THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Individuals

TIME ALLOWED
3 HOURS 30 MINUTES

- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

  You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

  You will be assessed for competence in a number of broad topics for the following skills:
  - Identification and Application
  - Relevant Advice and Substantiated Conclusions

  For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- 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, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax manager in a firm of Chartered Tax Advisers, ClearTax LLP. You support the personal tax partner, Paul Smith. Clients of your firm, Julian Wood and his wife Olivia, retired a few years ago and currently live in their UK home. They also own a property in France.

Julian did not claim his UK state pension when he reached pension age because he had no immediate need for the additional income. Your firm set out the UK Income Tax implications of such a decision in a email provided in February 2015 (**EXHIBIT A**). As a result of the deferral, a lump sum has accrued which is payable when he claims his state pension as an alternative to higher weekly payments. The rules outlined in the letter remain unchanged for individuals who reached state pension age before 6 April 2016.

Julian and Olivia have decided that they wish to go on an eight month world cruise commencing on 6 October 2021 at a cost of £62,000 per person, which includes spending money. Immediately thereafter they will move to Italy, where they intend to live for at least three years and potentially permanently. They intend to rent initially while they find somewhere to buy, with a budget of approximately £400,000 for the property purchase. If they decide after three years that they are not enjoying life in Italy, they will return to the UK.

They are considering how to fund the cruise and the property purchase, and options include liquidating some or all of their assets and claiming Julian's state pension lump sum.

The following exhibits are provided to assist you:

EXHIBIT A: Email to Julian Wood on the taxation of his deferred state pension lump sum

EXHIBIT B: Letter from clients with information on jointly-held properties and Julian's state pension

EXHIBIT C: Extract from the UK-Italy Double Tax Agreement

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report addressed to Julian and Olivia Wood advising on how they might fund the world cruise and the Italian property in such a way which minimises their UK tax exposure. You are not required to comment on any tax implications in France or Italy.

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Continuation

EXHIBIT A

Email to Julian Wood on the taxation of his deferred state pension lump sum

To: Julian Wood
From: Paul Smith, ClearTax LLP
Date: 10 February 2015
Subject: State pension deferral

Dear Julian

I am pleased to set out below the UK Income Tax implications of choosing to defer your UK state pension.

You are due to reach state pension age on 6 April 2015. At this point, you have a choice of whether to claim your state pension or defer it until some later point. If you choose to defer, when you eventually make the claim for your pension you will have a choice of either higher weekly payments or – if you defer for at least 12 months – a one-off lump sum. The amount of the lump sum will be equivalent to the state pension unclaimed in the deferral period, plus interest.

If you choose the lump sum, by default it will be taxable in the tax year in which the date of the first benefit payment falls. This will usually be the same tax year in which you claim. However, at the point of claim you may elect, within a month, to delay receipt of the lump sum until the start of the following tax year.

The tax payable on a deferred state pension lump sum is at a flat rate, irrespective of the amount of the lump sum and whether or not you are resident in the UK. The rate of tax depends on the amount of other taxable income, as follows:

1) If your other taxable income is less than your personal allowance, the lump sum is taxed at 0%.

2) If your other taxable income is more than your personal allowance but less than the higher rate threshold, the lump sum is taxed at the basic rate (currently 20%).

3) If your other taxable income is more than the higher rate threshold but does not exceed the additional rate threshold, the lump sum is taxed at the higher rate (currently 40%).

4) If your other taxable income is more than the additional rate threshold, the lump sum is taxed at the additional rate (currently 45%).

It is important to bear in mind that your 'other taxable income' will include income which is taxed at 0%. For example, on 6 April 2015 the 10% starting rate for savings will be abolished and replaced by a 0% starting rate. If you have savings income which falls within the new starting rate, then you will need to consider it when you are determining the rate of tax payable on the lump sum.

In the event that you wish to claim your state pension lump sum, we recommend that you seek advice so that we can advise accordingly on how the above rules will be applied to you in light of your circumstances and the tax rates and thresholds in force at the point of claim.

I hope the above is helpful.

Kind regards

Paul Smith
ClearTax LLP

Continued

Continuation

EXHIBIT B

Letter from clients with information on jointly-held properties and Julian's state pension

Paul Smith
ClearTax LLP
11 Market Street
Biggleswade
Bedfordshire
SG18 2TP

Mulberry Lodge
Oak Avenue
Biggleswade
Bedfordshire
SG18 5RZ

1 November 2020

Dear Paul

Information on jointly-held properties and Julian's state pension

Further to our recent discussions, we are writing to provide some additional information about our two properties so you can consider the tax implications we might face as and when we sell them.

When we purchased Mulberry Lodge, it was in a state of disrepair. We spent £100,000 in order to make the property habitable and we moved into the property three years later. We understand from our discussions that, prior to us moving in, the property did not qualify as our main residence for Capital Gains Tax purposes.

Unfortunately, as a result of cost overruns and a recent downturn in the UK property market, selling our UK home today would result in a loss. Therefore, we would prefer to delay the sale of Mulberry Lodge until after June 2023 in order to benefit from an expected increase in market value after a new train station is opened nearby. In the meantime, we have been advised the property has a rental value of £1,000 per calendar month so we will let it out. We are not interested in re-occupying the property in the event we return to the UK as we would prefer to live in Cornwall, so it is likely we will sell it eventually in any case.

As you are aware, we also own a property in France, Villa les Roses, which we use as a holiday home and which is unoccupied at other times. It will be unoccupied while we are on our cruise and we do not intend to use this while in Italy.

Both properties are owned outright and in equal shares.

After considering the implications set out in your letter in 2015, Julian did not claim his state pension when he reached retirement age because he continued to work for a further two years. Thereafter we considered his dividend income and my pension sufficient to live on so it remains unclaimed. We don't think we'll need any more income on which to live when we move to Italy.

We have received a valuation from the Department for Work & Pensions showing that if Julian were to start taking his state pension now, he could receive a lump sum of £42,000 as a result of the deferral. The pension would then be £130 a week. We have decided we would prefer to take the lump sum rather than higher weekly payments.

Should you require any further information, please let us know.

Yours sincerely

Olivia Woods

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Continuation

EXHIBIT C

Extract from the UK-Italy Double Tax Agreement

ARTICLE 4
Fiscal domicile

(1) For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that Contracting State only if he derives income from sources therein.

(2) Where by reason of the provisions of paragraph (1) of this Article an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests);

(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he has no permanent home available to him in either Contracting State, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;

(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

(3) Where by reason of the provisions of paragraph (1) of this Article a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.

ARTICLE 18
Pensions

(1) Subject to the provisions of paragraph (2) of Article 19 of this Convention [Government Service], pensions and other similar remuneration paid in consideration of past employment to a resident of a Contracting State and any annuity paid to such a resident shall be taxable only in that State.

(2) The term "annuity" means a stated sum payable periodically at stated times during life or during a specified or ascertainable period of time under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

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ARTICLE 22
Other income

(1) Items of income of a resident of a Contracting State, wherever arising, other than income paid out of trusts or the estates of deceased persons in the course of administration, which are not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

(2) The provisions of paragraph (1) of this Article shall not apply to income, other than income from immovable property as defined in paragraph (2) of Article 6 of this Convention [Income from immovable property], if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case, the items of income are taxable in that other Contracting State according to its own law.

Continued

Continuation

EXHIBIT D

Pre-seen information

Extracts from permanent file

Client

Name:	Julian Woods
Date of birth:	6 April 1950
Place of birth:	Truro, UK
Address:	Mulberry Lodge, Oak Avenue, Biggleswade, Bedfordshire, UK
UK resident:	Yes
UK domiciled:	Yes
Occupation:	Retired teacher

Name:	Olivia Woods
Date of birth:	1 June 1952
Place of birth:	Lyon, France
Address:	Mulberry Lodge, Oak Avenue, Biggleswade, Bedfordshire, UK
UK resident:	Yes (since 6 April 2014)
UK domiciled:	No
Occupation:	Retired interpreter

Date of marriage:	21 March 2015 (no previous marriages)
Children:	None

Jointly-held property

Mulberry Lodge, Oak Avenue, Biggleswade, Bedfordshire, UK.

Purchase date:	November 2015
Cost:	£250,000
Market value:	£280,000

Villa les Roses, Rue des Fleurs, 03200 Vichy, France.

Purchase date:	June 2016
Cost:	£200,000
Market value:	£300,000

Income and other assets

Julian has a shareholding of 5,000 shares in Unoteq plc which have a total market value of £350,000 and a base cost of £150,000.

The annual dividend yield on this shareholding is approximately 4%, which currently represents Julian’s only income.

Olivia has no income other than a French social security pension equal to £10,000 per annum.