The Chartered Tax Adviser Examination

May 2018

Human Capital Taxes

Suggested solutions

Answer 1

To: Tobias Weber
From: Louise Marshall
Date:
Subject: Engineers attending customer site

Dear Mr Weber,

Thank you for your email. Based on the information provided, I can advise that the UK income tax treatment of the Solpan GmbH employees will be as follows:

The project manager and the specialist solar engineer will become UK tax resident under the Statutory Residence Test in 2018/19 either because they will spend more than 183 days in the UK in tax year or they will be working full-time in the UK for a period exceeding 365 days. In 2019/20 they are likely to be UK resident under the Statutory Residence Test due to working full time in the UK, on the assumption that they work sufficient hours during this period.

The other engineers may become UK tax resident subject to the number of days they spend in the UK and the number of ties they have in the UK. This would require further analysis when accurate information is available.

Nevertheless, as all the individuals are remaining tax resident in Germany, they will be able to claim to be treated as non-resident in the UK under Article 4 of the UK-Germany Double Tax Treaty. Whilst they have accommodation available to them in both countries, their centre of vital interests will remain in Germany as their social and economic tries are there and not in the UK (Article 4(2)a).

As treaty non-residents and as far as employment income is concerned, they will be liable to UK tax on workdays performed in the UK only (per Article 14(1) of the tax treaty).

They will not be able to claim exemption under Article 14(2) of the treaty as Solpan GmbH will have a permanent establishment in the UK and the salary costs will be considered to be borne by that permanent establishment.

All the individuals will be liable to salary withholding tax in the UK (known as PAYE), even if they are paid from the German payroll. Solpan GmbH will therefore be required to set up a shadow payroll in the UK for the purposes of calculating the PAYE. I would recommend applying to HM Revenue & Customs for a “Modified Payroll” in this case for the following reasons:

- A normal UK payroll has strict deadlines for reporting income on or before the payment date. This can be difficult to do when the payment is made on another overseas payroll. These deadlines are relaxed under Modified Payroll
- Where employees are not liable to tax on 100% of their earnings, deductions can be made for days worked outside the UK.
- Taxable benefits can be included in the payroll calculations too.
- Deductions can be made for tax reliefs

Details of the taxable pay and PAYE due must be reported each month for each employee. These can be estimated initially providing they are reconciled before the end of the tax year. The PAYE must then be paid over to HM Revenue & Customs by 22nd of the month following the pay month, if it is paid by bank transfer.

In terms of the remuneration package, you should note the following difference in treatment between the UK and Germany:

- Overtime will be liable to tax
- Cash daily allowances are liable to withholding tax unless a specific agreement is reached with HM Revenue & Customs. A deduction may be claimed for valid expenses incurred out of the allowance (see comments below).
- The accommodation costs for the Specialist Solar Engineer will be taxable. However, it is possible to claim that such costs for the other individuals are exempt (see below).

- The travel costs for all the individuals will be exempt, although under different provisions (see below).

There is a tax relief available for travel, accommodation and subsistence costs incurred while an employee is working temporarily away from his normal place of work (s.336-339 ITEPA 2003). The Project Manager and three skilled engineers have a normal place of work in Dusseldorf and the UK customer site will qualify as a temporary workplace as they are not expected to work there for more than two years. However, the Specialist Solar Engineer is on a fixed term contract for the duration of the UK project only. Therefore, his only and normal place of work will be the UK customer site.

There is also a tax relief available for the travel costs only (s.373 ITEPA 2003), where an individual is domiciled outside the UK and comes to work in the UK. Provided the individual has not been resident in the UK in the last two tax years, the travel costs from where they live to the UK and back again are exempt. Note that travel has to be back to Germany, not anywhere else in the world.

Therefore, the travel for the Specialist Solar Engineer will be exempt from UK tax but the accommodation and daily allowances are taxable in the UK.

For the other individuals, the travel costs and the serviced apartment costs will not be taxable because of the first tax relief. To the extent that the daily allowance is used to pay for travel and subsistence costs, e.g. food, tax relief can also be claimed. It is possible to agree with HM Revenue & Customs that a daily allowance is not taxable and not liable to PAYE if a sampling exercise can be done to demonstrate that the allowance does no more than cover the actual costs incurred on relevant expenses. HM Revenue & Customs may not accept that Solpan GmbH have enough employees on site at the start of the project to provide a reasonable sample. Alternatively, the employees can keep receipts for all the expenditure they do incur out of the daily allowance and a deduction can be made for these. If Solpan GmbH uses a modified payroll, the deduction can be made in the payroll calculations if the individuals supply the receipts in time. If not, the claim can be made via the annual tax return.

All the individuals will be required to complete a tax return at the end of the UK tax year. The deadline for submission is 31 January 2020 for 2018/19 and 31 January 2021 for 2019/20.

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

Best regards,

Louise Marshall

MARKING GUIDE

TOPIC	**MARKS**
Identifying UK residence status	2
Identifying treaty residence in Germany Centre of interests Overrides SRT	 1 1
Stating UK tax liability restricted to UK workdays	1
Stating that treaty exemption is not available as permanent establishment	1
Stating that PAYE and a UK payroll is required	1
Suggesting Modified payroll and reasons why Estimates initially Non-UK workdays excluded Benefits included Reliefs included	 ½ ½ ½ ½
Monthly reporting requirements and PAYE payment dates	1
Highlighting differences in tax treatment to Germany of Overtime Daily allowance	 1 1
Defining temporary workplace relief	1
Identifying fixed term contract issue	1
Defining non-dom travel costs relief	1
Advising on different tax treatment for different individuals	1
Treatment of daily allowances under PAYE Sampling exercise Receipted expenses Inclusion in payroll/tax return	½ ½ ½ ½
Requirement for annual tax return and deadlines	1
Presentation and higher skills marks	1
TOTAL	**20**

Answer 2

To: Evelyn Wright
From: Anthony Byars
Date: 10 May 2018
Subject: Company Cars

Dear Evelyn

Thank you for your email.

Pool Car

I can advise that you do not need to report the use of the pool car as a company car benefit on the employees' P11Ds for the following reasons:

Ed only uses the car for business purposes. Frequency is not a factor provided Ed's use is not to the exclusion of other employees. Other employees have used the car; it is not ordinarily only used by Ed.

It is permitted for a pool car to be taken overnight if the employee's journey is to start early in the morning. Any private use has to be merely incidental to the business journey and it cannot happen so often that the car is not ordinarily kept at the office. Your employees only took the car home to facilitate the business journey and it only occurred three times in the year, so this would not fail the pool car exemption criteria.

You are correct that the journey to the hospital would not be a business journey. However, HM Revenue & Customs have a statement of practice that such emergency use is ignored provided it does not make up more than 5% of the total mileage of the pool car.

Since there is no car benefit, there is therefore no fuel benefit to report either.

Derek's car

You could offer a cash allowance to Derek, either in lieu of the company car until he can choose his own or to cover some of the extra tax he has to pay. However, whilst these may appease Derek, it does not help to reduce Dreve Ltd's costs or make use of Malcolm's former company car.

Similarly, you could hire, short-term, a smaller car for Derek to use until he can choose his own car. However, again this would not reduce your costs or use the old car.

However, you could swap the pool car for Malcolm's former company car. This would use the old car and Derek would be charged a benefit based on the smaller car. It will make no difference to the employees using the pool car, since there is not a taxable benefit for use of the pool car. The approximate tax saving would be £238 per month assuming Derek is a 40% taxpayer.

Annual benefit for pool car	£14,200 x 21% = £2,982
Annual benefit for Malcolm's car	£27,400 x 37% = £10,138
Annual difference	£7,156
Monthly difference (£7,156 / 12)	£596

Dreve Ltd would also benefit from a reduction in Class 1A NIC of £82 per month (£596 @ 13.8%)

You would have to ensure that Malcolm's former car is then used as a pool car in the same way as you currently do for the pool car, e.g. only for business journeys, the keys are kept in your office and the same usage log is maintained.

You should also ensure that when Derek takes over the pool car he pays in full for any petrol that is in the car to avoid a fuel benefit charge, as the taxable amount will be higher than the actual value of the fuel.

Once Derek's long-term company car arrives, you can return the current pool car back to the pool and use it as before.

If you have any further concerns, please do not hesitate to contact me

Best regards,

Anthony

MARKING GUIDE

TOPIC	**MARKS**
Identifying no car benefit charge	½
Identifying no fuel benefit charge	½
Stating why no charge on Ed	1
Stating why no charge when taking car for weekend	1
Stating why no charge on hospital journey	1
Suggesting alternatives for Derek and appropriate analysis	2
Suggesting use of pool car instead	½
Stating no impact on pool car users	½
Calculating difference in car benefit charge	1 ½
Calculating company reduction in Class 1A NIC	½
Stating requirement to use former company car correctly as pool car	½
Stating fuel benefit charge if petrol in pool car.	½
TOTAL	**10**

<u>Answer 3</u>

Date: 8 May 2018
From: Terry Barker
To: Helena Jackson
Subject: Re 25th Anniversary Celebrations

Dear Helena,

Thank you for your email regarding the proposed celebrations for your 25th anniversary. Congratulations on your success!

Unfortunately, there will be some deemed taxable benefit but there are also opportunities to change the proposals to minimise the tax and NIC.

1. The party.
   A party will be exempt from tax on the attendees, provided certain criteria are met:
   a) It must be open to all employees, although not all employees have to attend.
   b) It must be an annual event.
   c) The total cost cannot exceed £150 per attendee (including vat). Attendees include staff, directors and their partners.
   d) All social events in the year have to be considered when assessing the £150 limit.

   You will meet the first and second criteria, since the party is open to all staff and will be held each year. You have potentially 31 attendees, so the maximum you can spend is £4,650 (inclusive of VAT). Is your budget of £4,500 including the VAT? Therefore, it is quite possible that the expenditure will exceed the tax-free limit. A reduction in the number of people attending could also affect whether the limit is exceeded. If the limit is exceeded, the whole of the benefit becomes liable to Income Tax and Class 1 or 1A National Insurance.

   If the limit is exceeded, you could apply the limit to other such social events in this same tax year. If the party is within the limit, it may mean that other social events become taxable (because they would be beyond whatever is left of the £150/head limit).

2. Service awards:
   Long term service awards are only exempt from tax if they:
   a) Are for service in excess of 20 years
   b) Equate to less than £50 per year of service
   c) Are not in cash form
   Therefore, only the award to Eve Black is potentially exempt, providing she takes the gift or the voucher is not exchangeable for cash.

   The other awards will be taxable and potentially need to be reported as a benefit in kind on a P11D for each employee. However, the company could avoid this by entering into a PAYE Settlement Agreement (PSA) with HM Revenue & Customs. Under a PSA, the company pays the tax due plus a gross up and a special class of NIC to HMRC. This is done directly to HM Revenue & Customs without the employee knowing, so it would not upset the employees.

   To obtain a PSA, you must write to HM Revenue & Customs, as soon as possible, detailing the benefits which you want to include. If HM Revenue & Customs agree, they will send you a formal agreement which you must sign and return. At the end of the tax year, you must calculate the value of the benefits covered under the PSA and send it to HMRC before 6 July. Payment of the tax and NIC is due by 22 October if paying electronically (or 19 October if paying by cheque).

   The PSA is an annual agreement. HM Revenue & Customs will automatically invite you to renew the PSA for the following tax year, which you can either accept if appropriate or you can notify HM Revenue & Customs of any changes required for that year, e.g. for different benefits.

The cost of the tax and NIC under the PSA would be (assuming the award to Eve is exempt)

	Award value	Tax rate	Tax	Gross Up	Total tax	Total for NIC Calculation	Class 1B NI @ 13.8%
	£		£	£	£	£	£
Bob White	£600	20%	£120	£30	£150	£750	£103
Liam Green	£600	20%	£120	£30	£150	£750	£103
Miriam Blue	£800	20%	£160	£40	£200	£1,000	£138
Charles Orange	£1.000	40%	£400	£267	£667	£1,667	£230
Sally Red	£1,000	40%	£400	£267	£667	£1,667	£230
Totals					£1,834		£804

3. Voucher:
   Giving a cash voucher would be a taxable benefit. However, if the employees received a non-cash voucher or gift, e.g. wine, it could qualify as an exempt trivial benefit as it is less than £50, it is not a reward for normal duties and there is no contractual entitlement. Therefore, I would advise that you give a gift, not cash vouchers or cash.

4. Bob White Special Award
   It is possible for staff suggestions to be exempt from tax but only if certain conditions are met and it is not clear form the information supplied whether the conditions are met. The conditions are:
   a) There must be a formal staff suggestion scheme open to all employees
   b) The suggestion cannot be made at a meeting specifically for proposing new ideas
   c) The suggestion must be one that Bob White would not have made as part of his normal job
   d) The suggestion must be business related

   It would seem that conditions a) to c) will not have been met. Therefore, any award will be subject to Income Tand Class 1A NIC. If, however, they are met, then the award could count as a
   financial benefit award. You can give the award as cash or as a weekend away. Both would be tax and NI free provided the value is no more than 50% of the money saved in the year after implementation or 10% of the money saved in the first five years capped at £5,000.

Should you not be able to exempt the party, the vouchers or the award to Bob White, then you could also include these items in the PSA at additional cost to the company.

So, in summary, although you cannot completely exempt the planned celebrations from tax, you should be able to avoid a taxable benefit for the party and the vouchers if you work within the limits. The service awards will be taxable but the company can settle the tax directly to HM Revenue & Customs without the need to involve the employees themselves.

If you have any questions regarding the above, please do not hesitate to contact me. If you would like assistance in applying for the PSA, I would be happy to help.

Best regards,

Terry Barker

MARKING GUIDE

TOPIC	MARKS
Party: Criteria for exemption (½ mark per criteria) Calculating within limit and vat issue Stating caution as close to limit Stating no other tax-free events possible	 2 1 ½ ½
Service Awards: Criteria for exemption (½ mark per criteria) Identifying Eve as exempt if not voucher Suggesting PSA and what it is Stating renewable each year Describing process of obtaining PSA Deadlines for PSA Calculation of PSA payments due	 1 ½ ½ 1 ½ 1 1 3
Voucher: Stating taxable as voucher Suggesting trivial benefit option and criteria Award to Bob White: Criteria for exemption (½ mark per criteria) Raising doubt that criteria met and consequences Position if criteria met	 ½ 1½ 2 1 ½
Advising changing arrangements to meet criteria. Party, vouchers, special award can be included in PSA if taxable	½ ½
PHS	1
TOTAL	**20**

<u>Answer 4</u>

To: Julian Brown
From: Marcus Hayman
Date: 6 May 2018
Subject: Employee Shares

Dear Julian,

Thank you for your email. Yes, I think I can help.

Giving employees free shares is seen by HM Revenue & Customs as taxable income and therefore there is a tax and NIC liability. What your colleagues have are restricted securities because there is a restriction in the fact that the shares can't be sold for four years. There are special rules that govern how the liabilities are calculated and when.

There was no tax or NIC due at the time of acquisition because the forfeiture period was less than five years. However, there is a liability when that forfeiture period expires, which is why you have an action now.

Holo plc is a quoted company and therefore there is a market for the shares. This makes the share scheme liable to PAYE and NIC. So, you must put the current market value of the shares through the payroll, calculate PAYE and NIC and deduct it from the employee's salary. Therefore, you will be deducting extra PAYE/NIC from the employees and their net take home pay will be lower than usual, which is what I think the note from your predecessor was referring to.

Let's look at an example:

Normal monthly payroll for an employee earning £27,000 or £2,250 per month on a normal PAYE code of 1150L (using 2017/18 rates).

PAYE:		Rate	PAYE due
1/12th of personal allowance	£958.33	0%	£0.00
Remaining salary	£1,291.67	20%	£258.33
Total	£2,250.00		£258.33

NIC:		Rate	Employee's NIC due
Primary threshold	£680	0%	£0.00
Remaining salary	£1,570	12%	£188.40
Total	£2,250		£188.40

So, the net take home pay for the employee would normally be £1,803.27.

Gross salary	£2,250.00
Less PAYE	-£258.33
Less NIC	-£188.40
Net salary	£1,803.27

The value of the shares which has to be included in the payroll is £1,920 (300 shares x £6.40). The PAYE and NIC on £1,920 would be:

PAYE	£1,500.00	@ 20%	£300.00	
	£420.00	@ 40%	£168.00	
Total	£1,920.00			£468.00
NIC	£1,500.00	@ 12%	£180.00	
	£420.00	@ 2%	£8.40	
Total	£1,920.00			£188.40

So, the net take home pay for the employee would become £1,146.87, i.e. £656.40 less.

Gross salary	£2,250.00
Less PAYE	-£258.33
Less extra PAYE	-£468.00
Less NIC	-£188.40
Less extra NIC	-£188.40
Net salary	£1,146.87

[Candidates may work to the nearest £]

This could have a quite an effect on the employee's financial position if they cannot afford to lose this amount of money in a single month. You might therefore consider the following options.

Holo plc could pay the PAYE/NIC initially and recover it back from the employee over a period of time. However, there is a special provision under s.222 ITEPA 2003 about the recovery of PAYE/NIC in relation to notional income payments, such as the value of share awards. The monies must be recovered from the employee within 90 days of the end of the tax year, otherwise there is an additional tax charge. The amount of the tax/NIC not recovered from the employee is reported on the P11D, which results in the employee being taxed on a deemed benefit in kind and Holo plc paying Class 1A NIC. The 90-day limit is a very strict one; repayments made even one day late will result in the additional tax charge being levied.

The employees could sell some of the shares (around 103 shares would need to be sold) to cover the additional tax liability but this may not be desirable, if the original aim of giving the employees shares was so that they had a vested interest in the success of the company.

Holo plc could give the employees a short-term, interest-free loan instead. As the amount of the loan will be less than £10,000, assuming this is their only loan with the company, there will be no beneficial loan charge. There would not be any restriction as to how long the loan lasts for either.

Finally, there are also end of year reporting requirements for Holo plc. Holo plc must report employment securities events using HMRC's "Other" template, which used to be known as Form 42. This report covers non-tax-advantaged or non-approved schemes and is completed on-line. The deadline for submitting it is 6 July following the end of the tax year. However, you should note that you have to register the scheme with HMRC first, if your predecessor did not already do so, which takes time. You, therefore, need to start the on-line reporting process several weeks before the deadline.

I hope that this helps to demystify your predecessor's notes. If you have any questions regarding the above, please do not hesitate to contact me.

Kind regards,

Marcus

MARKING GUIDE

TOPIC	MARKS
Stating restricted securities	½
Identifying point of taxation at four-year mark	½
Stating PAYE/NIC due as readily convertible assets	½
Explaining reduction in net pay	½
Calculating normal monthly net pay PAYE NIC Net pay	 1 1 ½
Calculating taxable share value	½
Calculating PAYE/NIC on share value and new net pay PAYE NIC Net pay	 1 1 ½
Suggesting solutions: S222 • 90-day limit • strictly applied • P11D charge • Employer NIC Sell shares • impact Beneficial loan • conditions to be tax-free • longer loan period	 ½ ½ ½ ½ ½ ½ ½ ½ ½ ½
Year end reporting • Other template • Deadline • Potential failure to report in prior years	 ½ ½ ½
Presentation /higher skills	1
TOTAL	**15**

Answer 5

Titanium Limited: Technical Note

Assignment implications

If Fred was sent on an assignment to Australia, he would remain an employee of the UK company and the company would retain a payroll reporting requirement. For tax purposes, Fred will not be liable to UK tax from his date of departure unless he performs any UK workdays. As such, a NT (No tax) code could be applied for (either by completing Form P85 notifying HM Revenue & Customs that Fred had left the UK or by including a claim on his tax return) so tax would not be required to be deducted on his salary. Please note that if any bonuses were paid that related to a UK resident period then a proportion of these would remain UK taxable, depending on the earnings period, and Fred would need to settle any tax due on these payments via self assessment.

As there is no social security agreement in force between Australia and the UK, class 1 National Insurance will continue to be due for the first 52 weeks of Fred's assignment where:

- The employer has a place of business located in the UK (ie a branch or office)
- The employee is ordinarily resident in the UK (ie where he ordinarily lives apart from temporary or occasional absences and this is where his settled and regular mode of life is), and
- Immediately prior to the assignment, Fred is resident in the UK.

All three conditions are met and so there will be a continuing liability to Class 1 National Insurance.

It is up to the company to monitor when the 52 week period expires and to stop paying Class 1. The company may wish to apply for an "EP Appendix 7B agreement" to operate the National Insurance due on a simplified basis. A settlement agreement return would be due to reconcile the employer and employee National Insurance due by 31 March following the end of the tax year.

On the basis that Fred is non resident liability to Class 1A National Insurance will only continue following Fred's departure from the UK if the benefit is liable to UK tax. Any bonus paid after the 52 week period has ended will not have a Class 1 National Insurance liability even if the earnings period related to a former UK resident period.

Any assignment-related benefits provided to Fred before he breaks UK tax residence will remain liable to UK Income Tax and Class 1A National Insurance although there are exemptions in place that will reduce the tax burden: There are a number of exemptions that will apply to the benefits provided which will reduce the Class 1a liability as follows:

- S. 325 ITEPA 2003 will exempt the medical benefit where an employee is provided with medical treatment outside the UK provided the need for it arises while the employee is outside the UK for the purposes of performing the duties of the employment or an employee is provided with insurance against the cost of providing such treatment.
- S. 336 ITEPA 2003 will exempt the visa costs from tax.
- S. 287 ITEPA 2003 will exempt relocation costs up to £8,000. This will cover both the travel costs (unless a separate provision will apply) and the shipment costs. Where a benefit is matched by a qualifying exemption, no reporting requirements arise so the above benefits would not need to be included on a form P11d under s.289A ITEPA 2003.
- S370 and 371 ITEPA 2003 will exempt the initial travel costs.

It may not be possible to put the school fees in to the company's name as some schools will only contract directly with the parents. If this is the case, the school fees paid on behalf of Fred will continue to have a Class 1 National Insurance liability for the first 52 weeks.

If the company does contract with the school directly, this would be a Class 1A benefit. Following Fred's departure from the UK, no Class 1A National Insurance liability will arise on the school fees or the accommodation benefit.

Local hire implications

If Fred was sent to Australia on a local hire basis, he would cease to be an employee of the UK company. Leaver information will need to be reported to HMRC and a P45 should be issued removing Fred from the UK payroll.

The Australian employment would not be a UK taxable employment (unless any workdays were carried out in the UK) and the UK company would not be liable to employers' National Insurance. Therefore Fred would not need to be included on the UK payroll going forwards and any remuneration paid or benefits provided would not be liable to National Insurance Any benefits provided would not be liable to UK tax or National Insurance; however any bonus payments made that related to a previous UK resident period may have a trailing UK tax liability.

Substantive vs incidental workdays

Where duties are mainly performed outside of the UK but the employee has some minor duties that are carried out in the UK then these UK duties will be regarded as incidental under s. 39 ITEPA 2003. There is no legislative definition of what is meant by incidental and therefore it is necessary to rely on case law and HM Revenue & Customs' guidance.

The general rule is that any work performed in the UK that is ancillary or subordinate to the work performed overseas will be incidental. Any days that Fred spends in the UK attending training courses are likely to be incidental; however, if Fred replies to client emails or attends meetings whilst in the UK, any time spent performing these duties will be regarded as substantial and chargeable to UK tax

Please note that HM Revenue & Customs would look at the role Fred carries out and his employment contract if they decided to look into the nature of the duties performed in the UK following his departure.

It is not clear if Fred is a company director; duties performed by a company director will be classed as substantive duties.

Summary

As Fred will cease UK residence there is less risk to the UK company by sending Fred to Australia as a local hire employee as all tax and National Insurance implications will cease (except on any final payments made by the UK company in respect of UK duties) on his departure and therefore from a UK perspective this is the preferred option.

Keeping Fred as a UK employee will increase the costs to the UK company who will have payroll obligations in the UK (to meet the National Insurance obligations) and Australia.

Any training days that Fred attends should be linked to his Australian role only to support an argument that these are incidental to his overseas role and therefore not UK taxable.

Finally, if Fred wishes to protect his entitlement to UK state benefits, he should apply to pay voluntary Class 2 National Insurance. Voluntary contributions can be backdated for up to six years.

MARKING GUIDE

TOPIC	MARKS
How Fred will be taxed as a non-resident	½
Assignment	
Remains on UK payroll and NT code can be applied for	1
Trailing payments (taxable and how to pay)	½
52 week period for NI	1
Company to monitor 52 week period	1
Company can apply for Appendix 7B agreement and reporting requirements	1
Benefit exemptions	
Visa	1
Relocation	1
Travel	1
Class 1A not due on benefits once Fred is not resident	1
School fees: subject to either Class 1 or Class 1A dependent on who takes the contract out.	1
Local hire considerations	
Leaver for UK payroll/issue P45	1
National insurance for Fred and company	1
Relocation costs	½
Trailing liabilities	½
Voluntary NI for Fred	1
Incidental vs substantial duties	
Ancillary or subordinate to	1
Reliance on case law	1
Tax treatment	1
Summary	
Dual payroll obligations if remains as an assignee	1
Presentation and higher skills marks	2
TOTAL	20

Answer 6

Geoff

As Geoff is entitled to split-year treatment under Case 1 for 2017/18, he will be treated as non-resident for the overseas part of the year (i.e. 1 July 2017 to 5 April 2018). Income received relating to duties performed outside of the UK for this part of the year will not be in scope of UK tax.

The bonus received in March 2018, however, relates partly to a period of UK residence (the period from 1 July 2017 to 31 December 2017 being treated as a non-resident period). Accordingly, we should ensure 6/12ths of the gross bonus is reported on the self-assessment UK tax return for 2017/18, corresponding to the amount earned to the period while Geoff was UK tax resident (and treated as such). We should tax the bonus on a 'gross-down' basis, rather than grossing-up the net bonus, on the understanding that it is the gross amount which is contractually determined and in any case it relates to a non-equalised period (unless the equalisation policy stipulates otherwise for income received while on assignment). That is, 6/12ths of £20,000 should be reported on the return (not grossed-up), rather than grossing up 6/12ths of £12,000.

There is no need to take any adjustment against Geoff's taxable employment income on account of the fact that the 2017/18 refund is being mandated to the employer. This is because it is paid to the employer on account of the 2017/18 Tax Equalisation Calculation settlement, which itself is outside of scope of UK tax as the settlement will be considered to be assignment-related income of 2017/18 and Geoff did not have any taxable UK duties while on assignment in this tax year.

Kathy

The 2016 US Tax Equalisation Calculation shows that Kathy's final hypothetical tax responsibility was $16,192 ($72,959 - $56,767) more than what was withheld. This amount is therefore available as a further deduction against Kathy's employment income for 2017/18 (assuming a full deduction was already taken for the hypothetical taxes withheld).

As the advances paid by the employer were not reported when they were paid, we should report them in 2017/18 as part of the TEC settlement figure (or alternatively the prior year returns can be amended).

We can see that the Federal tax withholding amounts which were taken as a deduction in 2015/16 and 2016/17 are not being refunded to the employer via the Tax Equalisation Calculation settlement. Therefore there is no basis for having taken a deduction and the amounts will need to be added back in 2017/18 or the prior year returns should be amended.

As Kathy meets the requirements of s26A ITEPA 2003, she will be entitled to claim Overseas Workday Relief on the amounts within scope of UK tax (after deducting the hypothetical tax adjustment), to the extent that income falling within s26 ITEPA 2003 is not remitted to the UK. Any gross-up will be applied after apportionment between UK and non-UK duties.

George

Under Chapter 5B Part 2 ITEPA 2003, the option gain will need to be sourced over the vesting period. This means that, broadly, 13/48ths will be liable to UK tax. It is possible to treat the amount relating to the post-departure UK workdays as exempt under the UK-US Double Tax Treaty.

The 2014 US Tax Equalisation Calculation (TEC) was settled in 2017/18 and so should be considered for UK tax purposes in this year. It relates to the 2014 calendar year. The hypothetical tax adjustment is in favour of the employer and as 1/12th will be within scope of UK tax, this element will be deductible in 2017/18.

Strictly speaking, the element of the TEC adjustment which would be sourced to the post-departure UK workdays may also be taken as a deduction, but one should be consistent in applying Article 14 equally both to the 'positive' income taxable under Chapter 5 and the 'negative' income which is in scope under s62 ITEPA 2003. So, if Article 14(2) is claimed to exempt the part of the option gain relating to the post-departure UK workdays, then no deduction should be taken from taxable income for the hypothetical tax adjustment relating to post-departure workdays. Note that such a deduction will be under Article 14 of the UK-US treaty, on the understanding George is treaty-resident in the US at the point of vest/settlement.

Vincenzo

Firstly, if the Italian withholding taxes on Vincenzo's assignment income will not be recovered by the employer (by whatever mechanism under Italian law), there is no basis for treating them as deductible in the UK (i.e. treating them as if they were hypothetical tax), because they do not reduce the income which is paid by the employer to or on behalf of the employee. Furthermore foreign taxes are, in general, not deductible against UK-sourced income under UK domestic law. Vincenzo's gross Italian pay will therefore be taxable in the UK.

Secondly, if the UK subsidiary will be bearing the UK taxes on behalf of Vincenzo and it is not anticipated that Vincenzo will be reimbursing the UK subsidiary for the UK taxes paid on his behalf, the UK tax liability must be grossed-up. HMRC are likely to challenge any attempt to treat the UK taxes paid on Vincenzo's behalf as a loan without a formal contractual agreement in place.

As a result of the above two points, on the UK tax return we will need to gross-up Vincenzo's gross Italian pay.

MARKING GUIDE

TOPIC	**MARKS**
Geoff	
Income for non-UK duties performed after departure ceases to be in scope of UK tax	1
2017/18 tax refund may be ignored and provide reason why (e.g. on account of equalisation settlement which is out of scope)	1
2017/18 TEC settlement is treated as income for assignment period in 2017/18 and hence out of scope (i.e. no deduction available)	1
6/12ths of the gross bonus should be reported in 2017/18 (as opposed to 6/12ths of the net bonus, grossed-up) and provide reason why	1
Kathy	
Correctly identify that Federal taxes taken as a deduction will need to be added back and explain why	1
Correctly identify hypothetical tax adjustment to be reported in 2017/18	1
Identify that Advances paid by employer will need to be reported in 2017/18 as they were not reported when paid	1
Overseas Workday Relief is available on the amounts, provided a sufficient proportion is kept offshore	1
George	
Calculation of option gain liable to UK tax under Ch 5B (or description of amounts liable)	1
Correct consideration of amount of option gain relating to treaty-exempt workdays	1
1/12th of 2014 TEC settlement will be deductible against Ch 5 income	1
Consideration TEC settlement amount relating to treaty-exempt workdays (1), highlighting the need to take a consistent approach with Chapter 5 income (½)	1½
Vincenzo	
Explain why there is no basis for taking a deduction for Italian withholding.	1
Explain why the UK liability must be grossed-up.	1
Conclude that the employer will therefore need to gross-up gross income	½
TOTAL	**15**