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Taxation

Excellence in Taxation

# Application and Interaction

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Centre Code

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><b>RELEVANCE OF ANSWER</b></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><b>PROVISION OF ADVICE</b></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><b>TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS</b></p>	22	

Covering email

From: Joe Grassmere

To: Kate Sharp

Date: 2 May 2018

Subject: Learnshape UK Ltd.

Hi Kate

As discussed, please find enclosed the draft report to Barry Balbis at Learnshape UK Ltd. Before this is sent to Barry, I just wanted to double check with you that all the usual client acceptance procedures have been carried out and that we have an active engagement letter in place.

In particular, I wanted to check with you that the engagement letter covers BigShape Group Ltd as well as Learnshape UK Ltd.

Kind regards,  
Joe

REPORT : Tom Johnson

Provided to Barry Balbis on  
2 May 2018

### Introduction

This report is provided to Barry Balbis to outline the UK tax considerations in respect of Tom Johnson's assignment from Canada to the UK. In addition, it highlights additional considerations in respect of risks or opportunities for both Leamstape UK Ltd and BigShape Group Ltd.

## Executive Summary

- Tom's assignment length should be restricted to 24 months maximum. Otherwise, tax equalisation costs could be increased from £52,287 to £180,955 in the 2018/19 alone.
- A certificate of coverage should be obtained to keep Tom in Canadian Social Security.
- The UK company will have PAYE obligations for Tom - these are best managed by setting up a modified payroll scheme.
- There may be opportunities to register tax-efficient share schemes with HMRC for future years.
- Tom would have child benefit clawed back as his income is too high - not advisable to claim in the first instance.

Residence

As Tom will spend more than 183 days in the UK in the 2018/19 UK tax year, he will be <sup>domestic</sup> UK resident under the statutory Residence Test. In addition, his only home will be in the UK from 31 May 2018, he also meets this automatic test for UK residence. Normally, an individual is either resident or non-resident in the UK for an entire tax year, but special provisions do exist whereby a tax year can be split into periods of residence and non-residence where an individual is an "arriver" or a "leaver". For example, if Tom's assignment were to be from 31 May 2018 to 30 May 2020, his UK residence would follow the below pattern:

- 6 April 2018 to 30 May 2018 - non-resident
- 31 May 2018 to 5 April 2019 - resident
- 6 April 2019 to 5 April 2020 - resident
- 6 April 2020 to 30 May 2020 - resident

31 May 2020 onwards - non-resident

### Implications of residence

Normally, if an individual is resident in the UK for a tax year, he would be taxable in the UK on his worldwide income and gains. However, in addition to tax residence, there is a legal concept known as "domicile" which can also affect an individual's tax position. Domicile refers to where an individual's long-term settled intentions lie and it is only possible to be domiciled in one place at a time.

From the information you have provided, it seems clear to me that Tom is domiciled outside the UK as he is a Canadian national who intends to return to Canada after his assignment ends.

This means that Tom can either be taxed on the "arising basis" of taxation, i.e. on worldwide income as described above, or on the "remittance basis" of

taxation, available to UK resident / non-UK domiciled individuals only. This means that, provided certain conditions are met, an individual would be taxable in the UK on UK sources of income and gains plus any overseas income and gains to the extent that they are brought into or enjoyed in the UK (e.g. paid into a UK bank account, an overseas credit card is used in the UK etc.). This is done via an election on the UK self-assessment tax return. In addition, it is possible to claim tax relief in respect of overseas workdays in Tom's case, as explained later in this report. The remittance basis does result in the loss of the personal allowance for income tax and the annual exemption for UK Capital gains tax. However Tom's income is so high that he would lose the personal allowance in any case. As I assume



Overseas Workday Relief

I would be interested in providing Tam with a UK tax briefing to discuss with him how his bank accounts can be structured to make sure Overseas Workday Relief is optimized. It would be best if a separate account was set up and the remuneration from Tam's Austrian workdays paid in here only, however HMRC understands that this is not always practical - in which case Tam's existing Canadian account could be structured to meet the "special mixed fund" rules which would enable the relief to be claimed for the benefit of the company as Tam is very equalized.

Legal considerations

It is fine for Tom's employment contract to remain with the Canadian company, however the UK company will need to ensure that UK employment law is adhered to for Tom for the duration of his assignment to the UK. Although Tom's legal employer is BigShape Group Ltd, his economic employer will be LearnShape UK Ltd. I would advise that separate legal advice is taken especially as Tom will be Managing Director, and I can arrange for you to speak with my employment law colleagues if necessary. I would also advise that an assignment letter is drafted and you can also assist with that.

Length of assignment

Thank you for highlighting that the assignment is likely to exceed the anticipated 18 months, as this can have a large effect on the tax position. Where the assignment is for ~~2~~ no more than 24 months, the UK would be a temporary workplace for Tom, meaning that he can avail of UK tax relief in respect of assignment-related costs such as housing, cost of living and school fees. ~~The~~ This is all based on intention. If commercially, Tom needs to be in the UK for more than 24 months, it would be the point at which the intention changed that the relief would be withdrawn. My strong advice is therefore that the assignment terms are agreed so that the assignment lasts for no more than 24 months and, if commercially viable, this is adhered to.

Child benefit

I note in your email dated 28 April 2018 that Tom has been told that he and his wife may claim child benefit while in the UK. While it is possible to claim child benefit, this is withdrawn completely where adjusted net income of <sup>at least</sup> one parent is in excess of £60,000. ~~Tom~~ As Tom's income exceeds £60,000, he would have to repay the entire child benefit received via his self-assessment tax returns. As this would be administratively burdensome with no net benefit to Tom, I would advise that he does not claim child benefit at all.



## Austrian duties

From the information provided, it seems likely to me that Tom will be non-resident in ~~the~~ Austria. Even if he were resident in Austria domestically, he would be non-resident under the treaty.

As he will spend fewer than 183 days in Austria in a 12-month period, his costs are borne in Canada and his employer does not have a permanent establishment in Austria (although see potential risk later in this report), the remuneration derived from Tom's Austrian workdays will not be taxable in Austria. In fact, they will also not be taxable in the UK under Overseas Workday Relief.

Payroll obligations

Although Tom will remain employed by the Canadian business and will be paid by through the Canadian payroll, there are UK PAME obligations for Lornstape UK Ltd as this is a UK business for whose ~~tax~~ benefit Tom is working. It is possible to set Tom up on the standard payroll, however the best course of action here would be to enter into what is known as an "EP Appendix 6 agreement" with HMRC, to set up what is commonly known as a "modified payroll scheme". Normally this should be agreed with HMRC in advance of the tax year, however as Tom has not yet come to the UK, HMRC may, by concession, agree to put the modified payroll scheme in place for 2018/19, which would be the

most straightforward here. This is available where an individual is inbound to the UK and is tax equalised, which allows the employer to account for PAYE (~~and other~~) on a best-estimate basis, provided a self-assessment tax return is submitted at the end of the year to reconcile the final position. In these circumstances, the employer would usually provide tax return assistance (home and host) to ensure the position is correct across all jurisdictions. We can of course help with this if required. Where there are 5 or fewer individuals on a scheme, PAYE can be paid quarterly on agreement with HMRC. Otherwise, it is payable on the 19<sup>th</sup>/22<sup>nd</sup> of ~~the~~ <sup>each</sup> month if paying by paper/electronically. As this is a best estimate, it reduces the risk of penalties for errors which can

be significant. Otherwise, PAYE earnings would need to be reported on an ~~as~~ accelerated real-time basis each month, and a P11D reporting non-cash benefits would need to be filed by 6 July following the end of the tax year. The modified payroll scheme extends the P11D deadline to 31 January following the end of the tax year (this is the same as the self-assessment deadline).

### Tax equalisation

Your understanding of tax equalisation is correct and its main purpose is to ensure that an individual is no better or worse off as a result of gains on assignment. Hypothetical tax is collected at the individual's stay-at-home rate and this effectively goes into a "pot" to meet any actual tax liabilities worldwide.

As you will see from Appendix 1, tax equalisation can be expensive and it is therefore important that Tom's package is structured as efficiently as possible. If ~~the~~ using the arrangements under the first calculation, for the 10 months remaining of 2018/19, the following should be reported per month on the FPS submission (due 19<sup>th</sup> following month):

$$\begin{aligned} \text{Pay: } & 147,467 / 10 = 14,747 \\ \text{Tax: } & 52,287 / 10 = 5,229 \end{aligned}$$

Note there are penalties for late submissions and payment of tax

Other areas of risk/opportunity

Finally, as you are a new client whose business needs I am keen to get to know better, I have listed a number of bullet points below of areas that I have seen on other clients in similar circumstances. Please let me know if you would like to discuss further.

- Stuart Shape - as Stuart Shape's departure was for the purpose of furtherance of trade, a Corporation Tax deduction is available for Learnshape UK Ltd. in respect of his termination package. I note that nothing has been done yet with regards to resolving Stuart's departure - please let me know if I can get my employment law colleagues to help you. Similarly, I would be happy to help you design a termination package for Stuart to take advantage

of the £30,000 tax-free exemption and potentially save the company costs in PAYE and NIC.

- Permanent Establishment - I note that Tom will be working for the benefit of BigShape Group Ltd while in Austria, and that this will involve a contract between BigShape Group Ltd and the DOEA. I would strongly advise that the contract is not concluded in Austria (by Tom or otherwise) as this presents a risk of a permanent establishment being created in Austria and BigShape's profits falling partly into the Austrian corporation tax net. I would advise you to seek Austrian tax advice on this point.

• Share schemes - I note that Tom was granted options over 10,000 BigShape Group Ltd shares. As this is a Canadian listed company, I have assumed in my previous calculations that these options were "unapproved" which means that they were not granted under one of the HMRC-approved tax-advantaged schemes. I would be interested in exploring the possibility of setting up a UK tax-advantaged scheme with you further, as this could result in UK tax <sup>and NIC</sup> savings for both the individual and the company. Where individuals are tax equalised like Tom, this would be of particular benefit. In any case, the granting of Tom's options (as well as grant/exercise/vest for any other UK individual with UK workdays over the vesting period) will be reportable to HMRC by 6 July following the end of each tax year.



This is CAN\$22,000 of employment income as the options were granted to Tom as part of his employment. This then needs to be apportioned for UK workdays over the grant to vest period:

• VAT - educational supplies are exempt for VAT purposes so this should be considered - ~~in respect~~ you may benefit from a discussion with my VAT colleagues in terms of registering for partial exemptions

• Transfer pricing - I am unsure of the size of the businesses and whether this would apply, but as corporation tax adjustment may be needed, let's discuss.

Paper Ref

A&I

Question No.

4

Your Candidate No.

• Tax return support - ~~Case~~ I would advise that both home and host support is offered

FOR EXAMIN  
USE ON

Paper Ref  
A&I

Question No.  
4

Your Candidate No.

Appendix 1) - Calculation for 2018/19	
Salary (10 months)	
$CAN \$240,000 \times 10 \frac{1}{12} \div 1.8$	<del>428,444</del> 111,111
Bonus	
$CAN \$240,000 \div 1.8 \times \frac{4}{12}$	44,444
Less: salary & bonus related to Austrian workdays	
$\frac{45}{200} \times 155,555$	(35,000)
	120,555
Less: hypothetical tax @ 31.5%	(37,975)
	82,580
Plus: Housing allowance, COLA, Car allowance, school fees, mileage allowance	NIL
Medical	600
Relocation (20,000 - 8,000)	12,000
	95,180



Note 1 - Bonus has been pro-rated as only that which is ~~UK~~ taxable related to UK duties is taxable (i.e. 4 months from 31 May 2018 to 30 September 2018)

Note 2 - Assumed annual total of 240 workdays, 5 workdays per month in Austria from July 2018.

$$240 \times \frac{10}{12} = 200 \text{ ~~UK~~ }^{\text{assignment}}$$

2018/19

$$5 \times 9 = 45 \text{ non-UK workdays during assignment period}$$

Note 3 - I have prepared this calculation on the basis that all reliefs are claimed where necessary and that the package is structured as tax-efficiently as possible.

The housing allowance, school fees and cost of living allowance have been excluded on the basis that

these are assignment-related costs for an assignment of less than 24 months (i.e. to a temporary workplace). Note that claiming the full £14,000 allowance per month as exempt is aggressive, and HMRC may argue that the accommodation provided to Tan is excessive compared to his needs as he has brought his family with him. However, this is generally accepted practice - you just need to be aware that HMRC may challenge it. Similarly with the school fees, as the children were in the state system in Canada, this may be challenged, unless it can be shown that private education is necessary to give the children the same standard of education they would have received at home.

Note 4 - I have marked the car allowance as "nil" because the provision of

the car can be structured in such a way that there is no taxable benefit. If ~~that~~<sup>it</sup> is leased by the company and provided to Tom for business use only, there would be no benefit to Tom and it would not need to be reported on his Form P11D (or put through payroll, if preferred). If Tom did use it for personal use, this would result in a benefit.

I have also excluded the mileage allowance, but this is on the basis that you take my advice and reimburse only 45p per business mile. Otherwise, the excess would be taxable.

Note 5 - As Tom is relinquishing his Canadian residence and making his main residence to the UK, it is possible to claim up to

£8,000 of a deduction in qualifying relocation expenses, such as costs involved in disposing of the old property, transporting belongings, legal fees etc. Tom should retain all receipts to back up the ~~claim~~ claim which will be made on his UK self-assessment return. There may also be additional scope to claim relief on travel and subsistence costs relating to the the whole family's move to the UK which I would be happy to discuss with you in more detail. This is because Tom is not domiciled in the UK.

Note 6 - If Overseas Workday Relief wasn't claimed and the rest of Tom's assignment wasn't structured tax-efficiently as structured above, the liability

would be much higher:

	£
Salary $240,000 \times \frac{10}{12} \div 1.8$	111,111
Bonus $240,000 \times \frac{4}{12} \div 1.8$	44,444
less: hypo. tax @ 31.5%	<u>(49,000)</u>
	106,555
Housing $2,000 \times 10$	20,000
COLA $14,000 \times \frac{10}{12}$	11,667
Medical	600
Car allowance	1,000
School fees $25,000 \times \frac{10}{12}$	20,833
Relocation	20,000
Mileage $(0.05 \times 6,000)$	<u>300</u>
	180,955
Gross-up: $26,800 \times \frac{100}{80} =$	33,500
$69,900 \times \frac{100}{60} =$	116,500
$84,255 \times \frac{100}{55} =$	<u>153,191</u>
<u>Gross</u> 180,955	303,191
less: net	<u>(180,955)</u>
Tax equalisation	<u>122,236</u>

Check:	33,500 @ 20% =	6,700
	116,500 @ 40% =	46,600
	153,191 @ 45% =	68,936
		<u>122,236</u>

Note 7

There is no charge to income tax for Tom in 2018/19 in respect of share option (assumed unapproved). However, when exercised, this will be employment-related income (subject to PAYE as the shares are listed on a recognised stock exchange). As soon as practicable once exercised, the following will be reportable as employment income. This assumes Tom leaves the UK on 31 May 2018 and the market value remains as is.

MV @ exercise:	10,000 x 4.70	47,000
Less: exercise price:	10,000 x 2.50	(25,000)
		<u>22,000</u>

Plan	Taxes: I.T. / NIC
Tom Johnson	PAYE
• Residence 31 May 2018	IHT
✓ >183 days → 31 May 2019	VAT
	18/19
	19/20
	20/21
• Implications of residence	SOLT
✓ - OWR for days in Austria	CT
✓ - Remittance basis	ATED
• Payroll - set up MPAYE scheme	
- A/L also applies - not NIC though	
• <u>NIC</u>	
• Child benefit → can claim, but clawback	
Other areas of risk/opportunity	
✓ <u>L1ET</u> deduction - termination	
✓ - structure redundancy package - PAYE & NIC	
<u>L.P.E.</u>	
• Companies v. different - MCINOCOT? Losses disallowed?	
✓ <u>Share schemes?</u>	