Application and Professional Skills

Taxation of Individuals

November 2024

Suggested answer

CTA Ltd
1 High Street
Nottingham
NG1 1AA

3 November 2024

Mr M Sousa
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Parque das Nações 1990-193
Lisbon
Portugal

Dear Mr Sousa

Working in the UK and Estate Planning Advice

You have asked us to provide tax advice and recommendations with respect to your forthcoming employment with Camil Ltd in Nottingham and also the investment and estate planning you wish to make. You should also seek advice from a suitably qualified Independent Financial Adviser (IFA) in respect of the investments you wish to make.

Introduction

You have recently received a lump sum of £500,000 from Camil Ltd. You wish to invest this money in either a property in Portugal, or purchase a property in the UK and shares in Camil Ltd.

You have also received an offer of employment with Camil Ltd beginning in January 2025. You wish to understand what your net pay will be and whether this will give you enough for your potential outgoings and savings.

You need to make provision for your young daughter, Sara, on your death. Your focus is to maximise your savings and investments over the next two to three years to create a fund to support her maintenance and future education.

My conclusions and recommendations are based on the information supplied by you. They are provided solely for your benefit. Other than for the purposes of discussing your decisions with your brother, an IFA,or your Portuguese tax adviser, the contents of this letter should not be disclosed to any third party without my firm's prior written consent.

Conclusions and Recommendations

In order to maximise the value of your income and assets over the next couple of years to create investments for Sara, you need to manage your income taxes now and also your Inheritance Tax liability in the future. You need to create a mix of income to cover annual maintenance costs and growth to last until Sara leaves tertiary education.

The salary package will give you a monthly income of £3,909 after Income Tax (IT) and social security (NI) and before child maintenance payments and your living costs.

The pension scheme will provide a tax-free lump sum on your death and you should therefore still consider joining the scheme.

The company car will not be a significant tax cost, but you should discuss with Camil Ltd, if you can take a cash allowance instead. Planning is required so that any medical equipment you receive through your employment with Camil Ltd is not treated as a taxable benefit. You should seek advice at the time before accepting any such benefits.

The provision of any medical treatment through Camil Ltd will be a taxable benefit.

From a tax perspective, I would recommend the UK property/shares combination, rather than the Portuguese villa. Purchasing the UK property, rather than the Portuguese property, will maximise available tax reliefs. You will also save more through not paying to rent it, than the likely after-tax rental profit on the Portuguese property.

If you believe that Camil Ltd will make a success of the future software developments, purchasing the shares would be advantageous from a Capital Gains tax (CGT) and IHT perspective.

You will be subject to UK Inheritance Tax (IHT). Although you are considering setting up some kind of investment trust to be managed while Sara is still a child, there is no benefit to setting up a trust for her now; you would be better to set up one of the two special trusts designed for this purpose as part of your Will. As you wish to secure Sara's situation through tertiary education, I would recommend an 18-25 trust. You can set the age limit to less than 25 if you wish.

General Overview of UK taxation

If you arrive in the UK in early January and begin full-time work at Camil Ltd, you will become a UK tax resident from the first day you work for at least three hours. You may also become a UK tax resident by virtue of having your only home in the UK or the combination of your ties/days spent in the UK. I would expect, however, the most likely outcome is that you will be tax resident from your first UK workday. This is likely therefore to align closely with the date you cease Portuguese residence.

Domicile is also just as important in UK tax law for determining your liability to UK tax. You are domiciled in the country of your permanent, long-term abode. However, there are certain situations where you can be deemed to be UK domiciled for tax purposes, even though you may not consider yourself domiciled in the UK. Although you are a Portuguese national and have lived in Portugal for twenty years, you were born in the UK and your father was UK-domiciled at that time. You therefore have a domicile of origin in the UK, although you would probably say you are now domiciled in Portugal. As you have been UK-domiciled before, then when you become a UK tax resident, you will be also deemed to be UK domiciled again. Furthermore, you are not likely to return to live in Portugal again.

As a UK resident and domiciled individual, you are liable to UK tax on your worldwide income and capital gains. You will also be liable to UK IHT from 6 April 2025.

You will be liable to UK NI on your cash earnings from Camil Ltd.

<u>Earnings from Employment with Camil Ltd</u>

I have summarised the IT and NI which will be due on the proposed package from Camil Ltd. Please see Appendix 1.

Your monthly net income will be £4,134 for January to March 2025, after tax and child maintenance. Thereafter, it will be £3,209. This amount assumes you do decide to participate in the pension scheme (see below). This net income will further reduce by £750 in rent, unless you buy the UK property. If the net amount is more than sufficient for your needs, any excess could be invested in some other savings plan. You should discuss savings options when you meet your IFA.

Although the car will become redundant over time, the taxable value of that benefit is only £1,596 a year as it is an electric vehicle. At current rates, this gives rise to income tax of £638 per year. It may be possible for you to forego the company car in any case, as Camil Ltd would be unable to force you to accept a company car. As an alternative, could you ask Camil Ltd for a cash allowance instead? Given they will not have to pay for the leasing of the car and associated running costs, they may be open to paying you an allowance based on the costs saved. A cash allowance would increase your net income by 58% of the allowance paid plus the tax on the car not now deducted. Camil Ltd could also pay for your travel to and from work each day in the future as a non-taxable benefit, subject to the disabled employee provisions outlined below.

You should also consider the value of the pension contributions. Although you are not personally going to benefit from any pension on retirement or life insurance, you can create a very tax efficient investment for Sara. Ordinarily, contributing for only 2 or 3 years would not see much growth in the plan and the fund value may even be less than contributed due to administration fees. However, it is usual for a pension plan to pay a lump sum to your beneficiary on your death. Were you to nominate Sara as your beneficiary, she would get a tax-free lump sum on your death of whatever the value of the pension fund was. The contributions are £10,500 a year, of which you have only made £3,504. In addition, you get tax relief on your contributions (as reflected in the calculations at Appendix 1). Therefore, joining the pension scheme would give Sara a tax-free payment, which will have cost you less than a third of the amount she receives to provide.

The use of Camil Ltd's equipment could be seen as a taxable benefit. The key factor is whether you are recognised as disabled under the relevant legislation. The standard taxable value is 20% of the market value of the item or in the case of items manufactured by Camil Ltd, 20% of the cost of manufacturing. If you are treated as disabled, Camil Ltd can provide equipment if it enables you to do your job, which would cover items like the wheelchair in the future. They can also provide or pay for transport to work, e.g. in a taxi. The equipment must enable you to perform your job, and is still tax-free even if you also use the equipment in a personal capacity at home as well. You need to ensure therefore, that there is a clear reason for using the equipment you do, which is linked to your disability. I would also recommend that if you are to test other equipment, which is not necessarily linked to your own ability to work, that your formal job specification includes testing.

If Camil Ltd pays for any medical treatment or medical consultations, this will be a taxable benefit. There is no special exemption for disabled employees similar to the above. The value will be the cost to Camil Ltd.

As and when you need such equipment or services, I can advise you on the consequences and whether they would qualify as tax exempt.

<u>Lump sum from Camil Ltd</u>

The sale has already been settled before you arrive in the UK and become resident. Furthermore, the sale is not connected with, or contingent on, your future employment. You are not, therefore, liable to UK tax on this payment. You will become liable to UK tax on the income/gains the lump sum generates subject to how you invest it.

After Portuguese tax you have approximately £360,000 of the lump sum to invest.

<u>Your Proposed Investment Options</u>

You are considering buying a property in Portugal, or a property in the UK and shares in Camil Ltd. I have set out below the Income Tax (IT) and Capital Gains Tax (CGT) treatment of each of these.

<u>Rental Income from Portugal</u>

If you buy the Portuguese property, the profit generated from the letting will be taxable in the UK at your marginal rate of tax. However, it will also be taxable in Portugal as the property is located in Portugal. The UK will give a credit for any Portuguese tax paid. If the Portuguese tax is higher than the UK tax, no further UK tax will be due. If the Portuguese tax is less, then you will have to pay additional tax in the UK up to your UK marginal tax rate. I calculate additional UK tax will be due of £1,080 per year (please see Appendix 1).

You would not sell this property, so I have not commented on the CGT position.

<u>Property purchased in the UK</u>

There would be no income from this property and so no charge to IT. However, it is saving you the cost of monthly rents, which would total £9,000 a year, which is more than the net Portuguese rental profit.
I presume you are unlikely to sell this property before your death.

You should seek advice as to whether the purchase of this property would be a good investment decision in terms of capital growth or rental income after your death.

<u>Camil Ltd Shares</u>

There would not be any dividend income from these shares to give rise to an IT charge. The potential value will be in capital growth by the time of any future sale in 3-6 years' time, which will be after your death. Camil Ltd is open to the idea of holding them on trust for Sara but I would recommend holding them in your name initially for IHT purposes (see below) and only passing them into a trust for Sara on your death.

I would recommend the UK property/shares option, since they do not generate an immediate tax charge and save you the cost of rent.

Estate Planning

As you will be domiciled in the UK from 6 April 2025, you will be liable to UK IHT on your worldwide assets. All your assets will be valued and to the extent they exceed the relevant thresholds, liable to 40% tax. It would, therefore, be prudent to plan your estate around UK IHT rules.

The total value of your estate will be calculated and if it exceeds £325,000, IHT will be charged at a flat rate of 40% on the excess.

Today, you have £420,000 which is the net proceeds after Portuguese tax from the software sale and your savings left from the termination payment. Currently the IHT due on £420,000 would be £38,000 ([£420,000 - £325,000] @ 40%).

There are two elements which would help to reduce the IHT charged:

i. Residence Nil Rate Band (RNRB). This excludes up to £175,000 from the value of your main residence, when it is passed on to a direct descendant.
ii. Business Property Relief (BPR). This excludes qualifying business assets from the value of the estate.

If you proceed with Option 1 or 2, your estate is likely to consist of either a Portuguese property or a UK property and shares in Camil Ltd. You may also have some cash savings or other investments.

The pension fund would result in a lump sum, which is outside of your IHT estate. Whatever the value received can be invested in full for Sara. There is no UK tax due on this amount.

<u>How you can minimise UK IHT</u>

<u>Property</u>

If you have bought the Portuguese property, then the full value of that property will be included in the IHT calculation. This is because it is not your main residence and would not qualify for RNRB. Let us assume the value would be £450,000 after the renovations are completed. This would exceed the £325,000 threshold by £125,000 and result in an IHT liability of £50,000. If you have any other assets, e.g., cash in the bank, this would also be taxed at 40%.

If you have bought the UK property to live in and leave it to Sara, the RNRB can apply to it. The IHT value of the UK property is reduced to nil if it is worth less than £175,000 or reduced to just the excess over £175,000. In other words, UK IHT would be unlikely to be due on this property and you effectively will have the full £325,000 limit to set against other investments.

It would therefore be better from a UK IHT position to buy the UK property, rather than the Portuguese property.

On your death, the UK property could be sold without CGT (if the sales price is the same as the value at the date of death) or IHT. The proceeds could be used to invest in another asset or could be used to buy a property in Portugal at that point. Alternatively, the house could be rented out which would generate income to cover Sara’s expenses.

<u>BPR</u>

BPR could apply to the Camil Ltd shares if you have held them for at least two years and Camil Ltd remains a private limited trading company. The investment in Camil Ltd is therefore potentially IHT free.

From an IHT perspective the UK property/shares option is better as it results in potentially no IHT due on either of these assets, leaving the £325,000 threshold to be set against the value of any other savings.

Trust for Sara

I note that you are planning to set up a trust for Sara to last until she is 22. There are a number of types of trust available in the UK. However, I would not recommend setting up one straightaway for a number of reasons.

When valuing your estate for IHT, transfers of assets within the last seven years are also included. These use up the £325,000 threshold. In addition, if you buy the Camil Ltd shares and transfer them into the trust before you have held them for two years, you will lose the potential BPR relief.

Assets transferred on death also have their base cost uplifted to the IHT value. This means when they are sold in the future, less CGT is due.

There are two types of special trust available at the time of death, where the beneficiary is under the age of 18.

1. Bereaved Minor's Trust

The assets in the trust and the income they generate are maintained exclusively for the benefit of the Sara. The trustees could pay out for her school fees, for example. At the age of 18, she will become entitled to all the assets and accumulated income and the trust will cease. She can be entitled to the income generated by the assets up to the age of 18.

There is no charge to IHT when the trust pays something out for Sara's benefit or when it ceases at age 18.

2. 18-to-25 Trust

Similar to the first trust the assets and the income are kept exclusively for Sara's benefit. However, the age limit can be extended to any age up to 25.

There will be a potential IHT tax charge on the trust at the point Sara becomes entitled to the assets at the age set. The charge is based on the value of the estate at the age set but time-apportioned only to the period after age 18. The effective rate of tax is no more than 4.2%.

Although there will be some extra IHT to pay under an 18-to-25 Trust, it would allow the assets to be held in trust up until Sara is 22.

I would therefore recommend not setting up a trust now but setting up an 18-25 Trust on your death.

Making a Will

It is good planning in the UK to make a Will to avoid the laws of intestacy. Although these laws would still leave your estate to Sara, the Will is your opportunity to set out how you would like your assets to be handled. It also makes the administration easier saving time and costs.

Without a Will, all your assets would be automatically held in a Bereaved Minor's Trust and the trust would end before she is 22.

You should write a UK Will to specify that you wish your estate to be left to Sara and under what type of trust, who will be the trustees, etc. It is also a good idea to set out how you imagine the trust will be used for Sara's benefit to guide the trustees. I would recommend speaking to an experienced trust lawyer to discuss the options further and to draw up the Will and the trust deeds.

You could have Sara's mother and Paolo as trustees. As you will be UK domiciled at the time of your death and Paolo is a UK resident trustee, the trust will always be considered a UK trust, even though Sara is resident in Portugal. Therefore, it is liable to UK IT and CGT.

Your assets could be sold to generate cash amounts to be invested as the trustees see fit. Alternatively, the assets themselves could be transferred into the trust.

Portugal

As Sara is tax resident in Portugal, you should discuss the Portuguese tax position to ensure that any decisions you make in respect of UK tax planning do not lead to adverse taxation in Portugal.

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

Yours sincerely,

XXXX

CTA Ltd

Appendix 1

Income from employment with Camil Ltd

	January 2025 to March 2025		April 2025 to March 2026	
	Salary per month		Salary per month	
		£		£
Salary	£70,000 x 3/12	17,500	£70,000 x 1/12	5,833
Car benefit	£53,250 @ 2% x 3/12	266	£53,250 @ 3% x 1/12	133
Pension contribution	£17,500 @ 5%	(875)	£5,833 @ 5%	(292)
Total		£16,891		£5,674
Tax due				
Personal allowance		(12,570)		(1,048)
Taxable income		£4,321		£4,626
Tax due	@ 20%	£864	3,142 @ 20%	£628
	Divide by 3		1,484 @ 40%	£594
Total tax due	Per month	£288		£1,222
NI due				
Monthly salary	£70,000 x 1/12	5,833	£70,000 x 1/12	5,833
Threshold		(1,048)		(1,048)
Liable to NI		£4,785		£4,785
NI due	£3,142 @ 12%	377	£3,142 @ 12%	377
	£1,643 @ 2%	33	£1,643 @ 2%	33
Total NI due		£410		£410
Net earnings				
Gross salary		5,833		5,833
Pension contribution		(292)		(292)
Tax		(288)		(1,222)
NI		(410)		(410)
Net salary		£4,843		£3,909
Child maintenance		(700)		(700)
Net spendable income		£4,143		£3,209

Pension Contributions per Year

		Monthly	Annually
		£	£
Paid by you	£5,833 @ 5%	292	3,504
Paid by Camil Ltd	£5,833 @ 10%	583	6,996
Value before administration fees		£875	£10,500

Portuguese Rental Income

		£
Rent		9,000
Tax due	@ 40%	3,600
Foreign tax credit		(2,520)
Net UK tax due		£1,080