THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Human Capital Taxes

May 2023

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- Additional marks may be awarded for presentation.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

<u>Extract from the Trade & Cooperation Agreement Relevant to Questions 3 and 4</u>

Article SSC.12

<u>Pursuit of activities in two or more States</u>

A person who normally pursues an activity as an employed person in one or more Member States as well as in the United Kingdom shall be subject to:

(a) the legislation of the State of residence if that person pursues a substantial part of their activity in that State; or

(b) if that person does not pursue a substantial part of their activity in the State of residence:

- (i) the legislation of the State in which the registered office or place of business of the undertaking or employer is situated if that person is employed by one undertaking or employer; or
- (ii) the legislation of the State in which the registered office or place of business of the undertakings or employers is situated if that person is employed by two or more undertakings or employers which have their registered office or place of business in only one State; or
- (iii) the legislation of the State in which the registered office or place of business of the undertaking or employer is situated other than the State of residence if that person is employed by two or more undertakings or employers, which have their registered office or place of business in a Member State and the United Kingdom, one of which is the State of residence; or
- (iv) the legislation of the State of residence if that person is employed by two or more undertakings or employers, at least two of which have their registered office or place of business in different States other than the State of residence.

Article SSC.14

<u>Obligations of the employer</u>

1. An employer who has its registered office or place of business outside the competent State shall fulfil all the obligations laid down by the legislation applicable to its employees, notably the obligation to pay the contributions provided for by that legislation, as if it had its registered office or place of business in the competent State.

2. An employer who does not have a place of business in the State whose legislation is applicable and the employee may agree that the latter may fulfil the employer's obligations on its behalf as regards the payment of contributions without prejudice to the employer's underlying obligations. The employer shall send notice of such an arrangement to the competent institution of that State.

1. Amy currently works for Huge plc, where she receives an annual salary of £300,000. She lives and works in London.

Amy has been in negotiations with Big Ltd about a new job and an offer has just been made to her.

Big Ltd will make a payment of £200,000 when Amy accepts the offer, which is expected to be on 31 May 2023.

As Amy needs to work her six month notice period at Huge plc, she will start to work for Big Ltd on 1 December 2023. She will receive an annual salary of £400,000.

As Big Ltd require Amy to work in Leeds, a relocation package will be paid to her comprising:

1) £10,000 towards her son's school fees in September 2023.

2) The reimbursement of £7,000 in legal fees for the sale of her old house, expected to take place in December 2023.

During December 2023, Amy will commute to Leeds and on some nights she will stay in a hotel. Big Ltd will reimburse Amy for return travel from London to Leeds and will pay directly for Amy to stay in a hotel. The travel costs are expected to be in the region of £1,000 and hotel costs around £6,000.

Big Ltd are not willing to pay any taxes on Amy's behalf in relation to these costs.

Requirement:

Explain the Income Tax and National Insurance consequences of the above payments including details of how Big Ltd should report any taxable elements to HMRC. (10)

2. Holdings Ltd is a UK incorporated and resident company providing sales training services. It was founded by Michelle, who is the sole director and majority shareholder. Beth is an employee of Holdings Ltd.

Holdings Ltd has wholly owned subsidiaries in Sweden, France and Ireland. Michelle and Beth regularly travel overseas to deliver courses to clients in these countries.

Michelle and Beth remain UK tax resident. They have remained on the UK payroll and continued to have PAYE and NIC deducted. There is no Appendix 5 agreement in place. Portable A1 certificates were obtained to keep them and Holdings Ltd within National Insurance and exempt from overseas social security.

Michelle and Beth have been set-up on shadow overseas payrolls to account for local tax on all earnings in the overseas countries. Holdings Ltd has loaned them funds to pay their overseas taxes. It is expected that when taking foreign tax credit for the overseas tax in their 2022/23 UK tax returns, tax refunds will be generated which will enable the loans to be repaid. If loans cannot be repaid in full from the refunds, any remaining loan balances will be waived so that they will be no worse off as a result of working overseas.

The loans made in 2022 have been included in Holdings Ltd's accounts for the year ended 31 December 2022. Michelle and Beth do not have any other sources of income.

Information about Michelle and Beth is as follows:

2022/23	Michelle	Beth
	£	£
Total income	220,000	205,000
Income liable to tax in overseas location (and included in the total above)	59,000	74,000
Total UK tax due before foreign tax credit	83,960	77,210
Started working overseas	1 June 2022	1 July 2022
Overseas taxes paid relating to the 2022/23 year:		
12 December 2022	16,500	22,500
31 March 2023	2,970	15,000

Other loans were made to Beth by Holdings Ltd are as follows:

Date of loan and purpose	£	Repaid
1 May 2021 season ticket loan	2,250	Repaid in full on 15 April 2022
1 June 2021 car loan made to Beth's husband Annual interest charged at 1.75%	4,600	Still outstanding
1 July 2021 car loan made to Beth's housekeeper	5,500	Still outstanding
15 March 2022 home repair loan	40,000	£20,000 on 31 October 2022 £15,000 on 31 January 2023
1 May 2022 Season ticket loan	3,500	Repaid in full on 23 April 2023
28 June 2022 Travel advances (see Note)	950	Repaid in full (see Note)

Note

Beth was provided with travel advances of £950 by Holdings Ltd before each overseas trip to fund expenses. She submits regular expenses following each trip and any balances of her advances are repaid within 30 days.

No entries have been made on P11Ds for these loans.

Requirement:

1) Calculate the refunds from the 2022/23 tax returns and explain the action needed by Holdings Ltd if any of the overseas tax loans are not fully repaid. (7)

2) Explain the tax consequences of the loans to Michelle and Beth and calculate the 2022/23 P11D entries Holdings Ltd needs to make in respect of the loans. (13)

Total (20)

3. DesGlaz Ltd is a UK registered company and manufacturer and supplier of bespoke glassware which is looking to expand their sales to the EU market.

On 6 April 2023 Pierre started to work for DesGlaz Ltd in a full-time field sales position. Pierre is a French national and will continue to live there and spend his personal time there at his family home. He will also remain tax resident in France under French domestic residence rules. His contract prohibits him from undertaking other employed or self-employed activities.

Pierre is expected to split his working time as follows over the next 12 months:

1) 20% in France, either carrying out administrative duties from home or meeting with prospective French clients.

2) 70% in various EU member states outside of France to visit prospective clients, but it is expected to be no more than 10% in any specific state. Pierre will not be deemed tax resident in any of these member states.

3) 10% in the UK. This is expected to be one week every quarter at the UK head office to attend quarterly team meetings and other collaborative tasks. Pierre will arrive in the UK on a Monday morning and depart on Friday evening for each week he is required to be in the UK, working each day. Pierre does not intend to spend any further time in the UK aside from these workdays.

As well as with Pierre's salary of £100,000, DesGlaz Ltd would also like to offer to pay for UK tax return services through a specialist firm should the appointment trigger a UK tax filing requirement.

Requirement:

1) Explain the social security position for Pierre and DesGlaz Ltd. (7)

2) Discuss Pierre's UK tax residence and the payroll tax implications for DesGlaz Ltd of Pierre's remuneration package, including any potential reliefs. (8)

Total (15)

An extract from the Trade & Cooperation Agreement is provided on page 2.

Extract from 2008 UK/France Double Tax Treaty

ARTICLE 15
INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 16, 18, 19 and 20, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first mentioned State if:

   a. the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days within any period of 12 months; and
   b. the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
   c. the remuneration is not borne by a permanent establishment which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship, aircraft or railway vehicle operated in international traffic may be taxed in the Contracting State of which the person operating the ship, aircraft or railway vehicle is a resident.

4. For the purposes of this Article the term "employment" includes in particular the exercise of management or executive functions, other than functions covered by Article 16, in a company subject to French corporation tax.

End of Question

4. Anna has been employed as the Head of Research for SkinUK plc, a UK company, since 6 April 2020. On 1 April 2022, she was also appointed as a Director of ShinySkin UK Ltd which is a subsidiary of SkinUK plc.

Anna is German and moved to the UK on 6 April 2020. She bought a flat in London but retained her home in Germany. On 6 April 2022, she returned to Germany to look after her elderly mother. She continued to carry out her roles from her home in Germany, with frequent UK business trips.

Both companies agreed with Anna that she could follow the work pattern below whilst in Germany:

<u>SkinUK plc:</u> Five UK workdays per month. Total workdays: 22 per month (including some weekend workdays).

<u>ShinySkin UK Ltd</u>: One board meeting per month of one day each. Of these meetings, eight meetings are held in the UK, which Anna attends in person. Her first trip to the UK for a board meeting was on 25 April 2022.

The remaining four meetings are held outside the UK, which Anna attends virtually from Germany. Anna also spends one day in Germany preparing for each board meeting.

When Anna visits the UK for business, she stays in hotels near her office, the costs of which are reimbursed by SkinUK plc.

SkinUK plc continued to pay Anna the following annual amounts via the UK payroll:

1) Salary: £210,000
2) Car allowance: £14,400
3) Reimbursement of hotel costs and subsistence: £1,500 per UK trip

ShinySkin UK Ltd paid Anna via the UK payroll:

1) Director's fees: £50,000 per annum
2) Travel allowance: £1,000 per trip
3) Business class airfare and hotel accommodation: £900 per trip

All costs of Anna's employment with SkinUK plc and Directorship with ShinySkin Ltd have continued to be borne by SkinUK plc and ShinySkin UK Ltd respectively.

Anna became UK tax resident on her arrival and remains UK tax resident under the Statutory Residence Test. She was tax resident under German domestic tax rules in 2022 and will be in 2023. Anna spent most of her time in Germany, when not travelling for business. Her close friends are primarily in Germany, and she is a member of her local church and golf club. Her investments are in Germany, she is registered to vote there and has a German driver's licence.

Anna is single with one son aged 14 who is in a UK boarding school. He spends his holidays with Anna in Germany, except for a one-week holiday per year spent with Anna in her flat in London.

Requirement:

1) Explain how Anna will be taxed in the UK on her 2022/23 income from SkinUK plc and ShinySkin UK Ltd and the resulting employment tax and social security implications for the two companies. (14)

2) Calculate with explanations, the amounts that should be reported to HMRC by both companies. (6)

Total (20)

An extract from the Trade & Cooperation Agreement is provided on page 2.

You should assume that the UK / Germany Double Tax Agreement is based on the 2017 OECD Model Tax Convention.

5. PubDrinks Ltd owns a pub, which has a residential flat above it. The flat has a market value of £275,000 and an annual value of £6,000. The company originally purchased the flat in 2010, for £200,000.

PubDrinks Ltd employed Greig as a chef from 6 April 2022 and as part of his contract Greig is permitted to live in the flat.

PubDrinks Ltd meets running costs for the accommodation and contracts directly with suppliers for the following:

1) Buildings insurance (but not contents insurance). The annual premium for the flat alone is £500.

2) TV and broadband in the flat at an annual subscription of £600.

3) Gas and electricity for the flat at a total cost of £2,595 for the year to 5 April 2023.

PubDrinks Ltd also reimbursed Greig for the Council Tax he paid of £250 per month.

Greig is responsible for any tax due on the benefits, none of which have been reported yet to HMRC.

Greig has his own mobile phone at a monthly cost of £100. PubDrinks Ltd reimbursed Greig for the cost and grossed this up via the payroll.

For Greig's duties as a chef, he receives an annual salary of £25,000. He works fixed hours and is not required to provide cover outside these hours. He does not have any other income sources.

Requirement:

Explain the Income Tax and National Insurance implications and reporting requirements of the above items and any savings that could be made in respect of the mobile phone. (15)

You are NOT required to discuss penalties.

6. Mandy is a UK resident and domiciled employee of an unlisted UK company.

On 1 October 2018 Mandy was awarded an option to purchase 10,000 shares in her employer's non-tax advantaged '2018 Retention Share Scheme' with an exercise price that matches the nominal value of the shares at £1 per share. The options can be exercised after three years. The overarching intention of the scheme is to reward key employees and encourage them to grow the value of the company for a potential future sale.

The shares subject to the option confer full rights to dividends, voting and capital, however under the Articles of Association the rights to dividends and to vote are restricted for one year after exercise. The result of these restrictions means that the market value of the shares is reduced by 25% on exercise. Over the lifetime of this restriction, the shares will revert to their full unrestricted market value.

The Articles of Association also set out that shares in this class can only be sold in the case of a sale of the company, in which case all shareholders would be required to sell their shares to the buyer. If an employee leaves the company as a 'good leaver' then shares are sold back to the company for their unrestricted market value, otherwise they are sold back for their original consideration. There is no time limit on either restriction and neither are anticipated to have any impact on the market value.

On 1 January 2019 Mandy was seconded to her employer's subsidiary in China for two years. During this period Mandy worked wholly outside the UK in a full-time position and is non-UK tax resident. However, Mandy returned to the UK for one month in mid-2020 to assist with a UK-based project for her UK employer before returning to China to complete her assignment. She returned permanently to the UK on 1 January 2021 and recommenced her full-time UK role. On 31 December 2021 Mandy exercised her option in full. No elections were entered into.

The unrestricted market value of the shares was as follows:

1 October 2018	£3.00 per share
1 October 2021	£4.25 per share
31 December 2021	£4.50 per share
31 December 2022	£5.00 per share

Requirement:

Explain the tax and National Insurance implications, including reporting requirements, of the option granted to Mandy. (20)