The Chartered Tax Adviser Examination

November 2020

Application and Professional Skills

Taxation of Individuals

Suggested Solution

REPORT FOR JULIAN AND OLIVIA WOOD

1 INTRODUCTION

We understand that you wish to raise a total of £524,000 to fund a world cruise (£124,000) and the purchase of a property in Italy (£400,000), where you intend to live for at least three years.

In the context of the above, this report discusses the UK tax implications of the following:

1) Full or partial disposal of Julian's shareholding in Unoteq plc;

2) Julian's claiming of his deferred state pension lump sum;

3) Disposal of Mulberry Lodge;

4) Disposal of Villa les Roses.

We consider the timing and manner by which each of the above may attract the least UK tax liability. In considering this, we understand that you wish to delay the sale of Mulberry Lodge until at least June 2023, and that after three years in Italy, you may either remain overseas or return to the UK.

This report does not consider any overseas tax implications of the proposed transactions in France or Italy and you should seek professional advice on these accordingly as they may substantially affect the optimum course of action.

2 EXECUTIVE SUMMARY

The world cruise may be funded tax-efficiently by:

- Transferring at least £42,000 of the Unoteq plc shareholding to Olivia and each of you disposing of £21,000 in 2020/21 and 2021/22. This would raise a total of £84,000.

- Julian may claim his deferred state pension lump sum in 2021/22 when the applicable tax rate, if planned properly, will be 0%. Julian should ensure that any dividend income plus his state pension and share of any property income is within his personal allowance for that year.

The above actions will raise a total of £126,000 (£84,000 from the Unoteq plc disposal plus the deferred state pension lump sum of £42,000) without attracting any UK Capital Gains Tax (CGT) or Income Tax liability and will provide you with sufficient funds for the world cruise (£124,000) with £2,000 spare.

Funding the Italian property in a tax-efficient way through the remaining assets is more complicated as it depends on unknown factors. Broadly, the gain on the French property may be excluded from UK CGT in the case where either (a) the gain is made while non-resident and not temporarily non-resident in the UK, or otherwise (b) the gain is attributable to Olivia, the remittance basis is claimed, and the proceeds are kept offshore. Note that any loss on Mulberry Lodge may only be offset against gains chargeable in the same or future tax years.

In order to give maximum flexibility and scope to minimise the overall CGT liability, we recommend that Villa les Roses is transferred to Olivia's name and sold while she is not UK resident (i.e. on or after 6 April 2022). This will raise £300,000 with no UK CGT liability. However, if you consider that the proceeds will be remitted in any case then you might keep the property in joint names to benefit from a lower effective rate of CGT should you return to the UK after a period of temporary non-residence. The remainder of the required funds may then be raised by selling £98,000 of the remaining Unoteq plc shareholding. Alternatively, you may sell Mulberry Lodge, though this would provide you with more funds than required and you have mentioned that you wish to delay the sale of Mulberry Lodge until June 2023.

As a result of the state pension and property income from Mulberry Lodge, we expect you will have sufficient income on which to live while in Italy.

3 GENERAL OVERVIEW

3.1 Residence

The first step in determining your liability to UK Income Tax and CGT is to establish your UK tax residence position for the period you will be outside the UK under the Statutory Residence Test. Your position for each tax year is determined separately and for each of you independently. If you are resident in the UK for a given year, you may be eligible for split-year treatment, under which the year is split into a UK and overseas part – during the latter you will be treated as if you were non-resident in the UK.

Whether or not you are resident for a given tax year depends to a large extent on the number of days you spend in the UK (i.e. days on which you are present in the UK at midnight at the end of the day), where you have a home, and other 'ties', such as whether or not you have available accommodation in the UK.

For each complete UK tax year you will be living outside of the UK (i.e. from 2022/23), you should each be non-resident in the UK provided you spend no more than 90 days in the UK in that year. This is on the assumption that, for each of you:

- you have an overseas home for at least 91 consecutive days in the year and you spend at least 30 days in that home;
- you do not work in the UK;
- you do not spend as many days in the UK as in any other country;

In your year of departure (2021/22), you would be UK resident because you would meet the automatic "only home" test as a result of having your only home in the UK for the first part of the year (note that Villa des Roses would not count as a home for this purpose). Furthermore, you will not be eligible for split-year treatment as you would not have a "sufficient link" with an overseas country after six months of ceasing to have a UK home (a "sufficient link" being either residence in that country, continuous presence in that country for six months, or having your only home(s) in that country). Nor will you be able to claim you are 'treaty non-resident' in the UK with no permanent home elsewhere for the duration of the world cruise.

If you return to the UK part-way through a tax year, you may be able to split the tax year either if you start to have your only home in the UK at some point in the year (and continue to have your only home in the UK until the end of the tax year), or otherwise you start to have a home in the UK (potentially in addition to an overseas home) until the end of the following tax year. In each case, there are restrictions on the number of days you can spend in the UK during the overseas part of the year. We will be happy to advise on this separately, if required.

3.2 Income Tax

While you are non-resident, or during the overseas part of a split year, any non-UK income such as Olivia's French pension will not be within scope of UK tax. You may wish to consider the Double Tax Agreement between Italy and France to understand where and how Olivia's pension will be taxed, but this will not affect the UK position.

Any dividend income which continues to be paid to Julian while non-resident (or to Olivia) will be considered 'disregarded income'. As such, the UK tax liability will be restricted to the amount deducted at source (deemed to be at the dividend ordinary rate for UK dividends paid to non-residents) if this is less than the Income Tax liability calculated taking account of the UK personal allowance (to which each of you will be entitled even while non-resident). The tax payable will therefore be nil.

Once the deferred state pension lump sum is claimed, the UK state pension will be taxable in the UK while Julian continues to be UK resident. However, once he is resident in Italy under the terms of the UK-Italy Double Tax Agreement, the state pension itself should not be taxable in the UK under Article 22(1) of the treaty. A claim to this effect should be made on Julian's UK Self Assessment tax returns for the relevant years.

3.2.1 Property income

You have stated that you intend to let out Mulberry Lodge until at least June 2023. The taxable profits from this will be treated as UK-sourced income and each of you will be taxed on your 50% share. Note that in calculating the taxable profits, you will be able to deduct any costs incurred wholly and exclusively relating to the letting out of the property, such as any letting agent fees or insurance. Alternatively, you may deduct the property allowance of £1,000 pa instead of actual expenses incurred. You have stated that the property is owned outright, so there will be no deduction available for finance costs.

Note that, as non-resident landlords, the UK letting agent (or tenant, if there is no agent) will have an obligation under the Non-Resident Landlord Scheme (NRLS) to withhold basic rate tax on the rent before it is paid to you. The tax withheld is remitted to HMRC and available to offset against your tax liability, or otherwise claim as a refund, when you complete your UK Self Assessment tax returns. You can apply to receive your rent gross should you wish, although you will each have to apply separately.

3.2.2 Claiming of state pension lump sum

As this is taxed according to the individual's marginal tax rate in the year of claim, the most efficient timing will be to claim this when the applicable tax rate is 0%. This can be achieved in 2021/22 by ensuring that the shareholding is sold such that Julian's dividend income for the year, plus the state pension income from the point of claim to the end of the tax year and the property income, does not exceed Julian's personal allowance. The timing of the share disposal, letting out of Mulberry Lodge, and the claim of the deferred state pension lump sum can be managed to ensure this is the case. It may also be necessary to transfer an additional number of shares to Olivia to achieve this.

For example, suppose the state pension lump sum is claimed in June 2021, and Mulberry Lodge is let from January 2022. We then have:

	£
Annual state pension after lump sum claimed (£130 a week)	6,760
Annual rental yield on Mulberry Lodge (£1,000 a month, assuming no deductions)	12,000
Julian's taxable income for 2021/22	
State pension (£6,760 * 10/12)	£5,633
Property income (50% share for 3 months)	£1,500
Remaining amount in Julian's personal allowance	£5,367
Personal allowance	£12,500

Here, you can see that Julian would need to transfer all but, say, £130,000 worth of the shareholding to Olivia before the beginning of the tax year in order manage his dividend income for 2021/22 so that it is less than £5,367 for the year (£130,000 at 4% is £5,200). Note that the transfer should take place before the dividends are declared, otherwise the dividends will be taxable on the transferor.

3.3 Capital Gains Tax

3.3.1 Impact of residence and temporary non-residence

While you are non-resident in the UK you will be outside of scope of UK CGT other than on UK land and property.

However, if you return to the UK within five years then you will be treated as 'temporarily non-resident' for CGT purposes. As such, you will be liable to CGT in the year you return on disposals made while non-resident, if the assets were held prior to your departure. These provisions apply where you are resident for 4 out of the 7 tax years immediately preceding your year of departure. Therefore, each of you is in scope.

3.3.2 Domicile and the remittance basis

The fact that Olivia is non-domiciled in the UK presents an opportunity as she will be able to access the remittance basis in respect of non-UK gains. This means they will be excluded from UK CGT if the proceeds are not remitted to the UK (they should be kept in a separate bank account to ensure this). However, claiming the remittance basis carries a cost as it means forgoing the CGT annual exempt amount and personal allowance for the year of claim.

In addition, if the remittance basis is claimed in a year where she has been resident in the UK for at least 7 out of the previous 9 tax years, accessing the remittance basis for her non-UK gains requires that she pay a £30,000 charge. Therefore, if the remittance basis is claimed for the 2021/22 tax year, the charge will be applicable. However, in the event that you return to the UK after being temporarily non-resident in the UK and claim the remittance basis in the year of return, then the charge will not apply in that year as Olivia will not have been resident in the UK for 7 out of the previous 9 tax years.

In the first tax year of claiming the remittance basis, Olivia should also consider whether to make an election for foreign losses to be allowable for this and subsequent tax years.

3.3.3 Inter-spouse transfers

You will each have a CGT annual exempt amount (currently £12,000) to offset against any gains made in the year. It is not possible to transfer any unused annual exempt amount to another tax year or to another individual, but spouses and civil partners are able to transfer assets between them for UK CGT purposes at 'no gain/no loss'.

3.3.4 CGT Rates

It should be pointed out that the rate of CGT payable on gains above the annual exempt amount depends on the amount of any basic rate band available and whether or not the asset is a residential property. Thus, disposal of the shares will attract CGT at rates of 10% (to the extent the gain falls within the basic rate band) and 20% thereafter, while the disposal of the properties will attract CGT rates of 18% and 28% respectively.

3.3.5 Summary

Therefore, from a CGT perspective, the most tax-efficient means of raising the cash will be one which takes full advantage of each person's CGT annual exempt amount and basic rate bands, maximising the ability to offset any capital losses (which cannot be carried back) and, where appropriate, use of the remittance basis.

4 DISPOSAL OF SHAREHOLDING

In order to take advantage of Julian's and Olivia's annual exempt amounts for 2020/21 and 2021/22, and the fact that the shareholding may be transferred at 'no gain/no loss', Julian should transfer at least £42,000 of his shareholding to Olivia in 2020/21. However, as we saw above, Julian may be better advised to transfer all but £42,000 of his shareholding to Olivia so that the tax rate on the state pension lump sum is managed. You may then each dispose an amount which realises a gain equal to the annual exempt amount in each of 2020/21 and 2021/22 (selling shares worth £21,000, less a base cost of £9,000 (=£21,000 * £150,000/£350,000), gives a gain of £12,000). This will allow £84,000 of shares to be sold without attracting any UK CGT liability, which will be more than enough to fund the world cruise when added to the state pension lump sum.

If any of the remaining shares are sold by Julian while he is temporarily non-resident in the UK, he will only have the benefit of one annual exempt amount to offset against the gains in his year of return. It may also be possible to take advantage of Olivia's annual exempt amount if additional shares are transferred to her and she does not make a remittance basis claim after returning to the UK from a period of temporary non-residence. However, if Julian is not temporarily non-resident, then he may dispose of as much of the remaining shareholding while non-resident in the UK without incurring any UK CGT.

5 DISPOSAL OF PROPERTIES

5.1 Mulberry Lodge

5.1.1 Private Residence Relief (PRR)

If Mulberry Lodge were to be sold today, it would realise a capital loss. This is because the costs in making the property habitable will treated as capital expenditure (rather than revenue expenditure) and therefore will be deductible in calculating the capital gain. However, as PRR applies (in part) to the disposal, this would have effect to disallow that part of the loss so that it cannot be offset against any gain. Only the remaining part may be offset, and then only if a capital gain (or gains) are made in the same or future tax year.

As at November 2020, the property did not qualify as your main residence for three out of the five years of ownership. Accordingly, if it were sold today, two fifths of the loss would be disallowed.

If sold at a gain, after June 2023, then PRR would exempt part of the gain from UK CGT for the period it was your home prior to October 2021, and in addition, the last eighteen months of ownership.

5.1.2 Non-resident CGT (NRCGT)

Where UK land or property is sold by a non-resident individual, anti-avoidance provisions mean that the disposal is in scope of NRCGT. The effect of this is that the individual (or individuals, in the case of joint owners) is required to pay any CGT due and file an NRCGT return within 30 days of the disposal.As this residential property was acquired after 6 April 2015, the whole of any gain is within scope of the NRCGT regime (subject to the PRR discussed above). There is therefore no tax benefit of a sale in a period of non-residence.

5.2 Villa les Roses

The UK CGT position upon disposal of Villa les Roses may be summarised in the following table:

	If sold while resident	If sold while temporarily non-resident	If sold while non-resident and not temporarily non-resident
Julian's share	Liable to UK CGT.	Treated as arising in the year of return. Liable to UK CGT in this year.	Not liable to UK CGT.
Olivia's share	Liable to UK CGT if taxed on the arising basis, but the remittance basis is available to exclude the gain from UK CGT to the extent that the proceeds are not remitted to the UK.	Treated as arising in the year of return. Liable to UK CGT if taxed on the arising basis, but the remittance basis is available to exclude the gain from UK CGT to the extent that the proceeds are not remitted to the UK.	Not liable to UK CGT.

From the above, it can be seen that if the property is sold while non-resident and not temporarily non-resident in the UK, the position in respect of Julian's and Olivia's share is the same. However, in the other two cases, it is possible to access the remittance basis in respect of the Olivia's share of the gain. If the property is transferred to Olivia's name under the 'no gain/no loss' rules, this may be 100% of the gain.

It is important to note that if the property is sold while temporarily non-resident in the UK, the gain will be treated as arising in the year of return. In this year, Olivia will only be liable to the remittance basis charge if she claims the remittance basis and has been resident for 7 out of the previous 9 tax years. In 2021/22 she will have been resident for exactly 7 out of the previous 9 tax years, meaning that if she is non-resident in 2022/23 and returns after 6 April 2023, she will not meet this latter test in her year of

return and therefore the remittance basis charge will not apply. However, she would lose her CGT annual exempt amount and her UK personal allowance for the year of claim.

Therefore, in order to minimise the chances of the gain being charged to UK CGT – and delay the payment of such UK CGT for as long as possible – you should consider transferring the property to Olivia's name and, if possible, selling it while non-resident (i.e. after 6 April 2022) in order to fund the Italian property. If you return to the UK within five years, Olivia will still be able to shelter the gain from UK CGT by keeping the proceeds from the sale of the Italian property offshore. Mulberry Lodge may be held for as long as required in order to realise any future capital growth (or sold at the same time if the funds are needed to purchase the property).

However, if it is considered that the proceeds from the sale of the Italian property will need to be remitted to the UK in the event of returning here in any case, there will be no benefit to claiming the remittance basis or transferring the property to Olivia's name. In this case, it would be better to retain the current joint ownership of the property so that each of your annual exempt amounts may be used in the year of return, and Olivia does not lose her personal allowance for that year. You would also be able to benefit from two basic rate bands to maximise the part of the gain charged at the lower CGT rate of 18%.

6 OVERALL CONCLUSION

It can be seen that there are a number of different options for raising the required funds, but if managed carefully it is possible to do so in a way which avoids UK income tax and UK CGT entirely:

Asset	Section	Amount raised	
Unoteq plc shares	4	£84,000	
Deferred state pension lump sum	3.3.2	£42,000	
		£126,000	
		£(124,000)	*To fund cruise*
		£2,000	
Villa les Roses	5.2	£300,000	
Unoteq plc shares	4	£98,000	
		£400,000	*To fund Italian property*

Note that, in terms of your joint income position, you have stated that you do not anticipate requiring more income to fund your living expenses while living in Italy. However, despite selling part of the shareholding (thus foregoing up to £182,000 * 4% = £7,280 of annual income) you would actually see an increase in your disposable income as a result of the state pension (£6,760 a year) and property income from Mulberry Lodge, assuming it is not sold (£1,000 a month, less expenses).