The Chartered Institute of Taxation

Advanced Technical

Human Capital Taxes

November 2024

Suggested answers

ANSWER 1

No Election under S.431 ITEPA 2003

Acquisition on 1 February 2018

Maya acquired employment related securities in 2018. Although DEBT is not her employer they were acquired by reason of her employment with Duggee Ltd. They will therefore be subject to the provisions of Chapter 2, Part 7 ITEPA 2003.

Part 7A (disguised remuneration) will not apply as there is an available exemption for employee share plans.

Chapter 2 states that if the Shares are subject to forfeiture provisions which last for five years or more following the award date, then there can be an immediate income tax charge. This will be a general earnings charge under s.62 ITEPA 2003. The income tax charge is based on the value of the Shares at the award date taking into account the impact of any restrictions on the value. This actual market value taking account of the impact of the restrictions ('AMV') is £20,000. As Maya paid nothing for the shares there will be an income tax and potential NIC liability on the full £20,000.

As there are trading arrangements in place the Shares would be "readily convertible assets" and the value of the Shares should have been reported as notional income on payroll and subject to PAYE and Class 1 NIC.

Forfeiture restrictions lapse on 1 February 2024

When the restrictions lapsed a chargeable event occurred (s.428 ITEPA 2003). The chargeable amount is calculated using the part of the Initial Unrestricted Market Value (IUMV) that was not taxed or paid for, multiplied by the market value of the securities when the restrictions lapsed: MV of the securities after the restriction is lifted x the proportion of IUMV that was not taxed or paid/for

£28,000 x 0.17 = £4,667

i.e. 2,000 x £14 x (2,000 x £2 / 2,000 x £12)

Dividend rights are amended 1 September 2024

Improved dividend rights for the Shares will have increased their value. If only the employee shares have been improved then this increase in value would have been liable to income tax and NIC as a post-acquisition benefit (s.477, Chapter 4, Part 7, ITEPA 2003). Duggee Ltd should have operated PAYE and Class 1 NIC on:

2,000 x £1 = £2,000.

If all Shares have their dividend right improved then there is an exemption from any further income tax charge.

Notional payments

The PAYE and Primary Class 1 NIC due on the notional payments of £20,000, £4,667 and £2,000 are pecuniary liabilities of Maya's. If these were not taken from Maya's net pay or Maya did not make good the liability to Duggee Ltd by 6 July following the end of each tax year the notional payments arose then a s.222 charge will arise on the amount unpaid which Duggee Ltd would have reported as a taxable benefit via form P11D and also through the payroll as earnings for Class 1 NIC.

Maya sells the Shares on 31 October 2024

No income tax or NIC liability would arise because these securities are not restricted at the point they are disposed of by Maya.

Employer reporting for Employment Related Securities

Duggee Ltd must register the scheme with HMRC for the purposes of Employment Related Securities reporting by 6 July after the tax year when the reportable event took place. Duggee Ltd should have reported the acquisition of 2000 restricted Shares by Maya for the 2017/18 tax year along with any other employees who acquired ERS. The annual ERS report would also need to report the chargeable event occurring when forfeiture restrictions lapse on 1 February 2024 and when dividend rights are amended on 1 September 2024.

Election under S.431 ITEPA 2003

Acquisition on 1 February 2018

If a joint election is made under s.431 ITEPA 2003, the chargeable employment income at acquisition is based on the value of the shares ignoring the impact of any restrictions. This is referred to as the Initial Unrestricted Market Value (IUMV). The IUMV will be higher than the RMV that had been calculated at £10 a share. This means that Maya would pay more income tax under PAYE and Class 1 primary NIC and Duggee Ltd would be liable for more Class 1 secondary NIC on acquisition.

i.e. 2,000 x £12 = £24,000

If the value of the shares decreases then no relief is given for the income tax and Class 1 NIC paid (by Maya and Duggee Ltd) on the IUMV.

Forfeiture restrictions lapse on 1 February 2024

No income tax or NIC charge would arise because income tax was paid on the IUMV at the date of acquisition.

Dividend rights are changed on 1 July 2024

The s.431 election would not affect the income tax charge that arises under Chapter 4. PAYE and NI would again apply to £2,000.Sale of Shares on 31 October 2024

There would again be no PAYE or NI obligations on the sale of the shares.

Notional payments

The PAYE and Primary Class 1 NIC arising on the notional payment of £24,000 on 1 February 2018 and £2,000 on 1 July 2024, are pecuniary liabilities of Maya's requiring funding to prevent a s.222 charge arising.Reporting requirements

Duggee Ltd would still need to register the scheme with HMRC for the purposes of Employment Related Securities reporting. The initial award would need to be reported (noting the s.431 election made in respect of those securities) and the subsequent charge arising when the dividend rights are changed on 1 July 2024.

MARKING GUIDE

TOPIC	MARKS
No s.431 Election	
Identify that the shares will be regarded as employment related securities and explain that this is because they are awarded by reason of employment	2
Identify that as the forfeiture restrictions last more than 5 years there will be an immediate income tax charge	1
The income tax charge is based on the Restricted Market Value (RMV) of £20,000	1
Identify that as the DEBT is able to buy back the shares these are trading arrangements that make the shares readily convertible assets and subject to PAYE and Class 1 NIC.	1
When the restrictions lapse this will be a chargeable event	1
The chargeable event is based on the formula and a reasonable description of the charge is given.	2
The s.428 charge is calculated at £4,667	1
The change in dividend rights results in a post-acquisition benefit subject to income tax/NIC	1
The increase in value would need to be calculated and PAYE applied.	1
The PAYE needs to be funded by Maya otherwise there is a s.222 charge.	1
The sale of the shares would not be a chargeable event as the securities are not restricted.	1
Explain ERS reporting requirements to HMRC.	1
S.431 Election	
Explain the impact of a 431 election at acquisition (IT and NIC on the IUMV)	2
Explain that a 431 election means that there would not be a chargeable event when the forfeiture restrictions lapse.	1
Explain the 431 election has no impact on the post-acquisition benefit charge	1
Explain that as the election taxed the IUMV there were lower employment tax charges overall benefitting Duggee Ltd for NIC.	2
TOTAL	**20**

ANSWER 2

BlueCo Ltd will need to assess its employer tax compliance position considering each option presented to Rikka, for both 2023/24 and 2024/25.

Original UK tax residence position

Rikka will be UK tax resident in 2023/24 having spent more than 183 days in the UK. BlueCo Ltd expected Rikka to 'split' the 2023/24 UK tax year under Case 1 of the Statutory Residence Test, and will have concluded that she:

- Had been UK tax resident in 2022/23 and would fulfil the criteria for full time work abroad (FTWA) in 2023/24, with up to 10 UK workdays and 30 UK days of presence between 6 December 2023 and 5 April 2024.

- Needed to be non-resident for the 2024/25 tax year under the FTWA criteria: spending up to 30 UK workdays and 90 UK days of presence in 2024/25, with no substantial break in the period of overseas work.

The operation of a No Tax (NT) code means that no PAYE tax has been paid across to HMRC from 6 December 2023 onwards. Whilst the 'in-year' position may have been accurate, BlueCo Ltd will now need to assess if this remains accurate given the options available to Rikka.

Option 1: Redundancy

If Rikka's role is redundant in 2024/25, then she is likely to have a significant break (at least 31 days) from overseas work and this would mean the FTWA criteria is not met for 2024/25. Therefore, case 1 can no longer apply to split the 2023/24 tax year. BlueCo Ltd would need to consider if any other 'split year' case applies for 2023/24:

Case 2: would not apply as Rikka is not leaving to accompany her partner working abroad

Case 3: would not apply as BlueCo Ltd are now aware that Rikka continued to have a home in the UK after 6 December 2023.

Next, BlueCo Ltd will need to consider if Rikka can be considered non-resident from 6 December 2023 onwards under Article 4 of the UK / Swiss Double Tax Agreement (DTA):

- Rikka has a permanent home available in both Switzerland and the UK.

- Rikka's husband and daughter continued to live in the UK in 2023/24, and she continued to have social and economic ties with the UK. Her role is in Switzerland, so she also has economic ties with Switzerland. On balance, it is likely that Rikka remains DTA resident in the UK for all of 2023/24 and cannot split the tax year under the DTA.

BlueCo Ltd should file an amended Full Payment Submission to pay across PAYE tax to HMRC for the period 6 December 2023 to 5 April 2024. They should consider applying for a 'net of tax credit' arrangement (Appendix 5) to reduce the PAYE tax due by the Swiss withholding tax applied to income taxable in both locations. They will need to collect the PAYE tax due from Rikka.

BlueCo Ltd should also consider its PAYE compliance position for 2024/25. Even if Rikka is UK resident under the SRT, it is likely that Rikka will be DTA non-resident in the UK for this period as her family will be living with her in Switzerland and on balance, her social and economic ties will likely be stronger with Switzerland than the UK.

The next consideration is whether Rikka's UK workdays can be exempt under Article 15(2) of the DTA. As Rikka will spend less than 183 days in the UK in 2024/25 and the costs of her employment will be borne by the Swiss entity, it is likely that her UK workdays can still be exempt from UK income tax, without any impact from the merger. Relevant details can be included on BlueCo Ltd.'s 2024/25 Appendix 4 submission, and no PAYE tax withholding would be required in respect of her UK workdays.

Option 2: Return to the UK in 2024/25

<u>If FTWA can be maintained for 2024/25:</u>

Should Rikka take up the new role with DarkBlueCo plc and return to the UK on 6 March 2025, BlueCo Ltd will need to consider if she will fulfil the FTWA conditions in 2024/25. It is likely known when the merger is announced on 6 October 2024, that Rikka had spent the following time in the UK:

- Workdays: 10 – 14
- Days of presence: 14 – 20

Rikka will unlikely breach 90 days of presence in the UK in 2024/25 with this pattern and return date of 15 March 2025. However, to remain non-resident under the FTWA rules:

- She can only spend 16 – 20 more UK workdays between 6 October 2024 and 5 April 2025; and
- She should not have a significant break of more than 31 days from overseas work

Based on her current pattern she will have between 20-28 UK workdays (close to the 30-day maximum). BlueCo Ltd may wish to help Rikka manage her UK workdays from 6 October 2024 onwards (to keep these below 31 UK workdays for 2024/25), and also avoid a significant break from overseas work. Should Rikka be able to achieve this, she will remain UK non-resident under FTWA in 2024/25.

This is the best-case scenario for BlueCo Ltd, as it should not need to make any amendments to its PAYE compliance submissions for 2023/24 and can continue to operate an NT code for 2024/25 and include relevant details on the Appendix 4 filing for this year.

<u>If FTWA cannot be maintained for 2024/25:</u>

If Rikka will spend more than 30 UK workdays in 2024/25, then either of the following options are possible to be non-resident for 2024/25 and preserve the use of the NT code:Use of the sufficient ties test: she may have up to 3 connection factors (accessible accommodation; more than 90 UK days in 2023/24, and possibly substantive UK employment) – to remain non-resident of the UK, Rikka will need to manage her travel pattern and spend less than 46 midnights in the UK; or

By demonstrating closer social and economic ties with Switzerland for 2024/25 and being treaty resident of Switzerland.

Even if the above are met, an amendment to the 2023/24 payroll submissions will still be needed (by way of an ‘Earlier Year Update’) as Rikka will not be able to split that tax year under Case 1.

MARKING GUIDE

TOPIC	MARKS
Requirement:	
Tax position review will depend on options available to Rikka and separately assessed for each tax year	½
Original UK tax position:	
• Resident in 2023/24	½
• Split year considerations under FTWA	2
• Implications of NT code use	1
Option 1:	
• Case 1 no longer possible to split 2023/24 due to substantive break	1
• Assessment of Cases 2 and 3 to split 2023/24	1
• Assessment of DTA position to split 2023/24	2
• Conclusion on PAYE tax position for 2023/24 and operating Appendix 5	2
• Residence position for 2024/25	1
• PAYE tax position for 2024/25	1
Option 2:	
If FTWA can be maintained in 2024/25:	
• What will be known by 6 October 2024 for UK workdays / presence	1
• What is possible for UK workdays / presence	1
• BlueCo Ltd to discuss with Rikka possibility to manage UK workdays / presence	1
• Conclusion of 2023/24 PAYE tax position	1
• Conclusion of 2024/25 PAYE tax position	1
If FTWA cannot be maintained for 2024/25:	
• Alternative residence scenarios: Sufficient ties test	1
• Alternative residence scenarios: DTA	1
• Conclusion for 2023/24 PAYE tax position	½
• Conclusion for 2024/25 PAYE tax position	½
TOTAL	20

ANSWER 3

Social security

Under the SSC Protocol, Robert will only pay social security in the UK. This is because he will either spend less than 5 % of his time in any one EU country and so the work in these countries is disregarded for the purposes of the SSC Protocol or he will spend more than 5% of his time in one or more EU countries and is treated as a multistate worker. As a multistate worker for an employer who has a presence in the UK or EU, he will pay social security in the country he is habitually resident provided he spends 25% of his working time there.

Given there is a liability in the UK to social security under the SSC Protocol, the next step is to consider, the UK/US social security agreement Robert will remain subject only to social security contributions in the US as he is normally employed by his US employer and his secondment to the UK is expected to last no more than 5 years.

A certificate of coverage should be obtained from the UK authorities to exempt Robert from social security in EU countries and from the US authorities to exempt Robert from UK NIC. Class 1/1A NIC will not arise.

Relocation expenses

Qualifying relocation expenses of up to £8,000 can be reimbursed or met by the employer tax free as Robert will change his main residence to be within a reasonable commuting distance to the UK workplace.

Costs in excess of £8,000 will be taxable. Only qualifying expenses incurred by the end of the following tax year after the move will qualify (i.e., by 5 April 2027)

Allowable:

- Reimbursement for the transportation of domestic belongings are allowable £7,500
- Reimbursement for temporary accommodation required before moving into the new main residence will be allowed- £2,800.

Total, £10,300

£8,000 will be exempt, the estimated excess of £2,300 will taxable.

Not allowable:

- New bed – replacement of domestic belongings are allowable but only if it is a replacement of items that are not suitable for the new residence. If the new bed is intended to replace a bed at the previous residence, aside from difficulties in transportation it is unlikely the old bed would not be suitable for the new residence and therefore the exemption would not apply.

£2,000 will be taxable.

Annual allowance

Robert will be entitled to relief on his and his employer's 401k contributions under the UK/US double tax treaty as:

- It is a scheme that is exempt from tax in the US.
- It is operated in principle to provide a pension or retirement benefit.
- Contributions to the scheme began before Robert began employment in the UK.

However, contributions will be subject to the annual allowance.

Estimated input for annual allowance in 2025/26:

- Employee contributions of £12,000 for 2025/26, but only £9,000 will be relieved from UK tax.
- Employer contributions of £24,000, but first 3 months (£6,000) will not be subject to UK tax.
- Employer contributions exempt from tax under OWR are also deducted from the input value - £18,000 x 20% = £3,600

Total £23,400

Annual allowance for 2025/26 is £60,000, but likely tapered to the minimum of £10,000 given Robert's taxable earnings will be more than £360,000.

Claw back of relief via an annual allowance charge on the estimated excess of £13,400 may apply. The excess would be subject to tax at Robert's marginal rate of income tax and added as a charge on his tax return.

However, unused AA from the previous 3 tax years can be carried forward on a FIFO basis if in the year the concerned the individual was a member of:

- the currently-relieved non-UK pension scheme;
- a UK registered pension scheme; or
- another overseas pension scheme in respect of which relief from UK tax was claimed

Therefore:

- 2022/23 and 2023/24 he was not a member of the current scheme, nor any other UK scheme or another overseas scheme where UK tax relief was claimed, so no carry forward is available.
- 2024/25 he was a member of the current scheme and had no UK relieved contributions. Therefore, the full £60,000 is available, but this will be reduced by contributions made to the 401k in that tax year - £18,000 – leaving £42,000 to be carried forward.

Therefore, annual allowance charge unlikely to arise with the unused annual allowance from 2024/25 available to be carried forward to the next two tax years.

Overseas Workday Relief (OWR)

As Robert is non-UK domiciled with earnings paid to his non-UK bank account and may elect to be taxed under the remittance basis of taxation, he can claim OWR on income arising from non-UK workdays for the first three tax years of his assignment which, such earnings will not be taxable so long as they remained unremitted to the UK.

Modified payroll

A best estimate of Robert's tax liability for 2025/26 based on salary and benefits known will need to be determined and reported monthly.

The year end month 12 FPS submission must reconcile the position to consider bonuses and salary adjustments made in the tax year.

Provisional OWR and overseas pension relief can be given as part of the estimated PAYE calculation. If OWR is claimed, then a 0T tax code should be used.

If any benefits are provided, these should be included within the estimated PAYE calculations, but will need to be reported on form P11D and P11D(b). The normal deadlines for which are extended to 31 January following the end of the tax year.

The final position must be reconciled on Robert's 2025/26 tax return which will be due on 31 January 2027. As part of the Appendix 6 agreement HMRC will expect that the employer supports with this.

Calculation

Salary for 2025/26 from July onwards - £450,000
Non qualifying relocation expenses - £2,300
Other relocation expenses and allowances - £7,000
Hypothetical tax deduction – (£75,000)
401k employee contributions – (£9,000)
Total: £375,300
OWR: 20% x £375,300 – (£75,060)

Taxable: £300,240

Basic rate - 20% x £37,700 = £7,540
Higher rate - 40% x £87,440 = £34,976
Additional rate - 45% x £175,100 = £78,795
Total: £121,311

As the employer is meeting Robert's UK tax liability, this must be grossed up at Robert's marginal rate of tax.
£121,311 / (100%-45%) x 45% = £99,254

Total tax: £220,565
Total taxable earnings: £520,805

Monthly earnings, including a gross up totalling £57,867 should be reported from July onwards via the modified payroll as earnings which will be grossed up and PAYE of £24,507 due each month by the 22nd following each tax month. However, if less than 5 employees are enrolled onto the scheme then this can be paid quarterly.

MARKING GUIDE

TOPIC	MARKS
Will be subject to UK NIC under SSC multi state rules	1.0
Will remain subject to social security only in US under US/UK agreement	1.0
Certificate of coverage should be obtained	0.5
Qualifying relocation expenses up to £8,000 will be exempt as there will be a change in main residence	0.5
Outline limitation date of 5 April 2027	0.5
Allowable expenses of £10,800, excess of £2,800 taxable	0.5
Outlining which expenses will qualify	0.5
Allowance and non allowable expenses of £2,000 will be taxable	0.5
Outlining which expenses will not qualify with reason	0.5
401k contributions under treaty are deductible/exempt with reason	1.0
401k contributions will be subject to annual allowance limit	0.5
Estimated input for 2025/26 is £23,400, with explanations for full marks	1.5
Annual allowance likely tapered to £10,000	0.5
Claw back of pension relief at marginal rate of tax via tax return	0.5
Unused annual allowance from previous 3 tax years may be available	0.5
Total carry forward to 2025/26 is £42,000, with explanation for full marks	1.5
Best estimate of 2025/26 liability needs to be determined based on salary and benefits known and reported monthly	0.5
Appendix 6 and calculation	
A reconciliation must be undertaken by month 12 to account for bonuses and changes to salary in tax year	0.5
OWR and relief for overseas pension contributions can be provisionally provided	0.5
0T tax code needs to be used if OWR to be claimed	0.5
Estimated taxable benefit values to be reported as earnings but still need to be reported on a P11D and P11D(b) with a deadline of 31 January following end of tax year	0.5
Final position to be accurately reconciled on a tax return	0.5
HMRC will expect that the employer will support with completion of the tax return	0.5
Estimated taxable income after OWR £300,240	1.5
Estimated tax including gross up £220,565	1.5
£57,867 to be reported monthly as taxable earnings and with £24,507 due monthly as PAYE. If candidate states that PAYE will be based on tax tables instead of dividing the calculated figure by 9, then marks may be awarded as some firms have policies on overriding PAYE.	1.0
PAYE will be due by 22nd following each tax month	0.5
Can be paid quarterly if no more than 5 employees on the scheme	0.5
TOTAL	**20.0**

ANSWER 4

As Dawn is a director of Spotlight PLC in 2024/25, Class 1 NIC must continue to be calculated on an annual basis until the end of the tax year. As Dawn will not be a director of Spotlight PLC at the beginning of the 2025/26 tax year her payroll record should be updated to ensure Class 1 NIC is calculated on a pay period basis.

Once Dawn has left employment a P45 should be issued showing her taxable income and PAYE withheld for the tax year. If any further earnings subject to PAYE are paid post departure a 0TM1/W1 tax code should be used.

The bonus is a contractual obligation, it will be deemed employment earnings subject to PAYE/NIC. The tax point is the earlier of payment or when legal entitlement arises but can be earlier if a director.

The bonus will be determined and credited in the company accounts after 31 December 2025 and as such the tax point may be modified so that it occurs when the payment is determined. However, as Dawn will not be a director in or after the 2025/26 tax year, the tax point will remain the earlier of payment or when legal entitlement arises, i.e., 30 April 2026.

The award of shares is unlikely to be caught as earnings under s.62, ITEPA 2003 but will be deemed a restrictive undertaking under s.226, ITEPA 2003 as:

- It is in connection with past employment.
- It restricts her future activity or has been fulfilled.
- The award is unlikely to otherwise be caught as earnings.
- It is not in the form of money but is valuable consideration.
- Dawn is and was UK tax resident throughout period of employment.

The cash value of the shares will be treated as employment earnings in the tax year the shares are awarded.

As the shares can be exchanged for cash given Spotlight PLC is listed on the London Stock Exchange, they will be deemed a readily convertible asset and Spotlight PLC will be required to operate PAYE/NIC in the pay period of award. Spotlight will need to consider how the PAYE/NIC will be collected as the earnings reported are notional. Albeit primary Class 1 NIC may not be due if Dawn has reached state retirement age at the point of award and Spotlight PLC should update her NIC category code to C if this is the case.

Furthermore, shares acquired within 7 years of ceasing employment will continue to remain Employment Related Securities (ERS). As such, the shares are likely to be regarded as ERS if awarded three years after cessation of employment. Spotlight PLC will be required to report the acquisition on an ERS return for the tax year of award.

The gift of £50,000 will not be provided by reason of employment but is in connection with her retirement. As such it is likely considered a relevant benefit awarded under an Employer Financed Retirement Benefit Scheme. The payment will be subject to PAYE and Class 1 NIC.

MARKING GUIDE

TOPIC	MARKS
Class 1 NIC calculated on annual basis for remainder of 2024/25 as director during the tax year	0.5
Class 1 NIC calculated on pay period basis for 2025/26 as not a director at the start of the tax year	0.5
P45 should be issued on departure	0.5
Spotlight PLC should use a 0TM1/W1 tax code on earnings post P45	0.5
Bonus will be subject to PAYE/NIC as earnings	0.5
Tax point of bonus will be earlier of payment or legal entitlement	0.5
Tax point of bonus will not be amended as will not be a director in the tax year any potential tax points arise	1.0
Tax point of bonus will be 30 April 2026	0.5
Shares awarded will be considered a relevant benefit awarded under a restricted undertaking, with reasons for full marks	1.5
Share award will be an RCA and subject to PAYE/NIC	0.5
Employer will need to consider how PAYE/NIC will be operated on share award given it will be a notional payment	1.0
No primary Class 1 NIC if Dawn has reached state retirement age	0.5
Shares awarded after three years of ceasing employment will still be deemed ERS and reportable on an ERS return	1.0
Gift of £50,000 likely caught as a relevant benefit from an EFRBS and subject to PAYE and Class 1 NIC	1.0
TOTAL	**10.0**

ANSWER 5

Requirement 1

Tips are treated as taxable employment income since they fall within ITEPA 2003, s.62 as emoluments of employment. This is the case however tips are paid, collected or distributed. However the responsibility for compliance and the treatment for National Insurance will vary depending on the arrangements in place for Beauface Ltd's employees.

Currently

At present, there is no tax compliance issue for the company. Beauface Ltd has no PAYE obligations in relation to cash tips paid directly by clients to employees. Instead, employees are responsible for declaring their tips as extra employment income via Self Assessment.

Plan A

Under Plan A, Nelo would be operating a tronc system. As the troncmaster, Nelo would be personally responsible for collecting, allocating and distributing the tips. He would also need to administer PAYE on the tips and would need to set up a separate PAYE scheme. (HMRC will also accept an arrangement where Beauface Ltd's payroll is used, with the company acting as 'payroll agent', per HMRC guidance note E24.) Income tax would need to be deducted, but no national insurance would be due.

Beauface Ltd as 'principal employer' would be required to notify HMRC of the tronc arrangement and provide Nelo's name, per SI 2003/2682, Reg 100 (2). If HMRC were not to accept the tronc arrangement, it would be Beauface Ltd's responsibility to operate PAYE on the tips. Under per SI 2003/2682, Reg 100 (4), if HMRC found that Nelo failed to operate the Tronc correctly, the missing tax could be collected from salaries via employees' PAYE codings per regulation 14(1)(b).

Plan B

Under Plan B, Beauface Ltd as employer would take full responsibility for collection and distribution of tips. Tips would be treated as part of each employee's earnings, and included within the company's usual FPSs under RTI, on the 22nd of each month (or 19th if not paid electronically) and in due course on employees' P60s to be provided by 31 May each year. Class 1 NICs apply only where tips are pooled and where this is done by the employer. PAYE would apply, with both income tax and primary Class 1 NICs collected via Beauface Ltd's payroll. Beauface Ltd would be liable for secondary Class 1 contributions per SI 2003/2682, Reg 100.

(In all cases, tips are fully distributed with no amount retained by the employer. This is a requirement under the Employment (Allocation of Tips) Act 2023.)

Requirement 2

National Living Wage

Tips do not count as payment for National Minimum/Living Wage purposes. Yinka's hourly rate is £206/20 = £10.30 and the reference period here will be a week. This met the standard adult rate for a 22-year-old worker, so complied with the NMW for 2023/24, until Yinka had turned 23. From the start of the pay period immediately after Yinka turned 23, Beauface Ltd should have begun to pay Yinka at least the NLW of £10.42 per hour.

Auto enrolment

Unless the tips are brought within the company's PAYE scheme, they are not pensionable earnings. However Yinka's starting salary alone exceeded the £10,000 pa threshold. Therefore, unless a postponement was notified, she should have been automatically enrolled into the workplace pension from the date she joined, as an eligible jobholder with a salary of £206 x 52 = £10,712.

(Beauface Ltd should regularise its treatment of Yinka for both NLW and pension purposes, backdating a salary increase and enrolling her into the pension scheme. Otherwise the company risks receiving notices to comply from HMRC and the Pensions Regulator, and potential sanctions.)

Requirement 3

Plan A: Nelo's emoluments	NICs £	Employer Costs £
Salary £25,000 + (£300 x 12)	28,600	28,600
Employer pension 5% x 28,600		1,430
Tips	0	0
Benefit (ggods) £40 x 120% x 100/150 x 12 =		384
£384 x 100/80 = £480 gross, £96 tax (PSA)		96
Smartphone £52 x 12 (pecuniary liability)	624	624
NICs:	29,242	
Employer Secondary Class 1: 29,224 – 9,100 = 20,124 x 13.8% =	2,777	2,777
Class 1B (PSA): £480 x 13.8% =	66	66
Costs allowable for corporation tax		33,983
Deduction of CT relief @ 25%		(8,496)
Total cost to Beauface Ltd		£25,487

MARKING GUIDE

TOPIC	MARKS
Requirement 1	
Tips taxable, employees to self assess, no NICs	1
Current arrangement: No compliance problem. No obligation for employer. No records.	0.5
Plan A: tronc - Nelo responsible as troncmaster	0.5
Nelo controls allocation of tips	0.5
Income tax but no NICs	0.5
Not payrolled by Beauface Ltd/separate. (Though ‘payroll agent’ setup allowed.) Company as ‘principal employer’ to notify HMRC of arrangement and troncmaster. If HMRC do not accept tronc arrangement, company will be responsible. If HMRC not satisfied that Nelo compliant, may collect from salaries via PAYE codings (½ each point)	1.5
Plan B: Beauface Ltd responsible	0.5
Tips part of earnings for payroll under company’s PAYE scheme	0.5
RTI/FPS, deadline	0.5
P60, deadline	0.5
NI primary and secondary due on tips	0.5
Subtotal Marks	7
Requirement 2	
NM/LW: Salary hourly rate - tips ignored	0.5
NMW compliant at first	0.5
Yinka needed NLW after turning 23 – non compliant	0.5
Pension: Auto enrolment needed immediately based on figures. Tips pensionable. (Or alternatively, postponement allowed for new employee for up to 3 months if notified of this, with option to opt in.)	1.5
Subtotal Marks	3
Requirement 3	
Salary, pension, no tips	1
Class 1 Secondary	1
Class 1B including treatment of VAT element	1.5
Smartphone Class 1 amount	0.5
Total costs and CT deduction	1
Subtotal Marks	5
TOTAL	**15**

ANSWER 6

Non-cash employee benefits may be subject to employment taxes under the benefits code (Part 4 ITEPA 2003), however, where benefits are provided through third parties the provisions of Part 7A, frequently referred to as the 'disguised remuneration' rules, may apply. The purpose of Part 7A is to create or accelerate an income tax charge where benefits or loans are provided to employees. These rules are anti-avoidance measures introduced to deal with employment taxes planning using third parties.

In order for Part 7A to apply to the Yachtmaster Employee Benefit Trust ('YEBT'), it must be an arrangement where it is reasonable to suppose that it is a means of wholly or partly providing reward or loans in connection with employment. Given the purpose of the YEBT is to reward employees that test would appear to be met.

There must be a relevant third person. Given that Yachtmaster plc have appointed UK Trust Company Ltd, that test would appear to be met.

In order for an income tax charge to arise, the relevant third person (UK Trust Company Ltd) must take one of three relevant steps. The three relevant steps are:

- 'earmarking' (s.554B),
- payment of a sum (including making a loan), transfer of asset (s.554C), or
- making an asset available (s.554D).

The loan

A loan would be a relevant step of 'payment of a sum' (s.554C).

The value of the relevant step is the amount of the sum paid. In this case this means that Adrian is regarded as earning £100,000 of employment income liable to income tax and Class 1 NIC. There would be a requirement to operate PAYE on these notional earnings.

The beneficial loan charge that would normally arise on the difference between the interest rate charged and the HMRC official rate (Part 3, Chapter 7 ITEPA 2003) would be overridden by the rules in Part 7A. Part 7A takes precedence. It would therefore have been more tax efficient for Yachtmaster plc and Adrian to have made the loan directly. Yachtmaster plc would have a smaller Class 1 secondary NIC liability on a beneficial loan and Adrian would have paid less income tax and Class 1 primary NIC.

No tax relief is given if the loan is subsequently repaid.

The Yacht

The provision of the Yacht to Ben would be regarded as a relevant step of making an asset available (s.554D). Even though Ben is not an employee, he is connected to Adrian as he is his civil partner. The value of the relevant step would be the higher of:

The cost of the asset: £50,000

The cost of the relevant step: £4,000 (£1,000 x four weeks)

It would therefore have been better for Yachtmaster plc to have provided the use of a Yacht directly, rather than via the YEBT.

The shares

The allocation of shares by the trustee to meet the share options granted to Adrian would be a relevant step of earmarking (s.554B). Although Adrian does not own these shares, the trustee has informally earmarked them for him using an internal ledger. The value of the relevant step would be the value of the shares purchased by the trust.

However, there are a number of exclusions to Part 7A due to the fact that it is a very wide-ranging anti-avoidance legislation, which would cover a number of standard arrangements.

There is an exemption for certain non-tax advantaged share option plans. It should apply if the earmarking of the shares to satisfy the share option grants contain vesting conditions. It does not matter whether the vesting conditions are time or exit based.

As the share options vest in five years' time it would appear that this exemption would apply meaning that no employment income arises on the earmarking of the shares for Adrian (s.554L ITEPA 2003).

Equally there is no tax on the grant of the options. Instead income tax will arise as and when Adrain exercises the option in the future.

PAYE

The wide meaning of these three relevant steps means that an income tax charge can arise even if nothing is paid to the employee (for example the yacht provided to Ben). This means the employer would need to process the value of the relevant steps (£150,000 in total) as a notional payment for PAYE tax and Class 1 NIC purposes. If the PAYE cannot be collected from their cash pay, the employee must make good the tax due within 90 days of the tax year.

MARKING GUIDE

TOPIC	**MARKS**
Explain that the disguised remuneration rules (Part 7A ITEPA) are anti avoidance provisions designed to create or advance a tax charge to combat tax planning involving third parties.	1
There must be an arrangement which it is reasonable to suppose is wholly or partly a means of providing rewards in connection employment.	1
There must be a relevant third party and identify that UK Trust Company Ltd would meet that requirement	1
A relevant step must be taken by the relevant third person.	1
Identify the relevant step of 'earmarking' (s.554B) in respect of the shares purchased and notionally allocated for Adrian in the future	1
Identify the relevant step of 'payment of a sum' (s.554C) in respect of the loan made to Adrian	1
Identify the relevant step of making an asset available (s.554D) in respect of the yacht made available to Ben.	1
Identify that although Ben is not an employee he is connected to Adrian as he is the civil partner of Adrian.	1
Identify that the value of the relevant step in respect of the loan is the full amount of the loan (i.e. £100,000) and not the beneficial interest.	1
Identify that the value of the relevant step of the yacht would be the higher of the market value of the asset when acquired or the cost of the relevant step	1
Identify that the value of the shares purchased and notionally allocated is the value of the relevant step	1
Identify that there are a number of exclusions available and that one exists for non-tax advantaged share arrangements where share options vest on a specified date. This would mean there is no income tax or NIC charge.	1 ½
Explain that the tax and NIC charge under the disguised remuneration rules takes precedence over benefit in kind rules (for example the beneficial loan rules).	1
Identify that an income tax charge under Part 7A is PAYE employment income and subject to Class 1 NIC (i.e. it is not a P11D benefit).	1
Comment on the fact the employment income arising under Part 7A can be much higher than the charge under the benefits code.	½
TOTAL	**15**