



Chartered
Institute of
Taxation
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The Chartered Tax Adviser Examination

May 2019

Human Capital Taxes

Suggested solutions

ANSWER 1

To: Malcolm Stratton
From: Team Member
Date: May 2019
Subject: Remuneration package options for Sharon Liu

Malcolm,

Further to your request regarding the offer to Sharon Liu, please find our comments regarding the tax and social security implications for each remuneration package.

Calculations and comparison

Local package – Sharon Liu – net in pocket – UK tax and Class 1 primary NIC

Salary				<u>£</u> 250,000
		Rate	£	
Tax at basic rate	34,500	20%	6,900	
Tax at higher rate	115,500	40%	46,200	
Tax at additional rate	100,000	45%	45,000	
				<u>(98,100)</u>
Salary below PT	8,424	0%	0	
Salary above PT	37,926	12%	4,551	
Salary above UEL	203,650	2%	4,073	
				<u>(8,624)</u>
Sharon's net income				<u>143,276</u>

Local package – Memsie plc – Class 1 secondary NI

	Rate	Band	£
Salary below ST	0%	8,424	NIL
Salary above UST	13.8%	241,576	33,337
Total			<u>33,337</u>

Equalised package – Sharon Liu – net in pocket

	Rate	£
Salary		250,000
Hypothetical tax	30%	<u>(75,000)</u>
Sharon's net income		<u>175,000</u>

Equalised package – Memsie plc – UK tax

Net pay		<u>£</u> 175,000		
	Rate	Band	£	£
	20%	34,500	6,900	
	40%	115,500	46,200	
	45%	25,000	11,250	
Tax due before gross-up				<u>64,350</u>
Grossed-up	100/55			<u>117,000</u>

Comparison

	<u>Local £</u>	<u>Equalised £</u>
Sharon – net in pocket	143,276	175,000
Memsie plc – cost		
Salary	250,000	250,000
Hypo tax	NIL	(75,000)
Class 1 secondary NI	33,337	NIL
Canadian employer social security contribution	NIL	25,000
UK tax due	NIL	117,000
TOTAL	<u>283,337</u>	<u>317,000</u>

For Memsie plc, offering a local package would be simpler, cheaper and entail less administration than tax equalisation. Memsie plc would simply add Sharon to the existing UK payroll and she will suffer deductions for PAYE and Class 1 National Insurance contributions on the same basis as any other UK employee. Memsie plc will pay Class 1 secondary contributions. Memsie plc may need to help her to apply for a National Insurance Number.

In contrast, Sharon will receive a higher net income under tax equalisation and this, together with certainty about the amount she will receive, may provide her with more comfort regarding her financial position should she accept the role.

However, for Memsie plc, equalising Sharon will incur an additional tax cost of £33,663 (£317,000 - £283,337). Memsie would also have to consider whether the UK payroll could accurately accommodate the gross-ups required under equalisation and whether the flow of information required from the Canadian company would meet the 'on or before' the time of payment requirement of real time information. There is a risk of PAYE failure if either of these requirements are not met.

If Sharon is tax equalised, Memsie plc could apply to HMRC a modified PAYE agreement under EP Appendix 6. This involves paying an estimated amount of PAYE each month followed by a correcting calculation at the end of each year. It has the advantage of relaxing the strict requirements of PAYE, reducing the risk of PAYE failure, but will entail additional administrative costs in setting and running the scheme under its own references and performing the calculations required. Sharon will also be required to file a self assessment tax return and the company may wish to assist her by paying an advisor to prepare the return, as calculations can be complex.

On the basis that cost is the main driver for the choice of package, Memsie plc should offer Sharon package A (local terms). Package A is also easier to administer.

Other options

As an alternative, Memsie plc could consider offering Sharon tax protection, under which she could be better off than she had been in Canada but not worse off. This could be done by performing year end calculations to determine what tax and social security costs Sharon would have suffered in Canada and comparing those costs to what she actually suffered in the UK. If the calculations show she suffered more tax and social security in the UK, Memsie plc would pay her the difference. As this would be taxable income, the payment should be grossed-up to ensure that Sharon receives the correct amount. If she suffered less tax and social security in the UK, the difference is kept by Sharon.

You could also agree to net pay certain items – e.g. a cost of living allowance. A net paid item would result in Memsie plc paying tax and social security on the item on a grossed-up basis and Sharon would receive the full amount of that item without suffering deduction. You

may also wish to consider re-structuring the local employment package so that it is more tax-efficient (e.g. through the use of pension contributions).

Under either of these options, you would have to process her compensation on a local payroll –modified PAYE will not be available.

Please let me know if you have further questions,

Kind regards

Team member

MARKING GUIDE

TOPIC	MARKS
Presentation and higher skills	1
Sharon – local net in pocket calculation – tax and NIC	2
Memsie – NIC calculation	½
Memsie - equalised – tax calculation	1
Memsie - equalised – gross up calculation	½
Comparison of packages - local simpler and cheaper to administer	1
Comparison of packages - under local Sharon needs a NINO	½
Comparison of packages – under equalisation Sharon is better off and has a known net income	1
Comparison of packages – equalisation incurs an additional tax cost for Memsie	1
Comparison of packages – equalisation - risk of PAYE failure	1
Comparison of packages – equalisation - modified PAYE is an option	1
Comparison of packages – equalisation – modified PAYE advantage, disadvantage and self assessment requirement	1½
Recommend package (with reasoning)	1
Alternatives to tax equalisation	2
TOTAL	15

ANSWER 2

To: Frank Carpenter
From: Alan Jones
Date: May 2019
Subject: PAYE and Benefit in kind implications

Dear Frank,

It was good to speak with you recently.

Based on the information that you provided and the facts and figures given to you by the company accountant, I have set out below the potential PAYE, benefit in kind and National Insurance issues that may arise.

Finance Director

Further investigation should be undertaken to establish whether or not the £1,000 drawings are a loan and not general earnings. If interest has been charged, that may be evidence that it is a loan, however documentary evidence such as Board minutes or a loan agreement should be requested. In the absence of appropriate documentation, HMRC may class the drawings as general earnings assessable to PAYE and Class 1 National Insurance under s62 ITEPA 2003 and seek PAYE, Class 1 primary and secondary NIC, interest and penalties from the target company.

Assuming the documentation exists to support that this is a loan, if no interest was charged (or interest was charged at less than the official rate) there should have been an entry on form P11D, because the loan balance exceeds £10,000. Class 1A NIC due will have been due. HMRC will also have failed to obtain the related income tax from the Finance Director either by PAYE coding adjustment or via his self-assessment tax return. HMRC are likely to seek the missing tax from the company, rather than the employee.

This is based on the average loan balance and the average official rate of interest, as follows:

Tax Year	Opening Balance	Closing Balance	Average Balance	Interest rate	BIK
2017/18	£ 1,000	£ 12,000	£ 6,500	2.50%	£ 163
2018/19	£ 12,000	£ 24,000	£ 18,000	2.50%	£ 450
					<hr/> £ 613
Total BIK = £613	x	(40% Tax + 13.8% Class 1A NIC)	=		£330

In addition, there may be penalties for incorrect P11Ds of up to £3,000 per incorrect P11D per annum.

In order to mitigate the penalties, the target company may want to settle the tax liability on a grossed-up basis and pay NIC on the grossed up tax too. Where grossed up tax is paid voluntarily by the employer, HMRC do not seek penalties for incorrect P11Ds and may just pursue a tax geared penalty on the NIC due, based on whether the employer has made a mistake, been negligent or sought to understate their tax and NIC liabilities.

Marketing Director

HMRC will look at the position where the Marketing Director's wife is paid but has not undertaken any work for the business. HMRC will be concerned that this is a case of disguised remuneration or attempting to divert part of the Marketing Director's earnings to the spouse in order to avoid or reduce the amount of PAYE income tax and NIC payable.

Additional PAYE and Class 1 NIC will be due in respect of the Marketing Director, as follows:

Tax Year	Earnings	Tax Rate	Tax Due	Employee NIC rate	Employee NIC due	Employer NIC rate	Employer NIC due
2017/18	£ 5,200	40%	£ 2,080	2%	£ 104	13.80%	£ 718
2018/19	£ 5,200	40%	<u>£ 2,080</u>	2%	<u>£ 104</u>	13.80%	<u>£ 718</u>
			£ 4,160		£ 208		£ 1,436

Total due = £4,160 + £208 + £1,436 = £5,804

In addition, there are likely to be interest and penalties for PAYE failure. HMRC are likely to class this as Deliberate Understatement with Concealment and seek a penalty of up to 100%. In the circumstances we would not expect to be able to mitigate the penalty or seek a suspended penalty as this looks like a planned arrangement to reduce tax and NIC due and not simply a mistake.

Managing Director

As the yacht hasn't been given outright to the Managing Director, it is an asset placed at the disposal of an employee or director and has been used solely for private purposes. It is therefore a taxable benefit and should have been reported on form P11D.

As the asset is at the Managing Director's disposal most or all of the time, a charge based on it being fully available is likely to be seen by HMRC as reasonable.

The annual value in this case would be 20% of the market value of the asset at the time it was first used to provide a benefit. So, the benefit in kind would be:

Annual value = £650,000 x 20% = £130,000 plus running costs of £24,000 = BIK value of £154,000 per annum.

Tax Year	BIK	Tax Rate	Tax Due	Class 1A NIC rate	Class 1A NIC due
2017/18	£ 154,000	45%	£ 69,300	13.80%	£ 21,252
2018/19	£ 154,000	45%	<u>£ 69,300</u>	13.80%	<u>£ 21,252</u>
			£ 138,600		£ 42,504

In addition, there will be penalties for incorrect P11Ds, an amount of up to £3,000 per incorrect P11D per annum.

Based on the potential scale and seriousness of some of these items we expect that consideration will be given to the requirement for warranties and indemnities from the seller.

Due to the nature of certain items and the quantum of potential liabilities, we would recommend that if the target cannot show that they have fully settled these matters with HMRC before completion, then the buyer should seek either:

- 1) a price reduction, or
- 2) an amount based on the likely maximum quantified liabilities, interest and penalties to be held in escrow.

The purchaser should then contact HMRC and make a voluntary disclosure to agree a settlement with HMRC as soon as possible after completion.

In addition we would recommend post completion that the following actions are undertaken:

- All of the remuneration paid to the Finance Director is subject to tax and Class 1 NIC via the payroll.
- All remuneration relating to the Marketing Director or members of their family or household that don't hold appropriately remunerated legitimate independent positions on their own account should be subject to tax and Class 1 NIC on the Marketing Director via the payroll
- An assessment is made to consider if there is a genuine business requirement for a yacht and if it makes financial sense or if it should be disposed of.

Best regards,
Alan

MARKING GUIDE

TOPIC	MARKS
Finance Director Earnings or loan Mention s62 ITEPA Mention BIK Mention Class 1A NIC due Use average loan balance Use average official rate of interest Use marginal tax rate Use employers NIC rate Mention Grossing up Mention penalties for incorrect P11Ds	 $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$
Marketing Director Employed and paid in their own right Mention disguised remuneration Mention avoiding or reducing the PAYE income tax and NIC payable. Use marginal tax rate Use marginal employees NIC rate Use employers marginal NIC rate Mention penalties for negligence Mention unlikely to mitigate or suspend penalties	 $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$
Managing Director Asset placed at the disposal of an employee or director Without ownership of the asset being transferred to them Cash equivalent charged is: The “annual value of the use of the asset” plus Any expenditure on the asset Asset at that person’s disposal most or all of the time a charge = availability Annual value is 20% of the market value of the asset when first used	 $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$
Mention voluntary disclosure	1
Mention warranties and indemnities	1
Presentation	1
TOTAL	15

ANSWER 3

To: Neville Stott
From: John Briggs
Date: 4 May 2019
Subject: Site Closure

Dear Neville,

Thank you for your email.

It is possible for certain payments made in connection with relocation to be made free of tax and NIC provided certain general conditions are met;

- The costs incurred must fall into one of the following categories
 - Costs of disposal of the old residence
 - Costs of acquiring the new residence
 - Transporting household possessions
 - Travel and subsistence
 - Buying new domestic goods for the new residence where the old ones cannot be used
 - Bridging loans
- The total qualifying relocation costs cannot exceed £8,000 (including VAT)
- The costs must be incurred by the end of the tax year after the year of the site closure, so 5 April 2021.
- The employee must relocate from a residence that is not within a reasonable commuting distance to one that is.

Whilst there is no statutory definition of “reasonable” commuting distance, the commute of 90 minutes for the 15 employees to the north of Norwich is likely to be considered unreasonable. Therefore, a move closer to Ipswich would be a potentially qualifying relocation for them. However, it is unlikely that the 35-minute commute for the other 5 employees would be considered unreasonable and any relocation support would be liable to tax and NIC.

To qualify for the exemption it is also important that the employees actually do move. For example, if the employees simply took up Suggestion 2 or 4 for the maximum time but did not move closer to Ipswich any benefits provided would be liable to tax and NIC.

Qualifying relocation costs are not reported on a P11D or liable to employer’s NIC, so ensuring you meet the conditions where possible would be beneficial for Longbentons as well as the employees.

Let’s look at the individual suggestions in turn.

Suggestion 1

This could fall into the category of a works bus, the provision of which can be exempt regardless of whether an employee is relocating, which may benefit the 5 employees to the south, who do not qualify under the relocation expenses exemption. A bus that can carry at least 12 passengers or a minibus that can carry at least 9 passengers and which is used mainly for travel between the home location and the workplace, can be provided free of tax and NIC.

Suggestion 2

Ipswich will not be a temporary workplace because it will become the employees’ permanent workplace as soon as the Norwich site is closed or their position is moved permanently to Ipswich. Therefore, there is no exemption under these particular rules.

However, if the employees could demonstrate the additional travel costs, whilst they were waiting to permanently relocate, were at least equal to the £10 daily payment, then you could reimburse this cost under the relocation benefit exemption. I would make two cautionary comments.

- If you simply pay the £10 to the employee, then the amount would have to go through the payroll and be subject to PAYE and NIC for the employee and Longbentons. The employee could make a subsequent claim for reimbursement of the PAYE to HMRC if they can evidence that the costs incurred were at least £10 per day. However, the NIC would not be refunded and this additional interaction with HMRC would be burdensome. Therefore, you should arrange for the employees to complete expense claims and reimburse the actual additional costs, which could be paid tax and NIC free. Alternatively, if you reimbursed the additional mileage using HMRC's AMAP rates, this would be acceptable to HMRC.
- The time limit for making these reimbursements without tax and NIC will, in effect, be slightly less than two years. Therefore, you need to limit the timeframe of Suggestion 2 to 5 April 2021.

Suggestion 3

This could qualify as a qualifying relocation expense but only if certain conditions are met. It does not matter that some employees may be motivated to move to the school catchment area rather than closer to site.

Similar to Suggestion 2 above, the payment of a cash allowance would have to be reported via payroll and would suffer PAYE and NIC, with only the PAYE capable of recovery.

I would therefore suggest that you either pay the relocation supplier direct or reimburse the employee on production of receipts for the qualifying relocation costs incurred. I would be happy to help you draw up a list of relocation costs, which you are prepared to meet and which would qualify for the exemption.

For those employees, who take up suggestion 1 or 2 first and move later, the overall 5 April 2021 time limit may cause a problem.

Also, those who claim suggestion 2 first and move later may exceed the £8,000 overall expense limit.

Suggestion 4

A 7-seater MPV cannot qualify as a works bus. Nevertheless, it can qualify as an exempt relocation benefit provided that it is only used for travel to and from the Ipswich site and until the relocation takes place. If there is any element of private use, the vehicle would be treated as a company car and liable to tax and Class 1A NIC. The same rules would also apply for fuel, if provided.

Also remember that the 5 employees who live south of Ipswich could not get their travel or relocation costs under Suggestions 2, 3 or 4 reimbursed tax or NIC free as they are not outside of a reasonable commuting distance.

Suggestion 5

This would not count as relocation expenses as the employee is not relocating. However, there are other tax reliefs available. These are restricted to the provision of equipment for the sole purpose of working, although some incidental private use is accepted, such as computers, office furniture, etc. You can also provide separate work-only broadband or telephone facilities and pay for any additional utility costs. If the additional costs cannot be identified you can reimburse the fixed amount set by HMRC of £18 per month. You cannot pay for the construction of the garden office itself without incurring an income tax or NIC charge.

If you would like to discuss any of the above, please let me know.

Best regards,

John

MARKING GUIDE

TOPIC	MARKS
General Relocation: <ul style="list-style-type: none"> • Qualifying cost categories (½ mark per category to a max of 2 marks) • Total costs • Time limit • Distance 	2 ½ ½ ½
Highlighting distance issue for some employees	1
Highlighting timing issue for some suggestions	1
Highlighting actual relocation requirement	1
Suggestion 1: <ul style="list-style-type: none"> • Works bus conditions • Not relocation 	1 ½
Suggestion 2: <ul style="list-style-type: none"> • Not a temporary workplace • Can qualify as relocation expense • Cash payment <ul style="list-style-type: none"> ○ Through payroll ○ PAYE / NIC upfront ○ PAYE only refund • Suggestion to reimburse actual cost or AMAP 	½ ½ ½ ½ ½ 1
Suggestion 3: <ul style="list-style-type: none"> • School not an issue • Cash payment <ul style="list-style-type: none"> ○ Through payroll • Suggestion to reimburse actual cost and list of qualifying expenses • Potential to exceed £8,000 or exceed time limit 	½ ½ 1 ½
Suggestion 4: <ul style="list-style-type: none"> • Not works bus • Can be relocation • Private use impact • Fuel 	½ ½ ½ ½
Suggestion 5: <ul style="list-style-type: none"> • Garden room not exempt • Office equipment exempt • Some private use • Service costs 	½ ½ ½ ½
PHS	2
TOTAL	20

ANSWER 4

Under the Statutory Residence Test for 2019/20:

- *Automatic overseas tests.* Delia will not meet the conditions for full-time work overseas as she expects to exceed 30 UK workdays. Furthermore, with broadly $48 + 14 + 14 = 76$ residence days in the UK, none of the other automatic overseas tests are applicable.
- *Automatic UK tests.* These are not met either:
 - *First automatic UK test* – she spends fewer than 183 days in the UK;
 - *Second automatic UK test* – she has a home overseas;
 - *Third automatic UK test* – she carries out more than 25% of her work overseas.
- *Sufficient ties test.* Delia would have four ties:
 - UK-resident family;
 - available accommodation;
 - more than 40 UK workdays; and
 - more than 90-days present in the UK in either of the two previous tax years.

Therefore, she will be resident in the UK as she spends more than 15 days in the UK.

Furthermore, Delia will be treaty-resident in the UK as she will have a permanent home here with her centre of vital interests clearly remaining at that home.

Accordingly, she will remain in scope of UK tax on her worldwide income. As she has never previously lived abroad, she is likely to be UK domiciled so will not be able to claim to exclude from UK tax the French rental income which is not remitted to the UK.

Because the secondment is for no longer than 24 months, she will be entitled to temporary workplace relief on the accommodation benefit which means this will not be taxable in the UK.

The remaining elements of Delia's income should continue to be subject to PAYE in the normal way (if the private medical insurance benefit is not voluntarily payrolled, it should be reported on a form P11D).

Double taxation relief, by means of a Foreign Tax Credit (FTC), will be possible but only in respect of the German taxes relating to German duties. This is because the UK-Germany double tax treaty under Article 14(1) does not allow Germany to tax Delia on income performed outside of Germany, as she is not resident in Germany for the purposes of the treaty. Advice should be sought on a treaty claim for the German withholding taxes paid on non-German duties. A corresponding restriction to the German withholding taxes may also be possible.

The FTC will be given by comparing the German taxes attributable to the German workdays with the UK tax on that same income (known as the Doubly Taxed Income, or DTI). The amount of the FTC is the lower of the two figures. The UK tax on the DTI is calculated by taking the difference between:

- (a) the UK tax liability on Delia's total including the DTI, and
- (b) the UK tax liability on Delia's income excluding the DTI

The FTC must be claimed on Delia's self assessment tax return. Depending on how the foreign taxes are being funded, it may be possible to get provisional FTC relief in-year under either EP Appendix 5 (if the employer is required to deduct foreign tax in addition to UK PAYE from the same payment of earnings) or a PAYE coding adjustment under PAYE10040 (if the employee is required to fund the foreign taxes personally). If the taxes are funded separately by the employer (e.g. via a loan), no in year relief is available.

With regard to the French rental income, an FTC is possible in the UK in respect of the French tax. The UK-France treaty does not restrict either the UK or French right to tax the income. Irrespective of the German domestic provisions, Article 21 of the UK-German double tax treaty will have effect to exclude the income from German tax. Therefore, if any German tax has been paid on the rental income then HMRC will not allow an FTC to be claimed in the UK in respect of it and it will need to be reclaimed from the German tax authorities instead.

Because there are two separate sources of income on which the UK tax on the DTI must be calculated, it is necessary to determine which is the 'top slice' of UK income. This is at the discretion of the taxpayer. In order to calculate the UK tax on the DTI on the *first* source of income, one should compare the UK tax liability between (a) the UK tax on total income including *both* doubly-taxed amounts and (b) the UK tax on total income excluding the *first* doubly-taxed amount. The UK tax on the DTI on the *second* source of income is then the difference between (a) the UK tax on total income excluding the *first* doubly-taxed amount and (b) the UK tax on total income excluding *both* doubly-taxed amounts. In other words, the first calculation is done in the normal way, but the second must exclude the first DTI in each of (a) and (b) above.

MARKING GUIDE

TOPIC	MARKS
SRT analysis – discount automatic UK and overseas tests (1), conclude resident under sufficient ties test (1)	2
Treaty analysis – discount treaty non-residence on the basis of having a permanent home and centre of vital interests in the UK.	½
Consequence of being treaty-resident in the UK on employment income	1
Consideration of domicile/rental income	1
Temporary workplace relief	1
Advise that remuneration should continue to be subject to PAYE	1
Consideration of German right to tax under treaty	1
Impact of German right to tax on FTC available	1
Description of amount of FTC	1
Description of how to calculate UK tax on DTI	1
FTC must be claimed on SA return (½); provisional FTC relief may be available in some circumstances (1)	1½
FTC possible on rental income in respect of French taxes	1
Germany may not tax the rental income under Article 21	1
DTI calculation with two FTCs	1
TOTAL	15

Answer 5

To: Jose Marchant
From: Alison Havers
Date: 3 May 2019
Subject: Termination Payment

Hi Jose,

Thanks for your memo. There are some employment tax and NI consequences, which may affect your advice.

A key factor is whether Steve is UK tax resident during the 2019/20 tax year.

Option 1 (UK tax residence regained)

The statutory redundancy of £6,245 is exempt from UK tax and NI as it is under the £30,000 threshold. However, it does use up £6,245 of the £30,000 exemption, leaving only £23,755.

The remaining amounts are taxable in the UK as Steve is UK tax resident. As the termination payments is made prior to the expiry of Steve's notice period the amount of pay in lieu of notice (PILON) paid to him would need to be divided into two parts (Post-Employment Notice Pay (PENP) and amounts which are not PENP). Post-Employment Notice Pay (PENP) is liable to tax and Class 1 NIC and the amount which is not PENP is treated as part of the termination payment. The first step is to work out the amount of PENP.

Basic pay for pay period prior to notice	£20,000
No of days in pay period prior to termination payment (July 2019)	31
No of days in PENP (1 August to 31 October)	92
PENP (20,000 x 92)/31	£59,355
Termination payment (12 years x £20,000 + 3 x £20,000)	£300,000
Less statutory redundancy	(£6,245)
Termination award	£293,755

The PENP of £59,355 is liable to tax and Class 1 NIC (employee and employer contributions).

This leaves £234,400 (£293,755 – £59,355) of the termination award as the termination payment. The rest of the £30,000 exemption (£23,755) can be deducted from this amount to leave £210,645, which is liable to tax, but not NIC.

Assuming a tax rate of 45%, Steve would receive:

Redundancy, PILON	£300,000
Tax on £59,355	(£26,709)
NI on £59,355	(£1,187)
Tax on £210,645	(£94,790)
Gabonese tax	(£75,000)
Gabonese social security	(£14,000)
Net amount received	£88,314

There is no double tax treaty, therefore the only possibility of relief from double taxation is if HMRC grants unilateral foreign tax credit relief. Given that Steve's employment contract is with the UK company and more than half of his service was in the UK, there is no guarantee that HMRC would do this.

The cost to Ecmo Ltd would be:

Redundancy, PILON	£300,000
NI on £59,355	£8,191
Gabonese social security	<u>£14,000</u>
Total cost	£322,191

Option 2 (Termination in Gabon and not UK tax resident)

Steve would not be UK resident but as there is a UK employment contract and UK service, there is still a liability to UK tax. However, foreign service relief can apply. There would be no liability to Class 1 NIC for either Steve or Ecmo Ltd as Steve would not be liable to NIC in general.

Steve's service is 82 months in the UK and 63 months in Gabon. This is not enough foreign service to qualify for total exemption, which would have to be at least either

- $\frac{3}{4}$ of the total period, or
- The last 10 years, or
- If over 20 years, at least $\frac{1}{2}$ of the total service including the last 10 years.

Steve could therefore claim an exemption for only 63/145ths.

Basic pay for pay period prior to notice		£20,500
No of days in pay period prior to termination payment (July 2019)		31
No of days in PENP (1 August to 31 October)		92
PENP (20,500 x 92)/31		£60,839
Termination payment (1/5 x 63 months x £20,500)		£258,300
Damages		£15,000
PILON		£61,500
s403 ITEPA 2003 (258,300+15,000+61,500- 60,839)		£273,961
Exemption		<u>(£30,000)</u>
Amount charged to tax		£243,961
Exempt under FSR (63/145)		<u>(£105,997)</u>
Taxable		<u>£137,964</u>
Personal allowance over threshold)	(0)	
Basic rate band	£34,500	£6,900
Higher rate	£103,464	<u>£41,386</u>
Tax due		£48,286

Steve would therefore receive

Gross	£258,300
Damages	£15,000
Pay in lieu of notice	£61,500
UK tax	(£48,286)
Gabonese social security	(£12,500)
Gabonese tax	<u>(£64,575)</u>
Net amount received	£209,439

The PENP element would be general earnings earned overseas and therefore not liable to UK tax or NIC.

Assuming Steve is no longer on a UK payroll, Ecmo Ltd would be liable to operate PAYE on the UK taxable amount using a 0T tax code and Ecmo would need to recover the PAYE amount from Steve. Steve would need to file a tax return to calculate the correct amount of UK tax.

It would cost Ecmo Ltd

Redundancy, damages, PILON	£334,800
Gabonese social security	£12,500
Total cost	£347,300

Therefore, it would cost Ecmo Ltd more under option 2. However, Steve would receive considerably more and he will be able to continue working in Gabon as he prefers. Perhaps there is some scope for agreeing a reduced amount under option 2 so that all benefit? Obviously you need to take legal advice on this and ensure any agreement with Steve is recorded in a written agreement on which he has obtained his own legal advice.

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

Best regards,

Alison

MARKING GUIDE

TOPIC	MARKS
Impact of residence	½
<u>Option 1:</u>	
Treatment of statutory redundancy tax and NIC	½
Calculation of PENP <ul style="list-style-type: none"> • Liable to tax • Liable to Class 1 	2 ½ ½ ½
Remaining package <ul style="list-style-type: none"> • Exemption left • Tax but no UK NIC • (credit will be given if post 6/4/19 rules applied) • Calculation of net to Steve • Calculation of cost to Ecmo • Double taxation and social security relief 	½ ½ 1 1 1
<u>Option 2:</u>	
Impact of non-residence for tax and NI	1
FSR <ul style="list-style-type: none"> • Criteria • Calculation of FSR • PAYE due by Ecmo Ltd • PENP not liable to UK tax as general earnings 	½ 1 ½ ½
<ul style="list-style-type: none"> • Calculation of net to Steve • Calculation of cost to Ecmo 	1 ½
Conclusion as to which option is better and why	½
PHS	1
TOTAL	15

Answer 6

[on headed paper]

May 2019

Dear Alex

Re: Childcare vouchers and employer provided childcare

There have been a number of changes in relation to the tax treatment of childcare vouchers and other childcare provision since April 2011.

Cash payments to Directors - current position

Where you have provided a cash allowance to a Director or employee to help them pay for their own provision, the money will be regarded as earnings and liable to tax and NIC via payroll. You have failed to treat this as additional pay and to deduct tax and Class 1 NIC and are therefore liable to pay the tax and NIC, plus interest and tax geared penalties.

Action

We recommend that you approach HM Revenue & Customs (HMRC) to make a voluntary disclosure of the PAYE tax and Class 1 NIC due on the cash allowances provided. For payments that you have made to your employees there will be tax due in respect of the current and previous 4 tax years and NIC due in respect of the last 6 years.

HMRC are likely to seek interest and penalties. The penalty will be based on the tax and NIC due and this is likely to be considered as negligence, rather than a mistake, and so the penalty would be in the region of 15% to 30% of the tax and NIC due. We will seek to mitigate this and seek a suspended penalty on your behalf.

Childcare vouchers – background

Most workplace nurseries and childcare voucher schemes can be provided free of income tax and NIC, up to certain limits and when certain conditions are met.

For employer provided childcare or childcare vouchers to be exempt there are three conditions that must be met. They are:

Condition A: child

The child must be a child or stepchild of the employee maintained (wholly or partly) at the employee's expense or live with the employee who has parental responsibility.

A person is treated as a "child" up to the 1 September following their 15th birthday, or 1 September following their 16th birthday if they are disabled.

This means that the children of your employees that are divorced and living with your employee's partner will still qualify as they are supporting them financially.

Condition B: qualifying childcare

The childcare must be registered with or approved by the relevant authorities. It does not include care provided by a relative of the child in the child's own home.

Condition C: availability

The childcare vouchers must be available to all employees, or all employees at the location where the childcare scheme is offered.

Condition D: Relevant earnings amount

From 6 April 2011 exempt amounts are limited to the following for new entrants:

Rate of Income Tax	Weekly exempt limit	Monthly exempt limit
Basic	£55	£243
Higher	£28	£124
Additional	£25	£110

For employees who applied to join the scheme before 6 April 2011, the basic rate limits apply regardless of the applicable rate of income tax.

Action

To identify the amount of monthly exempt amount for each employee you must make an estimate of the relevant earnings when the employee joins the scheme, or (for subsequent tax years) the beginning of the tax year.

Relevant earnings means any salary, wages or fees and includes guaranteed bonuses, commission or overtime payments; certain allowances; and market rate supplements. It excludes pension contributions, donations i.e. payroll giving, work related expenses and removal expenses. An employer only needs to include income that they are aware of.

As you provide childcare vouchers to employees above the exempt limit, you must:

- report the amount above the limit on Form P11D
- deduct Class 1 National Insurance (but not PAYE tax) on the amount above the limit

For your employees that joined in 2011/12 or since then there will be a liability to tax and NIC on the £27 per week that they have received tax relief on, being the excess over £28 per week up to £55.

You should contact HMRC to seek a voluntary settlement of the tax and NIC due. If you agree to settle the tax on a grossed-up basis that will avoid the imposition of penalties of up to £3,000 per P11D per annum in respect of the provision of incorrect forms P11D.

There will still be interest charged and there could be penalties in relation to the NIC due, which again would be based on negligence and where we would seek to negotiate a penalty at the lower end of the 15% to 30% range and where possible suspended.

The benefit of employer provided childcare and the limited exemption for other forms of childcare are not affected by the restriction to salary sacrifice from 6 April 2017, and the benefit remains exempt, as long as it satisfies the conditions.

The tax exempt employer provided childcare voucher scheme was closed to new employees from October 2018, though existing employees can continue to benefit.

As an employer you must monitor that the conditions continue to be met in relation to the employee's children that are covered at the beginning of October 2018. We would recommend an annual review and to identify the children that the vouchers are being used for. Failure to have the appropriate processes and procedures in place and to continue to provide childcare vouchers to an employee that are for a 'non-qualifying' child could lead to additional tax and NIC liabilities for the employer and potential penalties for incorrect or incomplete forms P11D.

Workplace nurseries – background

For workplace nurseries an exemption applies when childcare for eligible children, meeting Condition A above, is provided by you on your premises or in other premises where you are responsible for managing and financing the arrangements (as long as it is not in a private residence).

You don't have to report or pay anything to HMRC provided the workplace nursery:

- has the appropriate registrations and approvals,
- is available to all employees,
- provides childcare for your employee's children or children for whom they have parental responsibility, and
- provides childcare up to the maximum age its registration and approval allows for.

If you cover the costs of employees' childcare in any of the following ways, it will count as earnings which are liable to Class 1 NIC and PAYE tax:

- paying them back for their childcare bills, or settling your employee's childcare bill on their behalf
- providing a cash allowance to cover childcare costs

Best regards
Tax Adviser

MARKING GUIDE

TOPIC	MARKS
Cash allowance PAYE failure, tax and Class 1 NIC due as earnings Recommend voluntary disclosure on grossed-up basis PAYE failure tax geared penalties and interest	$\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$
Childcare vouchers Condition A Mention dependent children of divorced parents still qualify Condition B Condition C Prior to April 2011 £55 or £243 per month Condition D Higher rate £28 or £124 per month Additional rate £25 or £110 per month Recommend voluntary disclosure on a grossed-up basis Basic earnings assessment Relevant earnings Excluded amount Not impacted by OpRA when in line with s318A ITEPA 2003 From October 2018 closed to new entrants	1 $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ 1 1 $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$
Workplace nursery must: Have the appropriate registrations and approvals Be available to all your employees Provide childcare for your employees' children, or Children they have parental responsibility for Provide childcare up to the maximum age its registration and approval allows for	$\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$ 1 1
Workplace nursery doesn't have to be at employers workplace It can be in other premises that they manage and finance, As long as it is not at a private residence	1 1 $\frac{1}{2}$
Paying for an employees' childcare in any of the following ways counts as earnings: Paying them back for their childcare bills Providing a cash allowance to cover childcare costs	1 1
Presentation and Higher Skills	2
TOTAL	20