

The Chartered Institute of Taxation

Advanced Technical

Human Capital Taxes

May 2022

Suggested solutions

ANSWER 1

Optional Remuneration Arrangements (OpRA)

These rules apply where employees give up earnings in return for certain non-cash benefits. A tax liability arises on the higher of the salary foregone and the cash equivalent of the benefit under normal rules. The rules cover salary sacrifice arrangements but exemptions exist for cycles and pension contributions.

Pension

Employer contributions are exempt from Income Tax, National insurance contributions (NICs) and the Apprenticeship Levy.

Currently, employees receive income tax relief at source with contributions to the pension provider being deemed to be net of basic rate income tax and HMRC topping up the pension fund with an amount equal to 20% of the gross contribution. Via salary sacrifice, the employee's salary will reduce and in return the employer will increase the amount of its contributions by the gross amount of the existing employee contribution.

Based on the average salary, a salary sacrifice in return for a tax and NIC exempt contribution would reduce employees Class 1 NICs by £131 ($£28,000 - 6,240 \times 5\% \times 12\%$). This will not affect employees over state retirement age as they do not make Class 1 primary contributions.

Employer Class 1 NICs would reduce by £150 ($£28,000 - 6,240 \times 5\% \times 13.8\%$) and the apprenticeship levy by £5 ($£28,000 - 6,240 \times 5\% \times 0.5\%$). The annual saving to Palm Ltd net of Corporation Tax would be £125.55 ($£155 \times 81\%$) per employee. However, there will be no savings for employees under 21 as Employer Class 1 NICs are not payable.

Due to the savings for both the employees and Palm Ltd, we would recommend this scheme is implemented. If Palm Ltd wished to provide additional benefit to the employees with no additional cost to itself, it could increase the contributions it makes by some or all of the Employers' National Insurance it will save.

To be effective employees must agree to a change in the terms and conditions of their employment.

Cycle to work

The provision of a cycle is exempt from Income Tax and National Insurance, provided:

- Ownership of the bicycle remains with the employer for the term of the scheme
- The bicycles are used mainly for qualifying journeys i.e. the whole or part of a journey between the employee's home and workplace, or between one workplace and another in connection with the performance of the duties of the employment.
- The scheme is available to all employees

If Palm Ltd provided a bicycle to employees under this scheme, their annual saving as a result on the salary sacrifice would be £120 ($£375 \times 32\%$), leaving a net annual cost to each employee of £255.

Employers NICs would reduce by £52 ($£375 \times 13.8\%$) and apprenticeship levy by £2 ($£375 \times 0.5\%$). Output VAT will be due on the taxable supply of the cycle to the employee but input VAT at the same rate can be reclaimed. The annual saving to Palm Ltd net of Corporation Tax would be £43.74 ($£54 \times 81\%$) per employee.

Palm Ltd should monitor the employees' use of the bicycle to ensure they are being used for qualifying journeys, including travel from home to work. If taxable, the benefit in kind for the employee would be 20% of the market value of the bicycle. Class 1A NICs at 13.8% would be payable by Palm Ltd. The limitation on use of the bike together with the paying the entire value of the bike as rent is likely to mean take-up of the scheme is low.

The key commercial problem with the proposal is that the total hire charges of £750 are the same as the cost to buy the bicycle so employees are unlikely to find the scheme attractive, even considering the tax relief given by the salary sacrifice. Often schemes offer an option to purchase for a nominal sum: this should be explored with the benefit provider. As an alternative, interest free loans could be provided to employees to enable them to purchase a bike themselves. Provided all loans from Palm Ltd are less than £10,000 no benefit in kind will arise and also it wouldn't matter whether or not they used the bike mainly to travel to work.

Private Medical Insurance

Under OpRA the taxable value of this benefit is the cost of £750.

The Income Tax cost per employee would be £50 ($£750 - £500 \times 20\%$). Employees' Class 1 NICs would reduce by £60 ($£500 \times 12\%$). The annual cost for employees would be £490.

Employer Class 1 NICs would reduce by £69 ($£500 \times 13.8\%$) and the apprenticeship levy by £2.50 ($£500 \times 0.5\%$). However, Class 1A NICs of £103.50 ($£750 \times 13.8\%$) would be payable, leaving a total cost net of Corporation Tax to the employer of £228.42 ($(£750 - £500 - £69 - £2.50 + £103.50) \times 81\%$) per employee who takes up the offer.

The amount of salary sacrificed will not reduce the benefit in kind value.

The suggested scheme will result in an additional cost to the employer but employees would benefit, potentially helping to attract and retain employees and improve employees' health possibly resulting in greater productivity and lower absenteeism. However, given the funding cost required by employees, take-up may be disappointing. With a flat rate for all employees, younger lower risk employees may find that they could purchase cover for themselves at a lower cost. In contrast, the older higher risk employees, who will usually face significantly higher premiums, may find the scheme far more attractive. The actual take-up across the age groups could affect the premium payable.

On-site car parking

The provision of car parking spaces can be exempt from Income Tax and National Insurance.

However, if the salary sacrifice scheme is entered into, under OpRA rules the employees would pay tax on salary foregone leaving an overall cost neutral Income Tax position.

Employee NICs would be reduced by £48 ($£400 \times 12\%$) which would be a saving for employees.

For Palm Ltd, Employer NICs would reduce but would be replaced by Class 1A NICs. The apprenticeship levy would reduce by £2 ($£400 \times 0.5\%$).

To allow the employees to benefit from the National Insurance savings and for Palm Ltd to achieve a small saving in apprenticeship levy, it is therefore recommended the salary sacrifice arrangements are introduced.

MARKING GUIDE

TOPIC	MARKS
<p>Optional Remuneration Arrangements (OpRA)</p> <p>Outline of when OpRA applies and implication for employees Set out excluded benefits</p>	<p>1/2 1/2</p>
<p>Pension Salary Sacrifice</p> <p>National Insurance Contribution savings Impact on National Insurance Contribution savings for employees over state retirement age and under 21 Current tax relief at source Higher / additional rate tax relief Calculate pension contributions under qualifying earnings Cost impact to Employee Employer Savings Recommendations and suggestion Contractual variation to Terms and Conditions of employment</p>	<p>1/2 1/2 1/2 1/2 1/2 1/2 1 1/2</p>
<p>Cycle to Work</p> <p>No tax and National Insurance Contribution where s.244 ITEPA 2003 met Tax and National Insurance implications where conditions not satisfied Cost impact to Employee Cost impact to Employer Advise on commercial considerations i.e. via loan</p>	<p>1/2 1/2 1/2 1/2 1</p>
<p>Private Medical Insurance</p> <p>Tax and National Insurance Contribution treatment Interaction with Optional Remuneration Arrangements Salary sacrifice does not reduce benefit in kind value Cost impact to Employee Cost impact to Employer Commercial impact on take up of benefit</p>	<p>1/2 1/2 1/2 1/2 1/2 1/2</p>
<p>On-site car parking</p> <p>Identify income tax and national insurance exemption applies Interaction with Optional Remuneration Arrangements Identify tax on salary foregone Cost impact to Employee Saving to Employer Advise on implementation of the scheme</p>	<p>1/2 1/2 1/2 1/2 1/2 1/2</p>
TOTAL	15

ANSWER 2

PAYE

As Kolya is an officer of the company, Minecomp Ltd must operate PAYE on any fees under RTI. There is no exemption under the double tax treaty as Article 15 allows the UK to tax directors fees. However, as a non-resident of the UK, Kolya is only taxable on the fees attributable to UK workdays. The duties are substantive in nature. HMRC has made it clear that director's duties are not treated as incidental and cannot be ignored.

In 2022/23, he will receive £25,000 for the prior year, when all duties were performed in Georgia. None of this payment is therefore liable to UK tax.

He will also receive £65,000 for the current year. He will spend a total of 17.5 days working for Minecomp Ltd. 7 of these are spent in the UK.

Duties	Georgia	UK
Georgian office meetings	8 x 0.5 = 4 days	
Board meetings	3 days	7 days
Preparation	3 x 0.5 = 1.5 days	
Flight to UK (pm arrival and worked pre-arrival)	1 day	
Flight from UK (am departure and travelling counts as overseas workday)	1 day	
Total	10.5	7

Therefore, only £26,000 of the fee is liable to UK tax.

However, the whole payment should be put through RTI unless prior approval is sought from HMRC. Minecomp Ltd would need to apply to HMRC for a s690 ITEPA 2003 ruling such that only the UK portion of the fees is subject to PAYE.

As Kolya is a Georgian national he is not eligible for a personal allowance and therefore he is liable to tax of £5,200 (£26,000 @ 20%). Kolya will pay £5,200 as his liability is capped at 20%. Minecomp Ltd will not ultimately be liable for any UK tax on the fees.

However, if the fees are paid as a single annual payment in May as Kolya has asked, the amount could be high enough to reach the 45% tax bracket. This depends on the PAYE code applicable and the time of year the payment is made. For example, paying the £26,000 now in May, on a 0T M1 code, would result in PAYE of:

Basic rate	£37,700 x 1/12 =	£3,142	£628
Higher rate	£112,300 x 1/12 =	£9,358	£3,743
Additional rate		£13,500	£6,075
Paid by Kolya			(£5,200)
Payable by Minecomp Ltd			<u>£5,246</u>
Grossed up	x 100/55		<u>£9,538</u>

This will result in Minecomp Ltd having to pay a much higher amount of PAYE initially and then waiting for Kolya to file a self-assessment tax return to reclaim the excess tax (and refund Minecomp Ltd). It would be better for Minecomp Ltd to pay the fees in several smaller amounts through the year or, if Kolya is on a cumulative PAYE code, later in the tax year. For this to be effective, as Kolya is a director, they should ensure there is no entitlement to the fees before they are due for payment.

NIC

If a director only attends one board meeting per year and the visit lasts no more than 2 weeks, no liability arises under the administrative concession for non-resident directors. There is therefore no liability to UK National Insurance for either Kolya or Minecomp Ltd.

Expenses

Reading will be treated as a permanent workplace since Kolya spends 40% of his working time there on an ongoing basis. Therefore, s338 - 339 ITEPA 2003 cannot apply.

Relief for travel between two group employments under s340 ITEPA 2003 also cannot apply as Kolya does not have two separate employments.

S373 ITEPA 2003 can apply for a total period of five years from April 2022 provided Kolya has either not been UK tax resident in the previous two tax years or has not been in the UK at all since April 2020.

However, s373 only covers travel and subsistence expenses incurred on the international journey and does not include other subsistence costs, such as the hotel and meal expenses incurred during Kolya's stay in the UK.

S374 ITEPA 2003 does not apply to cover the wife's travel costs, since Kolya does not spend at least 60 days in the UK.

The following expenses are not liable to tax:

Kolya's flight	£3,780
Trains	£425
Taxis	£160

The following expenses are liable to tax. If Kolya paid the costs and was reimbursed, then the amount should be reported via the payroll, otherwise, they need to be reported on a form P11D. Including the gross up, this will push Kolya into the 40% tax bracket.

Wife's flight	£3,780
London hotel	£10,400
Evening meals	£2,600

UK taxable fees	£26,000
Wife's flight	£3,780
London hotel	£10,400
Evening meals	£2,600
Total	£42,780

			£
	Tax at 20%	37,700	7,540
	Tax at 40%	5,080	<u>2,032</u>
	Total		9,572
Tax paid by Kolya			<u>(5,200)</u>
Tax to pay by Minecomp Ltd			4,372
Grossed up	x 100/60		<u>£7,287</u>

Alternative arrangements

Minecomp Ltd could apply for an Appendix 6 modified payroll. This would avoid the timing issue of the fee payments and allow calculation of the total annual tax position (including expenses and gross ups). However, this would involve a separate payroll for just one employee and may not therefore be cost effective.

Given that Minecomp Ltd has agreed to pay the taxes due, they could enter into a PSA for the P11D items. There would be no Class 1B NIC charge, since Kolya is not liable to NIC. However, HMRC may not agree these items are irregular/minor. A Free of Tax arrangement may be agreed with HMRC instead in that case. Nevertheless the timing of the fees issue will not be resolved with either of these alternatives.

MARKING GUIDE

TOPIC	MARKS
Fees <ul style="list-style-type: none"> • Identifying Art 15 applies, not Art 14 • Substantive duties • UK source only • No liability for £25,000 • Calculation of UK taxable portion of £65,000 • Amount payable by Kolya • Amount payable by Minecomp Ltd • Need for s690 and why • Identifying potential issue with timing of payments and suggest changes, e.g. multiple smaller, later in year 	½ ½ ½ ½ 1 ½ ½ 1 1½
NIC <ul style="list-style-type: none"> • No NIC and why 	1½
Expenses <ul style="list-style-type: none"> • Why s337 not applicable • Why s340 not applicable • Identifying s373 <ul style="list-style-type: none"> ○ Travel only • Why s374 not applicable • Calculation of tax on benefits <ul style="list-style-type: none"> ○ P11D or RTI subject to way provided 	1 ½ ½ ½ 1 1½ ½
Alternative arrangements <ul style="list-style-type: none"> • Suggesting either App 6, PSA or FoT arrangements • Discussion of pros/cons 	1½
TOTAL	15

ANSWER 3

The income tax and NIC implications of the tips and service charges applied at each restaurant are as follows:

London

As customers give tips directly to the waiting staff, and TH Cuisine Ltd is not involved in collecting or allocating the tips, no PAYE or NIC withholding is required.

Employees must notify HMRC of the tips received during a tax year. HMRC will collect any income tax, typically via an adjustment to the employee's tax code in the following tax year. No Class 1 NIC is due to be withheld or paid in respect of the tips.

Manchester

The tips which are withheld by the restaurant manager for payment to the team of Chefs will be subject to PAYE and NIC deductions as they are paid directly by TH Cuisine Ltd.

For the remaining amounts, as the restaurant manager collects all the tips and allocates these amongst the waiting staff at their discretion, this will be considered a tronc arrangement, with the restaurant manager considered a troncmaster.

A PAYE reference is typically set up in the troncmaster's name, and the troncmaster is responsible for operating PAYE on the amounts paid to the waiting staff from the tronc. The troncmaster can use TH Cuisine Ltd's payroll to operate PAYE on tips, with TH Cuisine Ltd acting as a payroll agent.

As TH Cuisine Ltd does not directly handle the amounts paid to the waiting staff via the tronc, and is not involved in the allocation of the amounts, the tip earnings are not subject to NIC.

Edinburgh

Mandatory service charge:

As the service charge payments are made direct by TH Cuisine Ltd, there is a requirement to operate PAYE and Class 1 Primary and Secondary NIC via payroll on the amounts paid.

Tips:

For the cash payment, TH Cuisine Ltd is not involved with the collection and allocation of the tips, therefore no PAYE and NIC withholding is required.

For the card payments, the restaurant manager will be considered the troncmaster and will be responsible for operating PAYE but no NICs are payable. Retaining 5% of the card payment receipts does not make TH Cuisine Ltd involved in the allocation of the tips.

TH Cuisine Ltd obligations

TH Cuisine Ltd should include taxable payments in their FPS submission to HMRC via RTI on or before date of payment. Tax and NIC are payable on the 22nd following the end of the tax month of payment.

TH Cuisine Ltd is required to notify HMRC of the tronc arrangement and that the restaurant manager is the troncmaster, as per reg.100 S.I. 2003/2682 HMRC will check the arrangement and notify TH Cuisine Ltd if the troncmaster is responsible for operating PAYE. HMRC can still require PAYE to be operated by TH Cuisine Ltd under para (5) reg.100 S.I. 2003/2682, where they consider that the tronc arrangement has not been set up correctly (i.e. TH Cuisine is involved with the distribution of amounts to the waiting staff) or it is not clear that the troncmaster has accepted their PAYE responsibilities under the arrangement.

National Minimum Wage / National Living Wage

TH Cuisine Ltd needs to ensure that all waiting staff are paid for all their working time at least equal to the NMW/NLW, during each pay reference period.

The waiting staff will be considered time-based workers for the purpose of NMW. The pay reference period is on a weekly basis. For NMW, pay allocated to a pay reference period is the pay received in that pay period plus the pay earned in that period but not paid until the next pay reference period.

Only basic pay and overtime at the normal hourly rate will be considered as pay for NMW purposes (i.e. must disregard the premium element for overtime).

Any tips or service charges will not count as pay for NMW.

The £5 weekly deductions are for the benefit of the employer and will reduce waiting staff pay below NMW in the pay reference period the deduction is made, in the absence of sufficient overtime being worked.

The deductions for refusal to attend the training courses, is treated as misconduct under the employee's employment contract, and will not reduce pay for NMW purposes.

Where arrears of NMW/NLW are identified, TH Cuisine Ltd should make good these amounts to the waiting staff using the relevant NMW rate at the time the arrears are paid. Where arrears are identified by HMRC, penalties of up to 200% of arrears may be levied, and potentially naming by HMRC in the public domain. The maximum penalty per worker is £20,000.

MARKING GUIDE

TOPIC	MARKS
<p>London</p> <p>No PAYE/NIC Income tax responsibility of individual</p>	<p>½ ½</p>
<p>Manchester</p> <p>Payment to chef team subject to PAYE and NIC Tronc arrangement in place for payments made by restaurant manager Restaurant manager is troncmaster PAYE operated by troncmaster TH Cuisine Ltd can act as payroll agent for troncmaster No NIC due on payments made from the tronc</p>	<p>½ ½ ½ ½ ½ ½</p>
<p>Edinburgh</p> <p>Mandatory service charge PAYE/ Class 1 NIC due on amounts paid to waiting staff</p> <p>Voluntary Service charge Cash payments – no PAYE and NIC Cash payments – responsibility of individual Card payments – no PAYE/NIC for TH Cuisine Ltd Card payments – PAYE operated by troncmaster Card payments – no impact to treatment with TH Cuisine Ltd retaining 5% of card payment receipts</p>	<p>½ ½ ½ ½ ½ ½</p>
<p>TH Cuisine Ltd obligations</p> <p>Where PAYE/NIC due Include in RTI on or before date of payment PAYE and Class 1 NIC due 22nd after tax month of payment TH Cuisine Ltd obligation to notify HMRC of tronc arrangement and troncmaster HMRC will decide if TH Cuisine Ltd still required to operate PAYE</p>	<p>½ ½ 1 ½</p>
<p>National Minimum Wage / National Living Wage</p> <p>Ensure all working time at NMW/NLW rates Waiting staff time-based workers Weekly pay reference period Include basic pay and overtime Disregard premium element of overtime Disregard tips and service charges from NMW/NLW calculation Deduction for £5 weekly rental will reduce pay for NMW/NLW Penalty deduction for misconduct will not reduce pay for NMW/NLW Requirement for TH Cuisine Ltd to work out any arrears and make good Penalties and naming</p>	<p>½ ½ ½ ½ ½ ½ ½ 1 ½ ½</p>
TOTAL	15

ANSWER 4

Emma

2021/22

Although she arrived in 2021/22, she will be non-resident in that tax year under the automatic non-residence test as she spent less than 46 days in the UK. She will have 2 UK sourced and taxable workdays, but the income for those days will be paid on 23 April 2022. Therefore, the income for those workdays will be taxed in 2022/23 in the April 2022 payroll run.

2022/23

Emma will be a UK tax resident for 2022/23, given that she will spend > 183 days in the UK in each tax year and be working full time in the UK for at least 365 days.

As she has a flat in Carlisle, she will be resident in England and subject to standard UK rates. It does not matter that she works in Scotland.

The hotel for April/May, which has been paid for by Nocha Ltd, can be exempted as relocation costs under ss271-272 and s281 ITEPA 2003. She is moving to within a reasonable distance of a new permanent workplace. It will be treated as temporary living accommodation.

Frank

2021/22

Frank also arrived in 2021/22. In all cases, if he spends fewer than 16 days in the UK in 2021/22 he will be automatically non-resident for that year. With 3 days (3/4/5 April) plus 10 days in February he will therefore be non-resident in 2021/22. Again, he will have 2 UK sourced workdays, but the income for those days will be paid on 23 April 2022. Therefore, the income for those workdays will be taxed in 2022/23 in the April 2022 payroll run.

2022/23

Frank will be a UK tax resident for 2022/23, given that he will spend at least 183 days in the UK in that tax year and that he will be working full time in the UK for at least 365 days.

As he has his only residence in Dumfries, he will be treated as a Scottish taxpayer and be subject to Scottish tax rates.

His student loan repayments will start to be deducted automatically via the UK payroll. Frank should note on his expat starter checklist that he has a student loan and Nocha Ltd should calculate the deductions immediately. The checklist will highlight it is a Plan 4 loan, since it is a Scottish loan (although the default, if not known, is Plan 1). After the first FPS, HMRC should issue a start notice SL1 to Nocha Ltd, confirming the plan type.

The monthly repayments will increase from the £280 currently (see workings). Frank should contact the Student Loans Company and stop his monthly payments to prevent double contributions. Given the new level of contributions, it is likely that the loan will be paid off before the end of the secondment. Frank could contact the Student Loans Company in the final assignment year and arrange direct payment to ensure he does not overpay. Otherwise Nocha Ltd must continue to pay until a SL2 stop notice is issued by HMRC.

Lucas

As Lucas is remaining Swiss resident, it will be necessary to consider Article 4 of the double tax treaty in any year in which he is also UK tax resident.

He will have a permanent home in both countries, as he has Frank's flat readily available in the UK and the family home in Switzerland. However, his centre of interests will be stronger in Switzerland. He has retained his immediate family, employer and presumably all other ties in Switzerland. His only UK ties are a temporary secondment to a UK company and his brother. Therefore, he should be treaty resident in Switzerland and deemed to be UK non-resident regardless of the outcome of the SRT.

He will still be liable to UK tax on his UK workdays. As he is not expecting to have any Swiss workdays, all his earnings will still be liable to UK tax.

Although he has the flat in Dumfries, as he will be non-resident in the UK, standard UK tax rates apply, not Scottish rates.

Annual Costs: 2021/22

Nil

Annual Costs: 2022/23

Annual tax cost to Nocha Ltd

Emma	£18,787
Frank	£21,891
Lucas	£18,787
Total	£59,465

Workings

		Frank Resident in Scotland £	Emma/Lucas Resident in England £
Salary	£50,000	50,000	50,000
Mobility premium	£800 x 12	9,600	9,600
Tax gross up		21,891	18,787
Total		81,491	78,387
Personal allowance		(12,570)	(12,570)
Taxable		68,921	65,817
Tax at 19%	2,097 / 0	398	
Tax at 20%	10,629 / 37,700	2,126	7,540
Tax at 21%	18,366 / 0	3,857	
Tax at 40%	0 / 28,117		11,247
Tax at 41%	37,829 / 0	15,510	
Total tax		21,891	18,787

Frank's monthly student loan

		£
Gross monthly pay	£81,491 / 12	6,791
Threshold amount	Plan 4	(2,083)
		4,708
Repayment rate	@ 9%	424
Annual repayment	£424 x 12	5,088
By end of assignment	£5,088 x 3	15,264
Outstanding balance		(14,000)
Potential overpayment		1,264

MARKING GUIDE

TOPIC	MARKS
Emma <ul style="list-style-type: none"> • 2021/22 residence status and why <ul style="list-style-type: none"> ○ no liability for either Emma or Frank and why • 2022/23 residence status <ul style="list-style-type: none"> ○ Reason why for either Emma or Frank • Why liable to UK rates • Hotel exempt as qualifying relocation expense 	1 1 ½ ½ 1 ½
Frank <ul style="list-style-type: none"> • 2021/22 residence status and why • 2022/23 residence status • Liable to Scottish rates • Loan <ul style="list-style-type: none"> ○ Via UK payroll ○ Plan 4 ○ Starter checklist ○ SL1 form ○ Contributions will increase ○ Calculation of new repayment ○ Recognising potential overpayment • Suggest <ul style="list-style-type: none"> ○ Ceasing personal payment ○ Checking end of loan <ul style="list-style-type: none"> ▪ Active management at end by contacting SLC ▪ Continue until SL2 	1 ½ ½ ½ ½ ½ ½ 1 1 ½ ½ ½
Lucas <ul style="list-style-type: none"> • Treaty residence applies and overrides • Swiss resident and why • Still liable to UK tax • Why liable to UK rates 	½ 1 ½ ½
Calculation <ul style="list-style-type: none"> • Amount under UK rates • Amount under Scottish rates 	2½ 2½
TOTAL	20

ANSWER 5

Mr & Mrs Jones, as founders of the business, acquired the shares for market value from the company formation agent.

Sarah Gregory acquired restricted securities by reason of her employment. Although she didn't enter into elections to disregard any or all of these restrictions for tax purposes, she has paid the initial unrestricted market value for the shares (as independently valued at the time). Therefore, there is no charge to income tax or NIC on her initial purchase of shares in May 2018 or on her disposal in October 2021. There are therefore no RTI requirements for Digital Lessons Ltd in respect of either event.

Whilst Digital Lessons Ltd is a private limited company, the deal with E-Learn plc was already in prospect by the time that Martin acquired his shareholding. This is likely to be regarded by HMRC as being a trading arrangement that is likely to come into existence in accordance with "any arrangements of another description existing when the asset is provided or, any understanding existing at that time" and on this basis, the shares should be regarded as being Readily Convertible Assets ("RCA"). Digital Lessons Ltd are therefore obliged to operate PAYE and NIC on any purchase or disposal if a tax or NIC liability arises.

In addition, although Martin and Digital Lessons Ltd agreed to disregard all restrictions on the shares for tax purposes, this took place outside the statutory 14-day time limit under s431 ITEPA 2003 and therefore would not have been effective for tax purposes. Therefore, as restricted non-forfeitable securities, there will be a tax charge based on the difference between the restricted market value and the purchase price in March 2021 when the shares were acquired.

Martin Bass purchased his shares for £75 per share on 15 March 2021. This was shortly after E-Learn plc entered into negotiations, on 1 March 2021, to acquire Digital Lessons Ltd for £50 million. This equates to an initial unrestricted market value of £90 per share (after taking into account discounts for minority rights etc) and so Martin has potentially underpaid. Based on the advice the purchasers received after the event, the actual restricted market value at the time of Martin's acquisition was 10% less, at £81 per share.

The 10% uncharged portion is taxable in October 2021 based on the value at that time. The final disposal proceeds give a value of £110 per share.

Payroll in March 2021

		£	£
Taxable income in March 2021	(£81-£75) x 5,000 shares		30,000
PAYE	@ 45%	13,500	
Primary Class 1 NIC	@ 2%	600	
Secondary Class 1 NIC	@ 13.8%	4,140	
Total tax/NIC due to HMRC			<u>£18,240</u>

As the employer has not operated PAYE, there has been an underreporting on the employer's Full Payment Submission. This is potentially liable for tax geared penalties, which in the case of "carelessness" would be due at a rate between 0% - 30% of the potential lost revenue. It would be sensible to disclose the underpayment to HMRC at the earliest opportunity to reduce the risk of later discovery as there is a 15% minimum for prompted disclosures. It may also be possible to agree with HMRC that any penalty may be suspended.

Furthermore, as the PAYE has not been made good by Martin by 4 July 2021, the shortfall is treated as additional earnings for 2021/22 under s222 ITEPA 2003. There is nothing within the scheme

documentation such as an indemnity that could be construed as “making good” for s222 purposes and which would therefore remove the charge.

However, it is worth noting that the s222 charge is calculated based on the tax that the employer was required to account for but was unable to deduct from the employee. As there has been a pay run delivering net income of £8,500 in the same tax month as the date of the chargeable event, any charge should be correspondingly reduced. This should have been reported on Form P11D for 2020/21 with Class 1 NICs due on the same amount as below:

P11D/P11D(b) in July 2021

		£	£
S222 charge	£13,500 - £8,500		5,000
Primary Class 1 NIC	@ 2%	100	
Secondary Class 1 NIC	@ 13.8%	690	
Total NICs due to HMRC			<u>£790</u>

If the employer wishes to settle the tax on behalf of the employee (known as “voluntary restitution” by HMRC), the tax on the s222 charge will need to be grossed up and further employee’s and employer’s NIC charged thereon as follows:

s222 charge	Grossed up income tax on s222 charge (x 45/55)	Employees NIC on grossed up tax (2%)	Employer's NIC on grossed up tax (13.8%)	Total liability
£5,000	£4,091	£82	£565	£4,738

It should be noted that there is no requirement for the employer to settle the tax on the s222 charge on the employees’ behalf. However, should the employer not wish to gross up, HMRC could technically seek incorrect P11D reporting penalties to reflect the s222 charge of £3,000 per form. This is clearly substantially less than the value of the voluntary restitution. Outside voluntary restitution, HMRC would also be able to pursue the individual separately for the tax on the s222 charge which may be regarded by the employer as being “unjust” as the charge arose as a result of the employer’s failure to operate PAYE.

Payroll in October 2021

		£	£
Taxable income in October 2021	10% x £110 x 5,000 shares		55,000
PAYE	@ 45%	24,750	
Primary Class 1 NIC	@ 2%	1,100	
Secondary Class 1 NIC	@ 13.8%	7,590	
Total PAYE/NIC due to HMRC			<u>£33,440</u>

As the 90 day limit to make good the tax expires on 4 July 2022, then provided that Digital Lessons recovers the PAYE from Martin before this date, no charge under s222 ITEPA 2003 should be in point..

Annual reporting

The acquisition of restricted securities by Sarah and Martin should have been reported on the employer's Employment Related Securities Annual Return. As the filing deadlines for the acquisitions by both parties has now passed, this could expose Digital Lessons Ltd to incorrect reporting or late filing penalties. It would be sensible therefore to include an up to date schedule to the annual returns as part of the disclosure to HMRC. There is no requirement to report either the acquisition or disposal of Mr & Mrs Jones' shares. Digital Lessons Ltd can still complete the annual return for 2021/22 by 6 July 2022 including the disposals.

MARKING GUIDE

TOPIC	MARKS
<p>Mr & Mrs Jones' founder shares</p> <ul style="list-style-type: none"> ● Acquired for MV and no chargeable event; ● No need to report acquisition or disposal in ERS return 	<p style="text-align: right;">½ ½</p>
<p>Sarah Gregory's shares</p> <ul style="list-style-type: none"> ● Identifying employment related restricted securities; ● acquired for IUMV therefore no income tax or NIC on disposal; ● Above is true despite no s431 election; 	<p style="text-align: right;">½ ½ 1</p>
<p>Martin Bass' shares</p> <ul style="list-style-type: none"> ● IUMV = £100; ● AMV = £90; ● IUP = 10%; ● S431 election concluded after 14 day deadline and consequence; ● Shares are RCAs; ● Due to trading arrangements which are likely to come into existence; ● Calculation of chargeable event in March: <ul style="list-style-type: none"> ○ PAYE; ○ Employee's NIC ○ Employer's NIC; ● Under reporting on FPS; ● Risk of tax geared penalties; ● Tax not made good by 4 July 2021 therefore s222 charge; ● No indemnity clause that could constitute "making good"; ● S222 calculated on tax the employer was required but unable to withhold ● S222 on P11D; ● S222 liable to Class 1 NIC; ● Calculate s222 charge: <ul style="list-style-type: none"> ○ Reduce s222 charge by net pay between chargeable event and end of tax month ○ Employer's NIC on s222 charge; ○ Employee's NIC on s222 charge; ○ Grossed up tax; ○ Employee's NIC on grossed up tax; ○ Employer's NIC on grossed up tax; ● ERS reporting for: <ul style="list-style-type: none"> ○ acquisition and ○ disposal; ● ERS past year for acquisitions and penalties potentially due; ● No s222 on disposal. 	<p style="text-align: right;">½ ½ ½ 1 ½ 1 ½ ½ ½ ½ 1 1 1 ½ ½ 1 ½ ½ ½ ½ ½ 1 ½ ½ ½ ½ 1</p>
<p>TOTAL</p>	<p style="text-align: right;">20</p>

Answer 6

Javier

PAYE

Javier will be exempt from UK Income Tax under the employment income article of the double tax treaty because:

- He is Spanish tax resident
- He is spending less than 183 days per 12 months in the UK
- He is employed and paid by (and on behalf of) a non-UK company. There is no recharge of his salary to the UK company so the UK company is not his economic employer.
- His employer (Carbon Cancel (Gib) Ltd) does not have a permanent establishment in the UK which bears (or should bear) the cost of his remuneration.

Since Javier is working for the benefit of the UK company, when in the UK, s689 ITEPA 2003 would require the UK company to operate PAYE. This would result in double withholding tax and although Javier would be able to claim a refund of the PAYE paid via a tax return, this is not good cash flow.

Alternatively, Carbon Cancel Ltd could enter into an Appendix 4 Short Term Business Visitors (STBV) Arrangement with HMRC. Under this arrangement, Carbon Cancel Ltd would not have to operate PAYE. Instead they would file a report by 31 May following the end of the tax year. Since this is an on-going part of his regular duties, Javier is in the category 1-91 days. Carbon Cancel Ltd therefore has to provide the following details.

- Full name
- Address in UK and overseas
- Nature of duties undertaken
- Date began and ceased
- Country where the worldwide income tax return is filed

Carbon Cancel Ltd would also have to confirm that it does not bear Javier's remuneration or function as his employer.

The flights, hotel and hire car are borne by the UK company. However, these are exempt from UK tax under s337-338 ITEPA 2003. The UK is a temporary workplace as less than 40% of working time is spent there. Travel from the airport and within the UK between the hotel and UK office/exhibition centre is also relieved under s338 ITEPA 2003. Provided the hire car is used for these journeys in the main and any other private journeys are incidental, the cost of the hire car will be exempt.

NIC

There is no liability to UK National Insurance. Under the UK-EU Trade and Co-operation Agreement 2021, Javier is liable in Spain as he is habitually resident there and he works at least 25% of his working time there. He should obtain an A1 portable document from the Spanish authorities to confirm this.

Maria

PAYE

Maria is likely to be treaty resident in Portugal due to having a permanent home there. Income tax on employment income is therefore limited to her UK workdays, all of which are substantive. PAYE is therefore due. There is no exemption available under the double tax treaty as she is employed by a UK company. She cannot therefore be included in the Appendix 4 STBV arrangement.

Carbon Cancel Ltd could apply to HMRC for an Appendix 8 arrangement. Maria spends less than 60 days in the UK (around 36 days) and therefore could qualify.

Under this arrangement, Carbon Cancel Ltd would operate payroll once a year at the end of the tax year under RTI. The submission and payment deadline is 31 May. It would include the total UK taxable income for the year and set the full personal allowance and full annual rate bands against it.

Maria qualifies for a personal allowance under s56(3) ITA 2007 as an EU national. Maria's UK taxable income would be £60,000 x no of UK workdays/total workdays. Assuming 15%, this would be £9,000. The business travel expenses would not be included as they are exempt, as described above. The kennelling fees are a benefit in kind. The value is added to the taxable salary and a P11D is not required. The total income of £9,600 would be under the personal allowance. No UK PAYE will therefore be due and so there is no cash flow issue with double withholding tax.

NIC

For the same reasons to Javier above, Maria is liable to social security in Portugal as she is habitually resident there and she works at least 25% of his working time there. She should also obtain a portable A1 from Portugal.

MARKING GUIDE

TOPIC	MARKS
Javier <ul style="list-style-type: none"> • Exempt under Spanish treaty and why • Suggesting App4 <ul style="list-style-type: none"> ○ Why ○ 1-91 days category ○ Employee Information required for report ○ Company statement ○ Deadline • Identifying social security position and why <ul style="list-style-type: none"> ○ Obtaining A1 	1 1/2 1/2 1 1/2 1/2 1/2 1 1/2
Maria <ul style="list-style-type: none"> • Identifying why no treaty exemption • App 4 cannot apply • App 8 could apply <ul style="list-style-type: none"> ○ Requires application to HMRC ○ Day limit ○ Annual payroll only ○ Filing deadline ○ Under PA ○ Avoids double withholding ○ Includes taxable benefits <ul style="list-style-type: none"> ▪ Full kennelling amount ○ No P11D required • Identifying Maria's social security position and A1 required 	1/2 1/2 1/2 1/2 1/2 1/2 1/2 1/2 1/2 1/2 1/2 1
Travel/hotel <ul style="list-style-type: none"> • Non-taxable as business trip expenses • 40% rule applies • Explanation of why hire car exempt 	1/2 1/2 1
TOTAL	15