



Application and Interaction

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 Date of Examination

Tick box if you have answered in accordance with Scots Law

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Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your paper not being marked. You must:

- (a) Complete the details on this page and on the answer pages using BLACK or BLUE ballpoint pen only.
- (b) Write on one side of the page.
- (c) Not write in the margin areas indicated.
- (d) If you have used additional pages, please add your candidate number and the question number to these pages.
- (e) Do not put blank pages into the envelope at the end of the exam.

Please do all of the above before the end of the examination.

	Tick question attempted	For use by examiner only
1		
2		
3		
4	✓	
5		

FORMAT & STYLE OF ANSWER	MAXIMUM MARKS	MARKS AWARDED
<p>The answer is set out in the format demanded. Thus, if it is a letter, it will be properly set out as a letter with addresses, date, "Dear X" and conclude "Yours sincerely" etc. If it is a report, it will give some indication as to what it is about and who it is for.</p>	1	
<p>The report or letter should contain an introduction setting out the terms of reference, information being relied on etc. It should also contain a summary of the key findings and recommendations.</p>	2	
<p>The body of the letter or report should be laid out in a clear way with appropriate headings so that the reader can navigate around it easily and spot the key areas without reading the entire document to try to find a discussion of, for example, income tax on some employment related shares.</p>	1	
<p>The answer "flows" so that a logical chain of thought presented to the reader rather than a series of random comments (which may nevertheless be technically correct).</p>	1	
<p>The style of writing should be appropriate to what is being produced. For example, a report to a client or lay person (which will always be the main element of a question) should not contain large numbers of legislative references whereas a technical note to the tax partner should. Technical advice should be conveyed in style appropriate to the reader.</p>	2	
<p>RELEVANCE OF ANSWER</p>		
<p>The answer does not contain large amounts of irrelevant material which would only serve to confuse a client.</p>	2	
<p>Technical knowledge (which will be rewarded through the technical marks and should not affect the awarding of these marks) has been directly applied to the specific circumstances of the reader and has this resulted in an answer tailored to their circumstances.</p>	3	
<p>The question(s) posed has/have been answered.</p>	2	
<p>PROVISION OF ADVICE</p>		
<p>The report gives advice. This means that where possible it should come off the fence and suggest the best option rather than simply giving a list of unweighted possibilities which fail to give the client an answer to their real problem: what should I do?</p>	4	
<p>Advice should include relevant and appropriate planning for the future.</p>	2	
<p>Advice should be commercial. This means that candidates should consider the bigger picture rather than narrowly focussing on saving tax.</p>	2	
<p>TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS</p>	22	

1) Letter to Brenda Long

Firm's headed paper

Firm's address

Brenda Long

Devan Ltd

Victory House

Parkhead Place

Newton

NT15 7RP

4 May 2017

Dear Brenda

Devan Ltd - Payroll Review

Thank you for your email dated 1 May 2017 regarding HM Revenue & Customs (HMRC) payroll review.

As requested in your email, I have set out advice on the following matters:

FOR EXAMINER
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- a) UK tax implications relating to Derek Pratt's UK properties and suggestions regarding his cash flow issues.
 - b) The UK tax implications of the Devan Ltd (Devan) long-term incentive plan, particularly for Derek Pratt and Alex Marsh.
 - c) Other payroll matters to be disclosed.

Derek Pratt - UK personal tax situation

Firstly, it should be noted that as Devan will be covering the cost of the advice set out in relation to Derek, this will constitute a taxable benefit.

The cost of the advice (i.e. our fees relating to this advice) should be reported on Form P11D, and subject to Class 1A national insurance (NIC) if Derek is within the scope of UK NIC.

Devan may wish to 'gross up' the value³
As Devan is ~~is~~ covering the cost of the advice, it is assumed that you do not wish him to bear any tax on this. Therefore, Devan could pay Derek a 'grossed up' cash bonus for him to find the tax. Once we know the value of the benefit, we can assist with any gross up calculation needed.

We understand that Derek is experiencing cash flow problems as a result of paying a significant amount of tax. In order to assist with this, Devan could offer Derek a loan.

This would be an employment related loan, and a taxable benefit would arise, ~~however~~, if the loan is interest free or interest is payable at a rate lower than HMRC's official rate (currently 3%). Where the loan does not exceed £10,000, there will be no taxable benefit.

Therefore, in order to have the greatest tax efficiency, Devan could either:

- offer Derek a loan of up to £10,000, or
- offer a loan with an interest rate of at least 3%.

If one of these routes are taken, there will be no taxable benefit and no reporting requirements for Devan.

Where the loan is greater than £10,000 or low interest (i.e. less than 3%), a taxable benefit will arise. This should be reported on the Form P11D and subject to Class 1A NIC.

In relation to Derek's UK properties, we understand he currently has two. Where a UK residential property is sold, there will be a charge to UK capital gains tax. However, this gain can be reduced or fully exempted using principal private residence (PPR) relief.

PPR relief is available on an individual's main residence. Broadly, PPR works by reducing the gain by the proportion of occupation of the property over the total ownership period.

There is actual occupation i.e. when you are physically in the property; and deemed occupation, for example a period of absence for any period of time when you were abroad. Periods of deemed occupation must always be preceded and followed by periods of actual occupation, otherwise it will count as a period of absence.

In addition, if the property is let out during a period of absence, Lettings relief would be available up to a maximum of £40,000.

It is worth noting that the last 9 months of ownership is always deemed occupation.

where an individual has more than one property, an election should be made to nominate one property to be your PPR. An individual can only have one PPR at a time. ⁶

As Derek is planning on transferring the Reading property to a trust, this will be a disposal for CGT purposes. Therefore, he could elect for this property to be his PPR in order to reduce any gain.

As the property has been rented out to Derek's daughter, ~~and it is~~ ~~pro~~ at less than market rent, the property business loss cannot be offset against the rental income of the London property. This loss ~~can only~~ ~~be used~~ will not be allowable as it is produced from a non-commercial lease.

Therefore, Derek will have made an incorrect tax return for 2015/16. This

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return was submitted on time on 31 January 2017. However, Derek has 12 months from this date to amend his tax return. Penalties and interest may apply for the underpayment of tax on property income.

In addition, when the property is transferred to the discretionary trust, this will be a disposal for CGT purposes and also a transfer for inheritance tax purposes.

The value of the transfer is the market value of the property. There is a nil rate band of £325,000. Any value in excess of this is subject to IHT at 20%.

This means the tax charge will be:
$$\begin{aligned} \pounds 375,000 - \pounds 325,000 &= \pounds 50,000 \times 20\% \\ &= \pounds 10,000. \end{aligned}$$

This tax is due on the later of 6 months

after the transfer or 30 April following⁸
the tax year.

As both CGT and IHT will be due, Derek could consider making a joint claim with his daughter for gift relief. This will mean only IHT is due. In this case, Derek would not benefit from electing for the Reading property to be his PPR as no CGT will be due.

Long-term incentive plan - potential issues

HMRC have stated in their letter that they have no record of the long-term incentive plan (LTIP).

The LTIP, as an employment-related share scheme, should have been registered online using HMRC's Employment Related Securities (ERS) online services. This should have been done in January 2010 when the scheme was set up.

Registration can be made online.

This is because although the LTIP is administered in the US, it had UK resident UK employees as participants.

In addition to registering the scheme, Devan should also have been filing annual returns, to report 'chargeable events'. Chargeable events include the grant of an award, grant of an option or exercise of an option, as well

as others. Even where no chargeable events occur in a tax year, an annual return (nil return) still needs to be submitted. Returns should continue to be filed until the company advises HMRC that the scheme is closed. The returns should be submitted online. 10

The returns are due by 6 July following the tax year. Where the return is late, penalties can apply as follows:

- initial penalty of £100
- additional penalty of £300 if more than 3 months late
- additional penalty of £300 if more than 6 months late
- if more than 9 months late, penalties of up to £10 per day.

Therefore, we would recommend registering the LTIP as soon as possible. Devan should then prepare annual returns for the tax years 2009/10 to 2016/17 and submit these as soon as possible to

Limit the penalties due. We can assist you with this.

The deadline for the 2016/17 return is still 2 months away (i.e. 6 July 2017) so we have some time.

The returns should include information on the participants and chargeable events to enable HMRC to calculate any tax due.

I will now consider the two individuals Alex Marsh and Derek Pratt, separately.

This is because there may be some potential PAYE and reporting issues and I note that HMRC state in their letter that ~~the~~ ~~review~~ the scope of their review may be expanded. It is always best to disclose any issues to HMRC as soon as possible as this will reduce any potential penalties and interest.

Alex Marsh

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Alex is currently on assignment in the UAE.

~~Alex will most likely be non-UK~~
Alex will likely have been UK resident in 2014/15 as he was working full time in the UK. However, this tax year would have been split into ~~a~~ UK and overseas parts as he started full time work overseas.

Therefore Alex would have been UK resident up to 31 May 2014 and ~~a~~ non-UK resident from 1 June 2014.

For the 2015/16 ~~tax~~ and 2016/17 tax years, Alex will likely be non-UK resident as he is working full time overseas, without any significant breaks, and spends less than 91 days in the UK, of which less than 31 days are

spent working in the UK. A significant ^B break here, means more than 31 days.

As Alex only spends up to 4 weeks at a time in the UK, he should not have any significant breaks from ~~the~~ overseas work.

Alex is intended to return to the UK in 2017/18. Alex will likely be UK resident for 2017/18 as he will either spend more than 183 days here, have a home here or resume full time work.

We can split the 2017/18 tax year as Alex is ceasing full time work. Therefore, he will be non-UK resident up to 31 May 2017 and UK resident from then on.

According, Alex will be non-UK resident for the whole of the assignment. He will also be UK domiciled as it is assumed he intends to return to the UK.

As Alex is non-UK resident, he should only be subject to UK tax on his UK earnings. Therefore, an NIT code should not have been applied for as this means \$ no tax is deducted.

As Devan has a UK tax presence, PAYE should be applied. However, Alex's earnings should be apportioned using workdays, so that only earnings from his UK work days are subject to PAYE. The earnings from Alex's duties in the UAE will not be subject to ~~PAYE~~ UK tax.

Devan should apply for a section 690 application which will mean PAYE only need be applied to Alex's UK earnings.

As Alex is a British national, he will be eligible for a UK personal allowance.

It is worth noting that although Alex comes out his UAE duties in the UK, as

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these duties will not be incidental to his non-UK duties, they will be regarded as UK duties and subject to tax, in the same way as the 3 days annual conference.

It is worth noting that the UK will be a temporary workplace for Alex as he spends less than 24 months here. Therefore, if Devan bears any costs in relation to Alex's travel, accommodation or subsistence on the UK trips, these will be deductible from UK earnings.

With regard to UK NIC, as there is no social security agreement with the UAE, we must consider the UK domestic rules.

~~As Alex~~ As the following conditions are met, Alex should have been subject to UK NIC for the first 52 weeks of the assignment:

- Devan has a place of business in the UK;

- Alex is ordinarily resident in the UK as he is employed in the UK and will be returning to continue living here.
- immediately before the assignment, Alex was resident in the UK.

After the 52 weeks, as Alex is still employed by a UK company and ordinarily resident in the UK, technically he is still within the scope of UK NIC so he may still be liable.

Alex should consider paying voluntary Class 3 NIC contributions for the remainder of the assignment to preserve his entitlement to the state benefits.

The LTIP awards would be considered earnings and therefore will be potentially subject to PAYE and Class 1 NIC if in relation to UK duties. I have assumed both awards are in relation to UK duties.

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I have calculated the tax due on Alex's salary and LTIP awards, assuming that out of 240 workdays in a year, only 13 of them are UK (i.e. 3 day annual conference and two weeks working remotely). This can be found in Appendix 1.

It is worth noting that the employer contribution of £9,000 will not be a taxable benefit, so there will be no reporting requirements. In addition, a deduction for corporation tax purposes is available.

Derek Pratt

Derek's assignment will span 5 tax years i.e. 2015/16 to 2019/20.

Derek is likely to be UK resident during his assignment as he will either spend more than 183 days in the UK or will work full time in the UK.

The years of arrival and departure can be likely be split into overseas and UK parts as Derek was starting full time work in the UK and then start full time work overseas.

Therefore, Derek will be UK resident for the whole of the assignment. Therefore, he will be subject to UK tax on his worldwide earnings as he receives them.

It is necessary to consider Derek's

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domicile position. Where a UK resident is non-UK domiciled a claim for the remittance basis can be made.

This means that any foreign income can ~~be~~ escape UK tax if it is not brought to the UK.

Although Derek is a UK national, he appears to have severed ties with the UK and moved to the US. His family are there and he doesn't appear to have any ties to the UK. Therefore, Derek may have acquired a domicile of choice in the US.

If so, Derek could benefit from overseas workday relief (OWR). This could mean that if his earnings are paid offshore, the earnings relating to his non-UK duties will not be subject to tax if not remitted to the UK.

OWR is only available for 3 tax years.

If UK is claimed/used, Derek should apply for a section 690 payroll arrangement so PAYE is only applied to the UK earnings. 20

Derek should be advised to keep a work diary so he can track the days he spends in each country working.

A disadvantage of claiming the remittance basis is, Derek will lose his entitlement to the personal allowance (PA). However, as Derek earns over £122,000 he would not have a PA anyway.

As Derek is also US tax resident, it is necessary to look at the double tax treaty to see where he is treaty resident.

Under Article 4 of the treaty with the UK, Derek will be resident where he has a permanent home. As his permanent

home is in the US, he will be US treaty resident. If he also has a permanent home in the UK, he will still be US treaty resident as his wife and teenage son are in the US so this is where his personal and economic relations will be closer.

The pension contributions that the company make will be treated as if they are contributions to a UK registered scheme so should not be a taxable benefit.

~~Under the~~

Under Article 18 of the double tax treaty, relief should be available for both employee and employer contributions as:

- employee and employer contributions ~~are~~ were made before Derek's UK assignment began (assumed); and
- the US 401k scheme corresponds to a UK tax relieved pension scheme.

Therefore, no taxable benefit arises for employer contributions so there are no reporting requirements.

The employee contributions should also be deductible from employment income.

The LTIP option granted in 2011/12, should not have had any tax consequences i.e. no tax or NIC at grant.

However, as the LTIP is non-tax advantaged, there will be a tax charge at exercise on the MV of the shares less the amount paid i.e. £70 000.

As Derek has been UK resident during the relevant period i.e. from grant to exercise, some of this will be subject to UK tax and some may be subject to tax in the US.

Under the exchange of notes referring to

Article 14 of the double tax treaty, ~~the~~ as Derek will be US tax resident for treaty purposes, the UK can only tax the portion of the £70,000 gain relating to the period between grant and exercise which ~~is~~ Derek was working in the UK.

The period between grant and exercise is 15 March ~~to~~ 2012 to 15 November 2016. Derek was working in the UK from 1 July 2015 to 15 November 2016, so only this portion is taxable in the UK.

The options can be exercised for shares in Devanti Inc. As this is a company listed on the New York Stock Exchange, the shares will be readily convertible assets (RCAs). As such PAYE should be applied.

As the shares are RCAs, this may reduce

Derek's cash pay to nil. However, Devan will still need to pay the tax due by the due date so they should find any tax needed.

Derek needs to repay the tax paid on his behalf within 90 days of the end of the tax year (i.e. by 4 July). If this is not done, this will count as additional earnings to be reported on the P11D and subject to Class 1 NIC.

As such Derek needs to be included on the UK payroll and taxes deducted. In addition as no certificate of coverage was obtained strictly Class 1 NIC should have been applied to earnings. Devan should obtain a certificate of coverage from the US authorities as soon as possible.

Otherwise, Class 1 NIC will be due as Derek is working in the UK.

I have calculated the estimated amount of tax due on the salary and option exercise in Appendix 2.

Please note, penalties and interest will be due on the failure of PAYE.

Conclusion

Devan should consider paying Derek a ~~cash~~ ~~bonus~~ groomed up cash bonus to find the tax on the provision of his personal UK tax advice.

Derek should consider which of his properties to elect as his PPR. He should also seek advice on the IHT implications of the transfer of his reading property.

Devan could consider paying Derek a loan of less than £10,000 or if more, then with an interest rate of at least 3% to help with his cash flow issues.

Devan should have operated PAYE in relation to Derek and Alex, as described above. Devan should disclose to HMRC to try to reduce penalties and interest.

I trust this is helpful.

Yours sincerely

Morcos White.

Appendix 1Alex Marsh

Salary	92 000
Gen pension contribution	<u>(9 000)</u>
	83 000
20.3.15 cash payment	25 000
20.3.16 cash payment	<u>17 000</u>
	125 000

~~£23,400 =~~ 

$$£125 000 \times 13/240 = £40 625$$

Gen PA	<u>(11 100)</u>
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Employment income	<u>£29 525</u>
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This amount should be subject to PAYE and employer and employee Class 1 NIC.

Tax @ 20%	=	£5 905
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Class 1 NIC @ 12% (after £8060)	=	£2 576
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Clam 1 NIC @ 13.8% = £ 2959
(after £811B)

Appendix 2

Derek Pratt

Relevant period for option = 1705 days
UK days = 503 days

$$\begin{aligned} & \text{£ } 70,000 \times 503 / 1705 \\ & = \text{£ } 20,651 \end{aligned}$$

Salary	200 000
Len out (25%)	<u>(50 000)</u>
	150 000
Len pension contribution	<u>(14 500)</u>
	135 500
Add option exercise	<u>20 651</u>
	156 151
Len PA	<u>nil</u>
	156 151

Paper Ref
A&I

Question No.
4.

$$\text{Tax @ 20\%} = 6400$$

$$\text{Tax @ 40\%} = 47400$$

$$\text{Tax @ 45\%} = 2768$$

$$\underline{56568}$$

$$\text{Clam 1 NIC @ 13.8\%} = \text{£}20429.$$

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2) Note to Tax Partner re: non-tax matters ²¹

There are two separate issues to consider:

- 1) Devan Ltd would like to ignore any historic issues; and
- 2) Provision of advice regarding an employee, Derek Pratt, to Devan Ltd.

The client would like to ignore any historic issues arising. However, in line with our professional responsibilities and duty of care owed to the client, we will not be able to do this.

This could result in an underpayment of tax which we cannot assist with. Therefore, we would be obliged to disclose this to HMRC.

We should advise Devan Ltd of the issue that we cannot ignore historic issues and advise them to disclose any historic issues to HMRC on a timely basis

We should do this orally in the first instance and advise that we will not be able to continue acting for them if they fail to disclose.

If they decline to disclose to tMRC, we should provide written advice ~~to~~ regarding the need to disclose, then cease to act.

After ceasing to act, we should:

- inform tMRC that we have ceased to act, but for confidentiality, not disclose the reasons.
- consider whether we should report this to the money laundering reporting officer.
- consider how we will communicate with the new advisor, following the professional clearance.

The advice provided will be in relation to an employee. Therefore, we need to review our engagement letter with Devan Ltd to see if work for its employees is covered.

If it is covered in the existing engagement letter, we should consider whether our 3rd party liability is limited. As Derek Pratt is not our client, he cannot rely on the advice.

Therefore, we could consider seeking an indemnity for Devan Ltd so that we are not exposed to any liability from Derek Pratt.

We should consider whether we owe Derek Pratt a duty of care. If so, we should engage with him as a client.

This will entail performing client due

diligence and know your client procedures, to identify and potential money laundering activity.

A separate engagement letter should be issued, to agree the scope of the assignment and the associated fees.

PLAN

2) Note to tax partner

- received email re potential PAYE failures

- Client wants to not look at historic

- we owe a duty of care

↳ obliged to disclose to HMRC

- need to make client aware of this.

↳ first orally → disclosure needed or cease to act

↳ if they don't agree → give written advice and cease to act.

- After ceasing: 1) Written → think of handover

2) Inform HMRC

3) Withdraw previous advice?

4) Consider MLRO?

5) Consider how to communicate to new adviser.

* Advise to Derek P → he is our client,

- need to engage with him

- Set out steps for new client
 - client DD, KYC for ML
 - EL \rightarrow separate.

- If provided to D Ltd, need to limit 3rd party liability. \rightarrow seek indemnity?

1) DE property:

- Covering cost \rightarrow taxable benefit - Claim IA report P11D.

\hookrightarrow may wish to gross it up so he doesn't pay.

- short of disposable - loan from co? taxable benefit? \rightarrow any options/etc? ~~(K)~~

- London \rightarrow PPR + Lettings relief \rightarrow if elect for this to be PPR.

- last 18m + deemed + actual.

- Reading \rightarrow non-commercial \therefore no loan \hookrightarrow cannot offset this.

- JATR incorrect for 15/16 \rightarrow due 31.1.17 \rightarrow 12m to amend

- Transfer \rightarrow CHT \rightarrow use null bond
 & excen taxed at 20% if trustee
 pays. \rightarrow due? bn from gift or 30 April.
 \rightarrow also a disposal for CGT
 \rightarrow gift relief?

1) other \rightarrow mention other issues (A)

a) General for scheme - registration \rightarrow how?
 \leftarrow non-tax adv. \leftarrow returns \rightarrow due?
 TYs? \leftarrow 4 penalties
 09/10 \rightarrow 17/18.

• UK res ee's \rightarrow issues?

b) Alex Marsh - UK \rightarrow UAE - 3yrs not tempwp
 \rightarrow PA - Salary less ee contr
 • 09/10 - no tax \rightarrow 14/15 \rightarrow cash £25k - PAYE
 • 10/11 - no tax \rightarrow 15/16 \rightarrow cash £15k - PAYE

- residence? 14/15 to 17/18 - split years.
 14/15 - UK res? 8 weeks + 3 days
 \rightarrow 56 \rightarrow 59 days
 - NIC?

- non-UK duties?

& NO PAYE \rightarrow issue (A)

e) Derek Pratt - US \rightarrow UK. 4 yrs not temp up.

\rightarrow no PA - salary less cost.

15/16 to 19/20 \rightarrow residence?
split years?

* MMR or treaty relief \rightarrow look at treaty

\rightarrow tax treatment of ee + er costs

\rightarrow CT deductions?

\rightarrow who has primary taxing rights?

- Domicile? intends to return to US?

- PAYE \rightarrow net of foreign taxes?

\rightarrow not on UK payroll (*)

* No NIC? \rightarrow need CoC.

* Dual residence \rightarrow see Article 4.

* Cronk \rightarrow 11/12 - no tax.

\rightarrow exercise 16/17 - tax on MV.

\rightarrow any FSI? \rightarrow see treaty.

\rightarrow RCA: PAYE and NIC? If applicable.

Paper Ref
A&I

Question No.

- Conclusion

1) DP property \rightarrow BIK
 \rightarrow actions

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