Chartered Institute of Taxation

Excellence in Taxation

# The Chartered Tax Adviser Examination

May 2019

## Taxation of Individuals

Suggested solutions

**ANSWER 1**

From: Tax@advisor.co.uk
To: Sam@Roo.ru
Date: 1 May 2019
Re: Remittance to the UK

Dear Samantha

Further to our recent meeting, I have considered the UK tax position on you bringing funds of £500,000 into the country to purchase a house. A UK domiciled individual is taxed on their worldwide income and gains on the arising basis whereas a non-UK domiciled individual can claim to be taxed on the remittance basis meaning that non-UK income and gains are not taxed to the extent that they remain outside of the UK.

In previous years you claimed the remittance basis and were only liable to UK tax on foreign income brought to the UK. However from 6 April 2017 long-term residents (defined as someone who has been living in the UK for 15 out of the previous 20 years) are regarded as deemed domiciled in the UK for UK tax purposes, meaning that the remittance basis is no longer available to them. As you arrived in the UK in May 2002 you have been resident for over 15 UK tax years you will be deemed UK domiciled from 6 April 2017.

Any income relating to tax years where the remittance basis has been claimed will be subject to tax in the UK in the year that you remit it into the UK. A taxable remittance would include bringing both cash and assets from outside of the UK into the UK as well as the use of foreign assets as security for a mortgage/loan secured on a UK property. You have mentioned you are looking to bring funds of £500,000 to the UK in order to purchase a property. It will be important to review the most efficient way to do this.

*Order of Remittance*

Clean capital (income and gains realised before you became UK tax resident) would not realise a UK tax charge and so should be brought to the UK first ideally. However, it is only possible to choose which funds you are remitting if different types of income and gains are held in separate accounts. If funds from different sources are mixed (either in a bank account, portfolio or used to buy an asset) this will be a 'mixed fund' and complex rules dictate how these are treated.

If funds, other than capital are brought to the UK, the tax payable will depend on the nature of the funds you remit. Remitted foreign income will be taxable at your marginal non savings rate of 45% and foreign capital gains will be taxable at 20% (or 28% for residential property).

*Bank Accounts*

The below accounts and asset are regarded as "mixed funds" as they hold funds from different sources:

- Savings Accounts A and B
- Ruritania Trucking company shares purchased using death benefit funds liable to income tax.

If you remit from one of these accounts, you will be deemed to bring funds to the UK in the following order, from the current year first, and then each previous year in turn:

1. Untaxed foreign income
2. Untaxed foreign gains
3. Foreign income and gains on which foreign tax has been paid
4. Capital and other income

Savings Account A contains rental income and some bank interest that has already been taxed in the UK and relates to the later years first. Thus £66,525 of funds can be brought to the UK with no further tax consequence. I do not recommend remitting more funds from Savings Account A as the complexity of the rules would realise significant compliance costs and you would suffer tax at rates of 45% on the taxable element of the remittance.

The position for your other accounts would be as follows:

- Remittances from your Jersey accounts would not realise a tax charge.
- Savings Account B holds a gain on residential property which would realise a tax charge of 28%, subject to the availability of your annual exemption

*Nominated Accounts*

As you have previously claimed the remittance basis, you have two nominated offshore accounts which the remittance basis charge is attached to. These funds, when brought to the UK, would suffer no further tax charge provided all other “un-nominated” foreign income or gains have been remitted. If this is not the case, there are strict ordering rules that would apply (unless an inadvertent remittance of under £10 is made).

As these accounts only hold minimal funds and these rules are complex and would greatly increase compliance costs, I do not recommend bringing these funds to the UK.

*Rebasing for shares*

As you became deemed domiciled on 6 April 2017, have previously claimed the remittance basis and paid the charge in an earlier tax year, your non-UK assets will be automatically rebased to the market value as at 5 April 2017. This would not affect your UK shares which would realise a gain of £65,000 taxable at 20%.

This provision allows you to ignore any gain arising on the asset prior to 5 April 2017 and to bring this element to the UK tax-free. Any growth in value since this date would realise a tax charge and, it is necessary to consider the underlying funds used to purchase the asset.

The Ruritania Banking PLC shares, if sold, would realise a UK tax charge (20%) on £10,000 based on their growth in value since April 2017. You purchased these shares using clean capital so no additional remittance issues would arise.

The Ruritania Trucking Company shares decreased in value between the date of purchase and 5 April 2017. You can elect for rebasing not to apply to these shares (done on an asset by asset basis via a claim on your tax return); however, as these shares were purchased using income, any remittance of the sale proceeds would contain an income element liable to tax at 45%.

*Recommendation*

Based on the above, my recommendation would be to remit £500,000 from the following accounts:

- £185,000 from the Jersey accounts.
- £250,000 from Savings Account B
- £66,525 from Savings Account A or the proceeds from the disposal of your Ruritania Banking PLC shares

I would suggest we have a meeting to discuss the above in more detail.

Kind regards

A Advisor

**Calculation A**

| | Current value | UK taxable gain | Remitted gain | CGT rate | CGT payable* | Net cash |
|---|---|---|---|---|---|---|
| Jersey accounts | £185,000 | - | - | | | £185,000 |
| Ruritania Banking shares | £110,000 | £10,000 | - | 20% | £1,738 | £108,262 |
| Savings Account B | £250,000 | - | £10,390 | 28% | £0 | £250,000 |
| UK shares | £100,000 | £65,000 | - | 20% | £13,000 | £87,000 |
| Savings Account A | £66,525 | - | - | - | - | £66,525 |

* Annual exemption deducted against remitted gain first and then offset against the Ruritania shares

**MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| Difference in taxation of UK/non-UK domicile | ½ |
| Deemed domicile/long term resident definition | ½ |
| Remittance basis doesn't apply once deemed domiciled | ½ |
| Prior year income (where remittance basis used) is taxable in year of remittance | 1 |
| Definition of **remittance** | 1 |
| Identifying order that funds should ideally be brought to the UK | 1 |
| Identification that clean capital should be brought in first | 1 |
| Definition of a **mixed fund** | 1 |
| | |
| **Cleansing rules** | |
| Jersey accounts can be brought in | 1 |
| Tax charge on other accounts | 1 |
| Identification of Samantha's mixed funds | 1 (½ for savings accounts and ½ for shares) |
| Order of remittance from a mixed fund | 1½ |
| **Nominated account** definition | ½ |
| De minimis rules for inadvertent remittances from a nominated account | 1 |
| Advise not to remit from a nominated account | ½ |
| **Rebasing –** conditions | 1½ (½ for each) |
| Gain prior to 5 April 2017 ignored | ½ |
| Can elect to disapply on individual assets | ½ |
| Election made via tax return | ½ |
| **Recommendations** – calculations and ensuring net cash funds brought in is higher than £500,000. | 2 |
| | |
| Higher skills and presentation marks | 2 |
| | |
| **TOTAL** | **20** |

**ANSWER 2**

**Introduction**

The Transaction in UK Land provisions are designed to catch disposals of UK land where the seller had a profit or gain motive and came into force on 5 July 2016. The provisions are primarily targeted at property builders but are widely drafted. The definition of UK land for these purposes includes buildings, structures and any estate, interest or right over land.

**How is the sale of land taxed?**

There are three main ways in which funds realised on the sale of land are taxed:

1. Where a home or income generating asset is sold, this will be taxed as a capital gain.
2. When an individual is trading, their profit will be taxed as trading profits and liable to Income Tax and Class 4 National Insurance. Regard should be had to the Badges of Trade (repeated transactions will be evidence of trading).
3. A transaction may be caught by the Transaction in UK Land provisions and will be liable to Income Tax. Class 4 National Insurance will not be due.

Losses realised under option 2 or 3 will be treated as a trading loss.

All disposals are taxed in the year of disposal (looking at date of exchange for unconditional contracts or date of completion where the contract is conditional).

**When will these provisions apply?**

For these provisions to apply, the transaction must meet one or more of the following conditions:

1. Condition A - Land is acquired with the main purpose or one of the main purposes to realise a profit or gain on disposal
2. Condition B - Property deriving its value from land is acquired with the main or one of the main purposes to realise a profit or gain on disposal
3. Condition C - Land is held as trading stock
4. Condition D - Land is developed with the main or one of the main purposes to realise a profit on disposal of the developed land.

**Who do they apply to?**

Individuals, companies, partnerships or trusts are all caught under these provisions (including people or entities who are not UK resident).

**Are there any exceptions?**

The government accept that these provisions are widely drafted and have stated two main occasions when these provisions won't apply:

1. On sale of a person's main residence which is eligible for Principal Private Residence Relief
2. On any transaction where an Income Tax or Corporation Tax charge already arises.

The provisions should not catch disposals of investment properties acquired to generate rental income.

**When should you consider these provisions?**

These provisions should be considered on <u>all</u> disposals of UK land where a taxpayer is not disposing of their main home.

Where there has been a change in intention, the property should be valued at the date the intention changed. Any period qualifying for capital treatment will be taxed as a capital gain and the profits relating to the development period will be subject to income tax.

**Is there a clearance procedure?**

There is no formal clearance procedure but an application can be made under the non-statutory clearance procedure where a taxpayer has genuine uncertainty.

**MARKING GUIDE**

| TOPIC | MARKS |
|---|---|
| Defining Transaction in UK Land:<br>Designed to catch profits from disposal of UK land<br>Includes buildings, structures and similar immoveable property<br>Profit motive | ½<br><br>½<br>½ |
| Explaining how land sales are taxed:<br>Capital<br>Trading profit<br>Provisions<br>Losses | ½<br>1 (½ for tax and ½ for NI)<br>½<br>½ |
| Conditions:<br>Stating all four conditions | <br>2 (½ for each condition) |
| Who it applies to:<br>Should be considered on all disposals from 6 July 2016<br>Also applies to non-residents | <br>½<br>½ |
| Exceptions:<br>Main residence<br>Other tax charge<br>Not designed to catch investment properties<br>Change of intention | <br>½<br>½<br>½<br>1 |
| Clearance:<br>Can apply for non-statutory clearance | <br>½ |
| **TOTAL** | **10** |

**ANSWER 3**

To: Mike Carter
From: Tax Manager
Date: 10 May 2019
Subject: Capital Gains

Dear Mike

Thank you for your e-mail dated 1 May 2019.

I set out below the current position for each of your holdings if you were to sell them this tax year.

Lemon VCT

Your investment in Lemon VCT is currently standing at a loss. Providing the company was an approved VCT company both at the date you acquired the shares and when you dispose of them, any gain is exempt from Capital Gains Tax (CGT). However any loss arising on a disposal would be exempt. There would therefore be no tax consequences on the sale of your shares in Lemon VCT.

Orange Ltd – EIS

Your investment in Orange Ltd is currently standing at a gain of £50,000. As you have complied with all of the conditions required for an EIS investment, this gain will also be exempt from CGT.

When you invested in Orange Ltd however, you deferred £50,000 of the gain on the sale of your trading company into these shares and this deferred gain will now come back into charge. Although the shares would have qualified for Entrepreneurs' Relief (ER) if you had not deferred the gain, as you sold your original shares before 3 December 2014, you will not now be able to claim ER on the gain which comes back into charge. You will therefore have a capital gain of £50,000 less your annual exemption, chargeable at 20%.

Grape Ltd – EIS

Your investment in Grape Ltd is currently standing at a loss of £55,000. Unlike VCT losses, this loss will be an allowable loss, although we need to adjust for the original Income Tax relief you received as follows:

| | | |
|---|---|---|
| | £ | £ |
| Sales proceeds | | 15,000 |
| Original cost | 50,000 | |
| Less: Income Tax relief on investment | -15,000 | |
| Allowable cost | | 35,000 |
| Loss on disposal | | 20,000 |

You have two options with this loss. You can either use it to reduce your other capital gains in the year, which would save CGT at 20% (£4,000). Alternatively you can make an election to set this loss against your total income for the year of disposal, or the previous year and reduce your Income Tax liability. This would save income tax at 40% (£8,000) in the current year, so would be the more valuable option.

Your deferred gain on the sale of shares in your trading company of £50,000 will also come back into charge.

Lime Ltd – SEIS

Again you have a loss on this investment, totalling £10,000. However, as you received Income Tax relief at 50% when you made this investment, your allowable cost for Capital Gains Tax on the original investment is reduced from £60,000 to £30,000, so there is no allowable loss in this instance as this is less than the current value of the investment. However a chargeable gain will not arise on the disposal of these shares.

When you invested in Lime Ltd, you claimed SEIS relief on the gain on the disposal of your painting. This would have exempted 50% of the capital gain and this gain will not come back into charge when the SEIS shares are sold.

In summary, if you sell everything, you will have capital gains coming back into charge of £100,000. From this, you can deduct your annual exemption of £11,700, leaving Capital Gains Tax payable at 20% on £88,300, giving a total CGT liability of £17,660.

You will, however, save income tax of £8,000 by offsetting the loss on disposal of Grape Ltd against your Income Tax liability this year, so the net tax cost if you sell all of your shares would be £9,660.

You could save further CGT by transferring the shares in Orange Ltd to Cathy before selling them. As you are married this transfer would be on a no gain no loss basis for CGT. The deferred gain on the shares in your trading company would be transferred to Cathy and will be taxable on her when she sells the shares in Orange Ltd. This would not only mean that you can both claim an annual exemption against your gains, saving £2,340 of CGT (£11,700 at 20%), but Cathy would also only pay CGT at 10% on most of the gain as she is not a higher rate taxpayer, saving a further £3,450 of tax overall (£34,500 x (20 – 10)%).

Your total CGT bill would therefore be £11,870. If we deduct the Income Tax saving of £8,000 this gives a total tax cost of £3,870.

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

Regards

Tax Manager

**MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| Presentation and higher skills | 1 |
| VCT loss not allowable | 1 |
| EIS gains exempt if conditions met | 1 |
| Deferred gain back into charge | 1 |
| ER not available as sold pre 3/12/2014 | 1 |
| EIS loss allowable | 1 |
| Adjust for income tax relief given | 1 |
| Calculate correct allowable loss on Grape Ltd | 1 |
| Can offset against other gains | 1 |
| Or can elect to offset against income tax | 1 |
| Lime Ltd – no allowable loss after adding back IT relief given | 1 |
| Gain on painting is exempt so does not come back into charge | 1 |
| Calculate CGT liability | 1 |
| Transfer Orange Ltd shares to Cathy would give extra annual allowance | 1 |
| And would save tax at 10% on most of the gain | 1 |
| **TOTAL** | **15** |

**ANSWER 4**

**Notes for client meeting**

**Sale of the business**

Following the disposal of the company assets Robert can wind the company up and withdraw the cash from the company as a final distribution. The tax treatment will depend on how the company is wound up.

As all of the liabilities will have been paid and the company will just have a cash balance, Robert could apply to Companies House and apply to have the company struck off on an informal basis. Costs associated with this would be minimal, however, as the company has more than £25,000 of reserves, any final distribution will be treated as a dividend and income tax will be payable at dividend rates.

As an additional rate taxpayer, Robert would have a tax liability of £190,500 on a dividend of £500,000 (assuming his dividend allowance has already been used elsewhere).

Alternatively, Robert could choose a Members Voluntary Liquidation (MVL). For this, he will need to appoint a qualified liquidator, which is likely to cost several thousand pounds. The advantage of this route would be that the resulting distribution will be a capital gain rather than an income distribution, and Capital Gain Tax rates will apply.

Because Robert's company has been a trading company and he has owned the shares and been a director of the company for more than 1 year, the disposal would qualify for Entrepreneurs Relief (ER),

This will mean that the rate of tax will be just 10%, giving rise to a tax liability of £49,400 (W3). This gives a substantial saving when compared to the tax liability if he chooses the informal option of £190,500 (see above).

**House**

The sale of the house and garden will not attract a Capital Gains Tax charge as any gain will be covered by Principal Private Residence relief. The full proceeds would be exempt.

**Yard**

The yard will not qualify for PPR relief as it is not part of the garden, and has been used exclusively for business purposes throughout the period of ownership. However, as the yard has been used in the business since purchase, if the disposal of the yard is made after the disposal of the business and in association with his withdrawal from the business, this could be an associated disposal for ER purposes. To qualify it must be sold within 3 years of the business disposal and not be put to any other use prior to the sale. Although there will be a chargeable gain on the disposal, Robert will be able to claim ER on part of the gain.

ER will not be available on the full gain as Robert has received rent from the company since April 2008. The gain will need to be split between that which is eligible for ER and that which is not (W2)

**Proposed self-employment**

Robert needs to take great care if he is considering running a new fast food business on a self-employed basis. A targeted anti-avoidance rule (TAAR) was introduced in April 2016 to prevent shareholders from winding up their company to extract profits as a capital distribution and to then operate the same activity from a new business.

If the TAAR applies, the distribution on the winding up of Best Burger Ltd will be reclassified as a dividend, and the higher rates of tax will be due.

The TAAR will apply if four conditions are met. The first two already apply - Robert owns at least 5% of the share capital, and the company is a close company.

The third condition is that the recipient of the distribution carries on a trade similar to that of the wound up company within two years of the distribution. The final condition is that it is reasonable to assume that the main (or one of the main) purposes of the winding up was to reduce tax liabilities. There is no formal clearance procedure, so we cannot check with HM Revenue and Customs to see if they believe the rules would apply and there would be a requirement for Robert to self assess this liability.

Given the amount of tax at stake, I would advise great caution, and would suggest that Robert should not undertake any such activities for a period of at least two years.

**W1 CGT payable**

| | | Gains eligible for ER | Gains not eligible for ER |
|---|---|---|---|
| | £ | £ | £ |
| Sale of yard – proceeds | 1,625,000 | | |
| Original cost | (75,000) | | |
| Cost of office addition | (25,000) | | |
| | ------------- | | |
| Gain | 1,525,000 | | |
| Rent restriction (W2) | (438,438) | | 438,438 |
| | ------------- | | |
| Gain eligible for ER | 1,086,562 | 1,086,562 | |
| | ======= | | |
| Gain on disposal of company (W3) | | 494,000 | |
| Annual exemption | | | (11,700) |
| | | ------------- | ----------- |
| Liable to CGT | | 1,580,562 | 426,738 |
| | | ======== | ====== |
| Tax payable at | 10% | 158,056 | |
| | 20% | ====== | 85,348 |
| | | | ===== |
| Total CGT payable | 243,404 | | |
| | ====== | | |

**W2 Rent Restriction**

| | |
|---|---|
| Period of ownership since April 2008 | 11.5 years |
| Total period of ownership | 20 years |
| 50% rent paid | |
| Gain on sale of yard before restriction | £1,525,000 |
| | ======== |
| Rent restriction – 11.5/20 x 50% | £438,438 |
| | ======= |

**W3 Gain on disposal of company**

| | |
|---|---|
| | £ |
| Cash within the company | 500,000 |
| Costs of MVL – estimated | (5,000) |
| | ---------- |
| Cash available for distribution | 495,000 |
| Original cost of shares | (1,000) |
| | ----------- |
| Gain eligible for ER | 494,000 |
| | ====== |

**MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| Distribution on informal dissolution will be taxed as a dividend | 1 |
| Calculation of approximate income tax liability on this dividend | 1 |
| MVL - need to use qualified liquidator, more costly | 1 |
| But resulting gain will be liable to CGT | 1 |
| Conditions for ER to apply – Robert qualifies | 1 |
| Calculation of gain on disposal of company (candidates will not be penalised if they do not deduct potential MVL costs) | 1 |
| Gain on house covered by PPR relief | 1 |
| Sale of yard will be associated disposal for ER | 1 |
| Conditions for associated disposal | 1 |
| ER will be restricted as rent charged | 1 |
| Calculation of gain on sale of yard | 1 |
| Calculation of rent restriction | 1 |
| Allocation of annual exemption against non ER gain | 1 |
| Calculation of CGT at ER rates | 1 |
| Calculation of CGT at standard rates | 1 |
| Possibility of TAAR applying | 1 |
| must not carry on similar trade within 2 years | 1 |
| Main purpose is to reduce tax liabilities | 1 |
| No formal clearance | 1 |
| Conclusion | 1 |
| **TOTAL** | **20** |

**ANSWER 5**

Notes for Julie Smith's Meeting with Mr Blake
May 2019

Mr Blake will prepare his rental accounts using the accruals basis rather than the cash basis as his gross rental income exceeds £150,000 per annum.

Oak Lane

The electrical work, decorating and shower replacement expenses incurred by Mr Blake would usually be an allowable deduction unless there was any element of improvement. However, if the flat was not fit for purpose on purchase the cost will not be allowable. This is a principle established by the case of *The Law Shipping Co Ltd v CIRs*
[1923] 22 TC.

One-third of the rent received on 1 April will be taxable in the year ended 5 April 2019. The balance relates to April and May 2019 and will be taxable in the year ended 5 April 2020.

As the property is mixed-use, the mortgage interest and fees must be apportioned on a just and reasonable basis between the commercial and residential income. In this case a fifty/fifty split would appear reasonable.

The fees are allowable but they need to be accrued over the mortgage term.

The interest and fees relating to the commercial element of the property will be allowable in full as a deduction from the rent.

The interest and fees relating to the residential element will be restricted. For the year ended 5 April 2019 50% of the expenditure can be claimed via the accounts. The remaining 50% will only qualify for basic rate tax relief. A basic rate reduction will be available on the lower of:

a) the finance costs subject to restriction;

b) the net property income for the year (less any losses brought forward); or

c) adjusted total income (being total income less any savings income, dividend income and available personal allowance).

If the amount eligible for relief is less than the amount of interest and fees actually paid, the balance can be carried forward for use in a future tax year.

Blossom House

Mrs Blake will not be able to declare all of the income from this property on her tax return. Nor will she be able to declare 70%. Income from property owned jointly by married couples is treated for tax purposes as beneficially owned by them in equal shares, even if they own the property in different proportions.

Where a couple are beneficially entitled to the income in unequal shares, they can opt to have their income taxed in accordance with their entitlement by submitting a Form 17 to HM Revenue and Customs, together with evidence of beneficial ownership.

The form must be signed by both spouses and submitted within sixty days of signature.

Income from the property will be split in the new way from the date the form was signed.

It would make sense for the couple to file this election bearing in mind their individual income levels.

Alternatively, the couple may wish to consider transferring the whole of this property, together with some of Mr Blake's other properties into his Mrs Blake's name or into joint names. This will enable them to benefit from Mrs Blake's lower tax rates. There would be no capital gains tax consequences of this, as transfers between spouses are at no gain/no loss.

Ash Crescent

The expenditure has to be restricted to the amount of rent that Mr Blake received from his brother, as the property is not being rented on an arms-length basis. No tax relief is available on the amount of expenses that exceed the rent received.

Ceramics Factory

The loan for this property is secured on Mr Blake's own home, but tax relief will still be available for the proportion of the interest that relates to the funds that were used to purchase the factory.

Mr Blake can submit an amended self-assessment tax return for the year ended 5 April 2018 at any time up to 31 January 2020.

For the two earlier years he will need to submit overpayment claims. The deadline for the submission of an overpayment claim is four years from the end of the tax year that the claim relates to.

If you require any further information please let me know.

Tax Manager

**MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| Reason why rent is on accruals basis | ½ |
| Decorating/electrical work/new shower usually allowable unless element of improvement | ½ |
| Expenditure on flat not allowable unless fit for purpose when purchased | ½ |
| Amount of rent taxable in 2018/19 | ½ |
| Interest & fees split between commercial & residential on a just & reasonable basis | 1 |
| Mortgage fees are allowable & need to be accrued over the mortgage term | 1 |
| Commercial element of interest & fees allowable in full | ½ |
| Treatment of residential element of interest and fees | 2 |
| Married couple taxed on rent 50/50 regardless of beneficial ownership | 1 |
| Can opt to be taxed in accordance with beneficial ownership | ½ |
| Form 17 process | 1½ |
| Reason why Form 17 would benefit the Blakes | 1 |
| Could transfer Mr Blake's share of Blossom House to Mrs Blake so that she can declare 100% of the rents | ½ |
| Could transfer other properties to Mrs Blake to save tax overall | ½ |
| Transfer of properties between spouses is at no gain/no loss | ½ |
| Ash Crescent expenses restricted to amount of rent received | 1 |
| Interest on funds for factory purchase allowable even though loan secured on own home | ½ |
| Can amend 2018 SATR and deadline for this is 31 January 2020 | 1 |
| Ability to submit overpayment claims for earlier years & deadline | 1 |
| **TOTAL** | **15** |

**ANSWER 6**

| | Non-Savings | Interest | Dividends |
|---|---|---|---|
| | £ | £ | £ |
| **Employment Income** | | | |
| Salary | 92,188 | | |
| Taxable benefits: | | | |
| Car (W1) | 1,200 | | |
| Fuel card (W2) | 1,462 | | |
| General expense allowance (W3) | 1,400 | | |
| Childcare vouchers (W4) | - | | |
| Gift of sink (W5) | 1,000 | | |
| **Dividend Income** | | | |
| UK dividends | | | 5,000 |
| **Foreign Income** | | | |
| French bank interest | | 10,000 | |
| French dividends | | | 4,000 |
| Total Income | 97,250 | 10,000 | 9,000 |
| Less: Personal Allowance (W6) | (4,225) | | |
| Taxable Income | 93,025 | 10,000 | 9,000 |

| | |
|---|---|
| Earned income (Scottish income tax rates) | |
| 2,000 @ 19% (W7) | 380 |
| 11,150 @ 20% (W8) | 2,230 |
| 19,430 @ 21% | 4,080 |
| 60,445 @ 41% | 24,782 |
| 93,025 | |
| Savings and dividend income (UK income tax rates) | |
| 500 @ 0% (W9) | Nil |
| 9,500 @ 40% | 3,800 |
| 2,000 @ 0% | Nil |
| 7,000 @ 32.5% | 2,275 |
| 112,025 | |
| Tax Liability | 37,547 |
| Less: | |
| PAYE | (30,475) |
| Foreign tax credit (W10) | (600) |
| Tax Due | 6,472 |

**Workings and explanations**

**Working 1 Company car**

- The relevant percentage is 25%
- The modified cash equivalent is £1,750 (£28,000 x 25% x 3/12). The initial contribution is ignored.
- The amount foregone in respect of the benefit is £1,800 (£600 x 3).
- The amount foregone is higher and is therefore used to calculate the company car benefit.
- The deduction in respect of the capital contribution is £600 (£2,400 x 25%).
- The company car benefit for 2018/19 is £1,200 (£1,800 - £600)

**Working 2 Fuel card**

- The cash equivalent is £1,462 (£23,400 x 25% x 3/12).
- The cash allowance foregone is £600 (£200 x 3).

- The cash equivalent is higher, so this figure is used for the fuel benefit.

**Working 3 General expense allowance**

- A round sum allowance which is spent partly on non-qualifying expenditure is taxable but deductions are made where the sum is spent on qualifying expenses.
- The professional subscription costs and business travel costs are allowable deductions.
- Non-business client entertainment is not wholly, exclusively and necessarily incurred for the purposes of the employment so is disallowed.
- The coat is disallowed. Clothing has a duality of purpose as it provides warmth and decency.
- Taxable allowance is £1,400 (£2,500 - £900 - £200)

**Working 4 Childcare Vouchers**

For higher rate taxpayers the maximum monthly exempt limit is £124. Alexa receives fewer than the maximum monthly limit and therefore the childcare vouchers are an exempt benefit.

**Working 5 Sink**

- Use the value of the sink at the date it was gifted, £1,000.

**Working 6 Personal allowance restriction**

| | £ |
|---|---|
| Net income | 116,250 |
| Less: Gross gift aid donation (800 x 100/80) | (1,000) |
| Adjusted net income | 115,250 |

Available personal allowance:

| | £ |
|---|---|
| Personal allowance | 11,850 |
| Less: Reduction ½ (ANI – 100,000) | (7,625) |
| | 4,225 |

**Working 7 Scottish Income Tax rates**

- The Scottish Income Tax rates apply to Alexa's non-savings and non-dividend income because she lives in Scotland.
- The UK Income Tax rates apply to Alexa's savings and dividend income.

**Working 8 Charitable Contributions**

- The £300 cash is gifted during the year.
- The £500 cash donation is gifted after the end of the tax year but an election can be made to carry it back to the 2018/19 tax year. The election should be made on the tax return.

| | £ |
|---|---|
| Amount of income taxed at Scottish basic rate | 10,150 |
| Add: gross donation £800 x 100/80 | 1,000 |
| | 11,150 |
| | |
| Amount of income taxed at Scottish intermediate rate | 19,430 |

**Working 9 Savings Rate**

Alexa's taxable income exceeds the Scottish basic rate band and therefore the savings allowance is £500.

**Working 10 Foreign tax**

Alexa can deduct the smaller of the foreign tax paid of £600 or the UK tax due on the foreign dividends.

The UK tax due is calculated as if the French dividends were the 'top slice' of Alexa's income. UK tax due is clearly higher than the foreign tax paid.

The foreign tax paid is less than the UK tax due so this figure is used.

**MARKING GUIDE**

| **TOPIC** | **MARKS** |
|---|---|
| Alexa is a Scottish taxpayer, | 1 |
| Car benefit - calculation of modified amount | 1 |
| Car benefit - calculation of foregone amount and determination that it is used to calculate benefit | 1 |
| Car benefit - calculation of benefit including treatment of capital contribution | 1 |
| Cash equivalent used for fuel benefit | 1 |
| Calculation of fuel benefit | 1 |
| General expense allowance taxable | 1 |
| Professional subscriptions and travelling expenses allowed | 1 |
| Coat disallowed | 1 |
| Client entertainment disallowed | 1 |
| No tax on childcare vouchers | 1 |
| Correct sink benefit value | 1 |
| Adjusted net income | 1 |
| Personal allowance restriction calculation | 1 |
| Correct total liable to income tax | 1 |
| Carry back election for charitable contributions | 1 |
| Gross up gift aid contribution | ½ |
| Extend Scottish basic rate band | ½ |
| Personal savings allowance restricted | ½ |
| Scottish rates applied to earned income | ½ |
| UK rates applied to savings and dividend income | ½ |
| Correct tax liability | 1 |
| Foreign tax credit | ½ |
| **TOTAL** | **20** |