have been employees if it were not for the intermediaries.

This should have been done on or before the date the contract for services was entered into, or, if the services began at a later date before the services were performed. This would be prior to any preparatory work for the training taking place. Notification could have been included within the formal contract for services issued, or in a separate letter.

It is therefore important that the Authority check and ensure that these notifications were made.

Where there is a chain involved, the lowest link in the chain has responsibility for paying the intermediary for the services of the worker (the fee-payer) and they have the obligation to work out the deemed direct payment and account for tax and NICs under PAYE in respect of it, unless that entity is not a 'qualifying person'. A qualifying person must be resident in the UK or have a place of business here. If the worker controls or has a material interest (5%) in a link in the chain, that link in the chain cannot be a qualifying person. Therefore Coach.com Ltd is the 'fee-payer' as they are a UK resident company and none of the trainers are connected. The deemed direct payment is the amount paid to the trainers' intermediary businesses, excluding any VAT, materials or expenses.

If Coach.com Ltd fails to fulfil its obligations under the regulations, there is the risk that HMRC could pursue the Authority for any PAYE, employee NIC and employer NIC along with the Apprenticeship Levy as the end user of the individuals provided under these arrangements. Transfer of debt regulations permit HMRC to raise assessments against the Authority, plus interest and penalties arising. In particular, where the Authority failed to issue notifications to Coach.com Ltd, it would be responsible for any PAYE and NIC arising.

It is therefore important for the Authority to check the arrangements that were entered into and if the appropriate notifications were given within the time limits required.

Please do not hesitate to contact me should you require anything further

Regards

MARKING GUIDE

TOPIC	MARKS
Off payroll working in the public sector	1
Stating condition 1 personal service	½
Stating condition 2 intermediary	½
Stating condition 3 employment	½
Identifying Michelle potentially excluded because covered by agency regulations	1
When agency rules apply	1
Responsibility for PAYE/NIC liabilities under agency regulations	1
Identifying intermediaries and where public sector rules apply	1
Relevant badges of trade – Substitution	½
Mutuality of obligation	½
Personal Service	½
Material and equipment	½
Supervision	½
Control	½
Take reasonable care and evidence	½
Status ruling requirement to next person in the chain	1
Timing requirement	½
Responsibility for PAYE/NIC liabilities on deemed direct payment	1
Identifying Coach.com Ltd as fee payer	½
Risk if Coach.com Ltd do not comply	1
Presentation and Higher Skills	1
TOTAL	15

ANSWER 2

Taxed Award Scheme

The proposed benefits would be regarded as arising by reason of employment and therefore would form part of the earnings of the recipient employees. However, the additional tax and interaction with HMRC would be unlikely to incentivise the employees and would defeat the aim of the scheme. Therefore Toriq Inc needs to find a way of alleviating this burden.

If there was sufficient evidence of the employer facilitating the awards, Best Motors World Ltd would need to enter into a PAYE Settlement Agreement ("PSA"). Payment would be due by 19 October 2022. Best Motors World Ltd would deal with the administration and incur the costs of the gross ups. As the employer only provides everyone's sales figures, and doesn't get involved in the awards, this is not likely to be applicable.

However, as it is a third party offering and running the scheme, Toriq Inc could apply for a Taxed Award Scheme (TAS). A TAS allows a third party to pay Income Tax and NIC on incentives and awards to employees of an unconnected employer, without having to operate PAYE. This has the advantage of enabling Toriq Inc to meet the Income Tax and NIC due. The disadvantage for Toriq is that the costs involved in providing the proposed incentives are higher as Toriq Inc will effectively pay the tax liability of the employee. Toriq would also be liable to pay Class 1A NIC on the value of the non-cash awards.

Assuming Toriq Inc has no PAYE presence in the UK, it does not have any liability to operate PAYE or submit P11Ds, nor does it have a liability to secondary Class 1 or Class 1A NIC. However, this stance does not aid the situation for the employees. Therefore, Toriq Inc should voluntarily apply for a TAS.

Nature of awards/event

A TAS can be used to settle awards made using items that cannot be exchanged for cash, such as actual gifts of goods or services. It can also cover the costs for the annual event. However, a TAS cannot be used for the proposed cash bonuses.

Assuming the cash awards are made, Toriq Inc could not settle the tax on the employees' behalf, which would defeat the object, since it does not have a UK payroll.

Toriq would also not be able to pay Class 1 A NIC since it is cash. The obligation to pay any Class 1 NIC remains with the employer, Best Motors World Ltd. Both employee and employer Class 1 NIC is payable. This would need to be grossed up for the amount of cash delivered **plus** the Income Tax paid for by Toriq Inc. Toriq Inc would therefore need to find a way to recompense Best Motors World Ltd for the NIC cost it would incur, which would be payable by 22 of the month following payment.

I would therefore recommend that instead of providing a £10,000 cash prize per person at the event, Toriq Inc considers making the award in gift form, so it can be included in the TAS.

Type of TAS

There are two types of TAS available, a basic rate or a higher rate scheme. To be sure that no further income tax arises for Best Motors World Ltd's employees, Toriq Inc would need to opt for the higher rate scheme as it is likely the employees are higher rate taxpayers. This could mean that Toriq Inc gross up at the higher rate even if the employees only pay income tax at the basic rate. In either case the employees are required to enter the value of the amounts they have received on their UK self-assessment tax returns, but so long as Toriq Inc pay all the tax that is due, nothing more is required to be done by the employee.

With a proposed start date of 1 January 2021, so long as awards are delivered on or after 6 April 2021, the scheme can be registered by 5 April 2022, otherwise it is to be registered by 5 April 2021. Annual returns are due to be submitted to HMRC. Assuming awards are from 6 April 2021 onwards: a return would be due by 6 July 2022. The Income Tax and Class 1A NIC due is payable by 22 July 2022 if paying electronically, or 19 July if not.

Administration

Toriq Inc need to agree a TAS with the Incentive Award Unit at HMRC, calculate the liabilities due, complete the annual returns due (P35(TAS) and P440) and if they do opt to use the higher rate scheme, provide each employee with a certificate (P443). If they opt for the basic rate scheme, Toriq Inc only has to provide a certificate if asked by the employee. The below computation shows the costs assuming a higher rate TAS is adopted, which would be the recommended approach.

Item	Income Tax	National Insurance
Quarterly gifts	$\text{£1,000 per person} =$ £1,000 /60 x 100 $= \text{£1,667 gross value}$ $\text{£1,667 x 40\% tax} =$ £667 $\text{£667 x 50 x 4} =$ £133,400	$\text{£1,000} +$ £667 tax £1,667 $\text{x 13.8\%} =$ £230 $\text{£230 x 50 x 4} =$ £46,000
Event	$\text{£5,000 per person} =$ $\text{5,000/60 x 100} = \text{£8,333}$ gross value £8,333 x $\text{40\% tax} =$ £3,333 $\text{£3,333 x 20} =$ £66,660.	£5,000+ £3,333 £8,333 x 13.8\% $= \text{£1,150}$ $\text{£1,150 x 20} =$ £23,000
Cash	$\text{£10,000 per person} =$ $\text{£10,000/58 x 100} =$ $\text{£17,241 grossed up}$ $\text{£17,241 x 40\% x 10}$ £68,964.	£17,241 x $\text{2\% employee NI} =$ $\text{£345 x 10} = \text{£3,450.}$ £17,241 x $\text{13.8\% employer NI} =$ £2,379 $\text{x 10} =$ £23,790.
Grand Totals	£269,024	£96,240

MARKING GUIDE

TOPIC	MARKS
Awards are taxable as employment income	½
Identifying a TAS	½
Identifying Class 1A NIC applies to non-cash awards	½
Why PSA is not appropriate	1
Non-cash items only	½
Tax can't be settled on cash within TSA	½
NIC via payroll on cash is the employer's liability	1
Flagging issue if NIC payable by employer	1
Recommendation to deliver in alternate form	½
Basic and higher rate option	½
Grossing up cost for income tax and NIC purposes	½
Employee obligations	½
Recommendation as to which option to take	1
Stating this is the car manufacturers liability	½
Correct due dates for payment	½
Registration/deadlines	1
Forms required:	
P35(TAS)	½
P440	½
P443	½
Calculation:	
Quarterly prizes income tax	½
Quarterly prizes NIC	½
Annual event income tax	½
Annual event NIC	½
Cash income tax	½
Cash NIC	½
TOTAL	15

ANSWER 3

To: Kerry Taylor
From: Janette Voss
Date: 5 November 2020
Subject: Riku Tanaka's UK Payroll

Dear Kerry,

Thank you for your email of 29 October.

Having a dual-contract structure is not in itself an issue. However, the contract and more importantly the working arrangements, have to be structured correctly.

As a UK tax resident and non-UK domicile, Riku is liable to UK tax on his worldwide income, although he can claim (through self-assessment) that the overseas income is only taxed if and when it is remitted to, brought into, enjoyed or used in the UK. For his Japanese earnings to be treated as overseas income, they must derive from an overseas employer and relate to duties performed wholly overseas.

You therefore have to examine if it is a case of one employment, which has simply been split between two countries or whether there are two distinct employments, capable of being performed separately. Although both are sales roles, it seems that the Japanese role is in relation to their machinery and the UK role is for UK-made parts and after sales service. Nevertheless, we need to examine this further to identify if there are enough distinctions between the roles to argue that there are two employments.

In any review, HMRC will also check into your internal administration and management for evidence of separation. For example, although you clearly have separate payrolls in operation, how are expenses managed and controlled? Are the reporting lines separate and distinct?

Assuming we can argue that it is two distinct roles, there is still an issue as to where the Japanese contract duties are carried out. These have to be carried out wholly abroad otherwise the whole of the earnings will be subject to UK tax as they arise. HMRC will often look closely at the duties listed in the overseas contract and make sure none of those duties were actually performed in the UK. Riku can have some incidental workdays in the UK but it seems he is perhaps doing more than this. An incidental workday is something that does not form part of Riku's specific role, for example reading generic work emails. Presenting to you at the management meetings about the Japanese machinery would seem to be part of his Japanese role, and in his capacity as VP of Sales for the parent company. HMRC will also want to verify that Riku does not take important telephone calls or answer emails in relation to his Japanese role, whilst he is in the UK. HMRC are very strict about this and given that the Japanese work is focused on sales into the UK, it seems there is a high risk that Riku could do some Japanese contract duties in the UK.

There is anti-avoidance legislation, which ensures that a single employment is not split into two simply to take advantage of any tax savings. If this legislation applies, the earnings are taxed when they are received, not on the remittance basis. Also, as the two employers are associated, to avoid the maximisation of chargeable overseas earnings as compared to other earnings, HMRC will compare the split of salary under the contracts with the actual workday split and the nature of the duties and they can allocate some of the Japanese earnings to UK duties. However, this legislation is not directly your concern but something Riku has to address on his UK self-assessment tax return.

PAYE

Your issue, however, is whether you are correctly applying PAYE and NIC. If it can be said that there is in reality only one employment, not two separate ones, then the question will be who is the employer: the Japanese or the UK company? If it is the Japanese company, then the question is whether the UK company is benefitting from Riku's services. If the UK company is benefitting, then you must include the Japanese earnings in the UK payroll under RTI. If the UK company is the employer, then all worldwide earnings must also be included in the UK payroll.

Given that Riku is subject to Japanese tax as well on these earnings, there would be double withholding tax in the event that UK PAYE were in point. Japan has the primary taxing right on duties performed in

Japan, so the UK would have to give a foreign tax credit to avoid double taxation. It is possible to apply to HMRC for an Appendix 5 agreement, which allows you to deduct the Japanese tax from the UK PAYE. However, this requires specific RTI software and, if you do not have this already, Appendix 5 may not be practical for a single employee. Alternatively, Riku could request an estimated foreign tax is included in his PAYE code. The accurate foreign tax credit would then be calculated in his UK tax return.

If Riku is performing duties in the UK solely for the Japanese parent company and they are not benefitting the UK company at all, then the Japanese company is responsible for the PAYE. However, providing it has no presence for PAYE purposes, then no PAYE is due. Riku is responsible for declaring the Japanese earnings and paying any tax due on his UK tax return.

NIC

If it is considered that the Japanese earnings are attributable to the UK employment, then you will be required to deduct NIC from Riku and also make secondary employer's contributions on the Japanese earnings. Under Article 4(2) of the reciprocal agreement, Riku is liable to UK NIC only if he is employed and working in both countries, since he ordinarily resides in the UK.

Should it be determined that Riku does have two separate employments, Article 5 (1) would not apply to the Japanese earnings, even though he has a Japanese contract, as he is not on detachment to the UK for a period expected to last less than five years. Article 4(2) would continue to apply, resulting in UK NIC being due on the Japanese earnings. However, assuming the Japanese company has no place of business in the UK, then employer's contributions would not be due. Riku would have to apply to HMRC to operate a direct collection scheme and would have to account for the employee's NIC due on his Japanese earnings direct with HMRC.

I would suggest that we discuss the nature of Riku's duties in a telephone call once you have had chance to consider the above.

With kind regards,

Janette

MARKING GUIDE

TOPIC	MARKS
Identifying dual contract arrangements and requirement to structure correctly <ul style="list-style-type: none"> • Risk of one employment <ul style="list-style-type: none"> ○ Discussion of distinction between roles ○ Company administration also considered • Risk of UK duties on Japanese contract <ul style="list-style-type: none"> ○ Location of duties key ○ Explanation of incidental duties ○ Role at management meetings not incidental ○ Other Japanese duties carried on in UK ○ Conclusion that high risk and the consequences of this 	 1 1 ½ ½ ½ ½ ½
Existence of anti-avoidance legislation <ul style="list-style-type: none"> • Taxed on arising basis • Re-allocation of earnings as associated employers • Adjustment is on tax return • Not company issue 	½ ½ ½ ½ ½
Issue is PAYE/NIC by employer One employment with Japan: <ul style="list-style-type: none"> • UK company benefitting, PAYE due on Japanese earnings by UK company • UK company not benefitting, then no PAYE and why <ul style="list-style-type: none"> ○ Tax due on tax return One employment with UK: <ul style="list-style-type: none"> • PAYE due on all earnings Japanese company not liable to PAYE and why	½ ½ 1 ½ ½ 1
Double withholding tax <ul style="list-style-type: none"> • Identifying • Suggesting Appendix 5 <ul style="list-style-type: none"> ○ Dismissing and why • Suggesting FTC in PAYE code <ul style="list-style-type: none"> ○ Estimate and finalised in tax return 	½ ½ 1 ½ ½
NIC <ul style="list-style-type: none"> • One employment, UK employee's and employer's contributions only • Art 4 application and why • Separate employments <ul style="list-style-type: none"> ○ Not Art 5 and why ○ Direct collection ○ No secondary contributions and why 	½ 1 1 ½ 1
PHS	2
TOTAL	20

ANSWER 4

To: Francis Lee
From: Susan Smith
Subject: RE: Gorman & Rajani LLP – HMRC Review
Date: 1 November 2020

Dear Francis

Thank you for your e-mail.

As you may be aware, the salaried members rules are an anti-avoidance provision introduced in April 2014.

The effect of these rules is to treat members of LLPs as employees, if they meet three conditions:

- Condition A (disguised salary),
- Condition B (no significant influence) and
- Condition C (inadequate capital contributions)

The LLP itself is then treated as the “employer” and is held responsible for applying PAYE, NIC and Apprenticeship Levy. Therefore, you want, if possible, to avoid any of your members being treated as salaried members.

It is worth noting all three conditions must be met, so we would only need to demonstrate to HMRC that the members have failed any one of the tests in order to defend the partnership against challenge in this area.

This test is applied on an individual-by-individual basis, although in the interests of simplicity I have broken down my analysis by reference to the groups described in your e-mail.

Leadership

Condition B above is probably the relevant point for this group.

The Leadership group, being the members of the board of management, runs the LLP. These members, in our view, are likely to be considered to have significant influence and consequently we don't think that Condition B is met.

The Leadership group members are not therefore salaried members.

Divisional Heads

In contrast, the Divisional Heads, whilst having a high degree of autonomy over their particular business lines, are likely to have met Condition B. This is because, this condition requires the members to have significant influence not just over their own area of the business but over the management of the LLP as a whole.

As such, we would need to look to one of the other two conditions in order to see if we can avoid them being categorised as salaried members.

It is worth considering Condition A (disguised salary) which (broadly) applies where, at the relevant time, it is reasonable to expect that at least 80% of the payments made by the LLP to the member for their services over the relevant period will be disguised salary.

An amount is disguised salary if it is:

- 1) Fixed;
- 2) Variable, but is varied without reference to the overall profits and losses of the LLP; or
- 3) Is not in practice, affected by the amount of those profits and losses.

Their drawings are fixed monthly sums not repayable once taken under the terms of the partnership agreement and therefore are potentially disguised salary under this legislation.

However, as the excess profits of the business are allocated between the Leadership group and Divisional Heads according to the profit share units, the discretionary allocations should not be considered disguised salary for either group.

The question then is whether the drawings constitute 80% or more of the total partnership income. For both groups it can be observed that discretionary allocations of more than 25% of Draw have been made for all members. As a result, Condition A is not met for both the Leadership and Divisional Heads and consequently neither group's members should be considered salaried members.

Junior Members

The junior members have little influence over the business and therefore will have met Condition A.

Furthermore, discretionary allocations for junior members are based solely on personal performance and hence must be considered disguised salary. Together with their drawings, all of their income would be regarded as disguised salary and as such Condition A is also met.

Condition C will be met where the member's contribution to the LLP is less than 25% of the disguised salary it is reasonable to expect will be payable for the members performance of services for the LLP.

As this group only commit 10% of drawings in capital, Condition C is met. It is likely that this group will therefore be considered salaried members under the tax legislation.

Exposure

Whilst the LLP would be liable to the "gross" amount of PAYE plus primary and secondary Class 1 NIC and Apprenticeship Levy in the first instance, we would expect HMRC to issue a direction notice enabling any PAYE to be set off against income tax paid under Self Assessment as well as allowing for a set off of primary Class 1 NIC against any Class 2 and Class 4 NIC paid.

In practice, for 2018/19. this would mean a NIC and Apprenticeship Levy liability (before deduction against the profits of the employer) of the following:

Total Class 1 NIC and Apprenticeship Levy due for 2018/19

Primary NIC

$((£46,350 \times 150) - (£8,424 \times 150)) \times 12\%$	
=	£682,668
$(£20,250,000 - (£46,350 \times 150)) \times 2\% =$	£265,950
	£948,618

Secondary NIC

$(£20,250,000 - (£8,424 \times 150)) \times 13.8\%$	
=	£2,620,123

*Apprenticeship Levy**

$£20,250,000 \times 0.5\% =$	£101,250
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Total	£3,669,991
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Less: Class 2 and 4 NIC paid for 2018/19

<i>Class 2 NIC</i>	
(£2.95 x 52 x 150) =	£23,010
 <i>Class 4 NIC</i>	
((£46,350 x 150)-(£8,424 x 150)) x 9%	
=	£512,001
(£20,250,000 - (£46,350 x 150)) x 2% =	£265,950
	<hr/>
	£777,951
Total Class 2 and 4 NIC	<hr/>
	£800,961
	<hr/>
Net amount due before business income tax deduction	<hr/> <hr/>
	£2,869,030

* Note that the levy allowance will already have been used by your employee population

I would expect these costs to also qualify as a deduction in computing the profits chargeable to tax and NIC which would further reduce the effective rate ultimately paid to HMRC in consequence of any settlement.

Please do not hesitate to contact me should you wish to discuss this.

Kind regards

Susan

MARKING GUIDE

TOPIC	MARKS
Overview of salaried member rules <ul style="list-style-type: none">• Listing salaried member conditions:• Stating all three tests must be met;• Stating treated as if employee;• Stating LLP would be treated as the employer and be responsible for applying PAYE, employed rates of NIC and Apprenticeship Levy.	1 1 1 1
Significant influence test <ul style="list-style-type: none">• Discussion of significant influence test for Leadership group and correct conclusion• Stating why doesn't apply to Divisional Heads group	1 1
Disguised salary test <ul style="list-style-type: none">• Stating drawings are disguised salary and why• Stating why discretionary payments are disguised salary for junior members• Stating why discretionary payments are not disguised salary for other groups;• Testing the 80% rule and concluding which groups pass/fail;	1 1 1 1
Capital contributions <ul style="list-style-type: none">• Testing if Condition C applies.	1
Calculation <ul style="list-style-type: none">• Calculation of Primary NIC• Calculation of Secondary NIC• Calculation of Apprenticeship Levy at 0.5%• Explanation that no Levy Allowance is available• Calculation of Class 2 NIC• Calculation of Class 4 NIC• Reference to set off available• Deduction against the profits on the remaining LLP members and benefits	1 1 ½ ½ 1 1 1 1
PHS	2
TOTAL	20

ANSWER 5

To: Darren Goodge
From: Helena Trent
Date: 7 November 2020
Subject: PAYE Coding for Gianluca

Dear Darren,

Thank you for your email of 1 November regarding the PAYE code for Gianluca.

The first point to emphasise is that, as his employer, you have no ability to amend Gianluca's PAYE code. You must operate the code of K309 M1 issued by HMRC, even if it is clearly wrong. In order to change the code, Gianluca must contact HMRC himself and request the necessary changes.

Nevertheless, we can help Gianluca to understand how his code has been calculated and therefore what changes are required. Gianluca can either telephone HMRC or, if he has a personal tax account set up, he can go online to request the changes.

We should also emphasise to Gianluca that his final tax liability on his tax return may not equal his PAYE, for example if he has other income sources or tax claims.

Code History

Completing an expat starter checklist was not the correct process as Gianluca is not a seconded employee for you. A normal starter checklist should have been completed. However, it would have produced the same result of 1250L.

It is correct of HMRC to adjust the PAYE code for the car benefit. However, they appear to have missed that the car did not start on 6 April. The 2020/21 car benefit should only be £4,477 ($£4,590 \times 356/365$). The correct PAYE code for Gianluca for 2020/21 is therefore 802L ($£12,500 - £4,477 = £8023$).

It would appear that HMRC have incorporated the benefits submitted on the 2019/20 P11D after it was processed in July. Then later, they have added in the benefits shown on the 2019/20 tax return when that was submitted. However, as these benefits relate to a prior employment and will not arise in 2020/21, there is no need to include them in the current tax code. Gianluca should contact HMRC, check if this is the reason for HMRC changing the codes and if so, explain that the 2019/20 benefits will not be received in 2020/21 and also request that the code is updated to 802L as above. You should advise Gianluca that you cannot do this for him as HMRC will only discuss the content of the code with the employee concerned. If HMRC has changed the code for any other reason, then they will be able to tell Gianluca and we can advise accordingly.

Impact on Gianluca's Tax

The change to 791L in June would have resulted in Gianluca paying an additional £459 in PAYE ($£4,590 / 12 \times 3 \text{ months} @ 40\%$). This would have caught up the tax due on the company car from April.

The July payslip would have had extra tax compared to April and May of £153, which would be tax due on the car.

From August, the PAYE would have increased by £234, as a result of HMRC's adjustment to the code. As it was a Month 1 code, the additional tax due was not backdated to April 2020.

For October the PAYE would have increased again by £133 ($[(£3,095 + £903)/12 @ 40\%]$), as a result of HMRC's second incorrect adjustment to the code. Again, it was not backdated to April 2020 as it was a Month 1 code.

If Gianluca can contact HMRC immediately and a new cumulative code of 802L is issued to you before the November payroll is run, he will get an automatic refund of the excess PAYE withheld to date via November's payroll. The refund should amount to:

Excess PAYE from August to October adjustment	£234 x 3	£702
Excess PAYE from October adjustment	£133 x 1	£133
Excess PAYE on car benefit	[£4,590-£4,477]/12 x 7	£26
Total PAYE refund due on November payslip		£861

NIC

The EU rules apply in Gianluca's case and as Gianluca is working in the UK and employed by a UK employer, he is liable to social security in the UK. The category A NIC letter is the correct one in this case. The A1 portable document will not be valid any longer following the change of employer. He should contact the Italian authorities to stop his payments to the Italian system, or to make voluntary contributions there, if that is an option.

If you have any questions about the above, then please do not hesitate to contact me.

With best regards,
Helena

MARKING GUIDE

TOPIC	MARKS
Changing codes <ul style="list-style-type: none"> • Employer must operate code issued • Employee has to request change • Ways to change 	½ ½ 1
1250L code <ul style="list-style-type: none"> • Wrong checklist • Same result 	½ ½
791L code <ul style="list-style-type: none"> • Identify why code changed • Calculate change to PAYE amount • Identify incorrect car value • Calculate correct code • Backdating 	½ ½ ½ ½ ½
90L/K309 codes <ul style="list-style-type: none"> • Suggest why codes are incorrect • Suggest specific action required by Gianluca • Calculate change to PAYE amount for each code • Why no backdating 	½ 1 1 ½
PAYE refund <ul style="list-style-type: none"> • Timing • Immediate refund • Calculate refund amount 	½ ½ 1½
NIC <ul style="list-style-type: none"> • EU rules apply • Liable in UK and why • Letter is correct • A1 ceases with change of employer • Cease Italian contributions 	½ 1 ½ ½ ½
PHS	1
TOTAL	15

ANSWER 6

To: Malcolm and Rachel Brown
From: Alex Smith
Date: 8 November 2020
Subject: Gift of business to employees

Dear Malcolm and Rachel,

Following your recent discussion with my colleague in relation to your desire to find ways to transfer your business to your employees, I am writing to outline the options available.

If you sell your shares you will have to pay Capital Gains Tax (CGT) on the amount that the shares have increased in value since you acquired them. This will be based on the market value of the shares despite the fact that you sell them for a discount. You should qualify for Entrepreneurs' Relief, which means you will be charged CGT at the basic rate (10%), on the first £10,000,000 of gains you each make during your lifetime.

If you were to award free or discounted shares as an employer to an employee, there will normally be an income tax charge on the employee at the date of the award. The value of this 'taxable benefit' is usually the difference between the market value of the shares on the day they are 'given' to the employee and the price paid (if any) by them employee.

You may therefore like to consider the use of an Employee Ownership Trust (EOT) to transfer the business to your employees.

An EOT is an indirect form of employee ownership, in which a trust holds a controlling stake in a company on behalf of all its employees and so provides a useful option for owners to transfer a controlling stake in their business to their employees.

To receive beneficial tax treatment an EOT must hold a controlling interest in the company (>50%) and must benefit all employees on an equal basis. The company controlled by the EOT must be a trading company, which Tasty Wedge Ltd is.

The major tax exemptions that apply to an EOT include:

- A complete Capital Gains Tax exemption on gains made when a controlling interest in a company is transferred to an EOT. However, special rules apply where a company's own funds are being used to finance payment of the purchase price, to ensure that the payments to the sellers are not "disguised dividends" caught as disguised remuneration. It is necessary to show that tax avoidance is not a reason for the sale. An advance clearance application can be made to HM Revenue and Customs, in which it will be important to explain why the transaction is in the interests of the company.
- Inheritance tax (IHT) relief in respect of property disposed of to a qualifying EOT
- An Income tax exemption of up to £3,600 per tax year on certain bonuses issued to all employees (national insurance contributions are not exempt). For this to apply the bonus must not form part of the employee's normal salary or wages, however this can be a single bonus or made up of several smaller amounts.

However, for the tax relief on the employee bonuses exemption to apply no more than 2/5 of the total of all employees and office-holders of the employer company can be made up of office-holders or employees connected with office-holders. All employees must be eligible to participate and every employee who participates must do so on the same terms, i.e. the same method (based on remuneration, length or service and/or hours of work) must be used to calculate the bonuses due.

You could sell your shares to the EOT and agree that the payment is deferred and paid for out of future profits, or the EOT may be able to borrow the money to pay you immediately and repay the loan out of future profits. Therefore, the initial selling price needs to be realistic from both perspectives, but if future profits dip this could be a problem to service

The Capital Gains Tax relief makes the EOT an ideal option for you in your desire to transfer your business to your employees without incurring a tax liability and the Income Tax relief provides a substantial benefit for all employees. This not only provides an additional source of remuneration in addition to wages or salaries, it helps engender a culture of ownership.

I hope that the above has been useful. This can be a complex area, but we believe an EOT will deliver your requirements fully in relation to the transfer of the business to your employees, enabling an 'income' to support your travels and avoid upfront costs and tax charges for the employees.

If you have any questions please let me know and I look forward to assisting you with this very exciting project.

Regards

Alex Smith

MARKING GUIDE

TOPIC	MARKS
General <ul style="list-style-type: none"> • CGT on disposal based on market value • Entrepreneurs relief at 10% on first £10m • Tax charge on employees based on discount • Definition, including indirect ownership • Controlling stake >50% • Trading company 	1 ½ 1 1 1 1
Reliefs <ul style="list-style-type: none"> • CGT where a controlling interest transferred to an EOT <ul style="list-style-type: none"> ○ Special rules for company funds 'disguised remuneration' ○ HMRC clearance • IT exemption of £3,600 per tax year on certain bonuses issued to all employees <ul style="list-style-type: none"> ○ Not form part of the employee's normal salary or wages ○ Can be a single bonus or made up of several smaller amounts ○ National Insurance Contributions are not exempt ○ Office-holder requirements ○ Same method of calculation for all employees 	1 ½ ½ ½ ½ 1 1 ½ ½
Benefits <ul style="list-style-type: none"> • Transfer business to employees with no tax liability and cultural benefits • Deferred payment possible to help employees with the purchase of shares and also fund travels • EOT can borrow to fund, so upfront cash not required 	1 ½ ½
Pitfalls <ul style="list-style-type: none"> • Realistic pricing/servicing of loan 	½
Presentation	1
TOTAL	15