Institution **CIOT - ATT-CTA**
Course **CTA APS Taxation of Individuals**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**2947**	**13799**	**16954**
Total	**2947**	**13799**	**16954**

Answer-to-Question-_1_

REPORT

From: Tax advisers
To: Julia Anderson
Date: 5 May 2021
Subject: Tax advice

Introduction

This report considers the issues set out in your e-mail dated 30 April 2021.

This report has been prepared for an is addressed to Julia Anderson and is intended for use by her only. No responsibility is accepted for any reliance placed on the contents of this report by third parties.

Contents

Abbreviations

IT: Income tax
CGT: Capital gains tax
SDLT: Stamp duty land tax
HICBC: High income child benefit charge

IHT: Inheritance tax
NICs: National insurance contributions.

Executive summary

- We recommend that you provide Steven with the funds to purchase the Coventry property in his own name. This will save stamp duty on the purchase of £10,000.

- Steven will also be able to claim rent-a-room relief on the rental income from the rooms. This deducts £7,500 from the rental profit in lieu of expenses and reduces the taxable amount to below his personal allowance so no income tax will be payable on the rent.

- This will save you income tax at approximately 59%.

- You should not stay at the Coventry property for more than 2 weeks a year.

- You should allow your employer to continue to pay for your hotel accommodation, instead of taking the round sum allowance. This will save income tax and NICs of £3,597 on the allowance, and also bring in an additional £6,000 of rental income.

- You should ensure that Orchard Road meets the conditions for a furnished holiday let.

- You should then secure the mortgage against Orchard Road in order to obtain tax relief from the interest payments. The saving will be £2,000 per year.

- As a furnished holiday let, Orchard Road will also qualify for business asset relief on disposal which will save £25,000 in capital gains tax on the eventual sale.

Main report

A) Tax planning and structuring

A1) High income child benefit charge (HICBC)

You are currently a basic rate tax payer because your income is below the £50,000 threshold. You are subject to tax at 20%.

You are also in receipt of child benefit payments. The child benefit payments for Steven will cease on 1 September 2021 when he attends university.

The child benefit that you will receive in total for 2021/22 is £1,906 (appendix 3), after taking account of the fact that the payments you receive for Steven will cease mid-way through the year.

Child benefit payments are clawed back by the Government if one parent earns over £50,000 per year.

The amount of benefit clawed back is calculated as 1% for every £100 earned over £50,000. Therefore if your income reaches £60,000 it will be clawed back in full.

As a result, for every £100,that your income exceeds £50,000, your effective rate of tax will be 40% plus the HICBC at 19%. Being 59% in total.

It is therefore advisable for you to try and keep your income levels below the £50,000 threshold.

The most advisable way to do so would be to ensure that the income from the Coventry rentals is not assessable on you, as outlined below.

A2) Purchase of 7 High Street, Coventry

You are in the process of purchasing a new property in Coventry.

If you purchase the property directly, you will be subject to the 3% surcharge on stamp duty for 2nd home owners. The total stamp duty on purchase will be £10,000 (appendix 3).

Alternatively, if Steven were to purchase the property, he would benefit from first time buyer's relief. Because the property has a market value below £300,000, there would be no stamp duty to pay and a saving of £10,000.

If Steven were the property owner, and because he is over 18, the income from the rented rooms would be assessable on him, rather than you.

This would make the most of his unused personal allowance (£12,500).

Furthermore, as he will be living at the property, he can claim rent-a-room relief of £7,500 against the rental income received.

Rent-a-room relief can be claimed in place of actual expenses. It is claimed when an individual rents a room in their home (being their only or main residence).

You would not qualify for rent-a-room relief because the Coventry property would not be your main residence.

If you were to assess the income on your own tax return, the tax on you would be £12,000 - 3,000 @ 59 % = £5,310 for the rental of two bedrooms. Or £8,187 if 3 rooms are rented (per appendix 2).

If the income is assessed on Steven, then after rent-a-room relief, the maximum profits would be £10,500 which would fall entirely within his personal allowance, so no tax would be payable.

I would recommend this as a better way of saving money for Steven and an alternative to charging him market rent for the room. If you did charge him rent, it would be taxable on you as income and result in tax leakage and a loss of child benefit at an effective rate of 59%.

However, if Steven does purchase the property himself, the rental income received will be his. This may not be ideal if he cannot manage money. Perhaps the income can be paid into your bank account, which he does not access until after he graduates.

Conclusion: From a tax perspective, it will represent a £10,000 saving on SDLT and a significant saving on your personal income tax/child benefit charge if the Coventry property was purchased by Steven directly.

We therefore recommend that Steven purchases the property and declares the income on his own return via self-assessment.

Steven will need to register for self-assessment by 5 October 2022 if income will be received in 2021/22.

A3) Inheritance tax considerations

From an IHT perspective, if you transfer the funds to Steven to buy the property, it will be a potentially exempt transfer ("PET").

It will not be chargeable to tax unless you should die within 7 years of the gift.

However, you should take note of the pre-owned asset tax ("POAT") rules, whereby a charge to income tax could arise if you retain beneficial use of the property.

Beneficial use could be considered staying at the property for more than 2 weeks a year.

The POAT charge would be based on the annual rental value of the land (assuming £500 per month for a room), you would be subject to income tax on £6,000 if you continued to use the room. Tax at 20% would be £1,200.

Alternatively, you could elect for the property to remain within your estate for IHT purposes - under the gifts with reservation of benefit rules. It would be taxable at 40% when you die.

Conclusion: Assuming that Steven purchases the property using the funds which you provide for him, you should not use the property regularly (more than 2 weeks a year), to avoid a POAT charge.

If you do choose to stay at the Coventry property, we advise that you elect for the property to fall within the gift with reservation of benefit rules ("GWROB"), so that no immediate charge to tax arises.

<u>B: Round sum allowance or additional rental income</u>

Currently your employer pays for your hotel and travel costs when you work one week a month in Coventry.

You have the option of claiming an allowance of £6,000 and staying in a room in the new Coventry property, or receiving

£6,000 in rent from that room and allowing your employer to continue paying for a hotel.

<u>B1) Round sum allowance and you occupy a room in Coventry</u>

If your employer were to pay you a round sum allowance, this would count as taxable earnings.

The amount would be subject to income tax at your marginal rate.

It would also be subject to national insurance (NICs) at 12%.

The income tax and NIC charge would be £3,597 (appendix 1), assuming that you have no further income because the rental income from the rooms is declared under Steven's tax return.

The loss of income would be £6,000 for Steven as you would be occupying the additional room, plus you would be subject to the GWROB rules.

If your work in Coventry is for limited duration, the travel expenses reimbursed by your employer will not be taxable up to the first 10,000 miles travelled because they are reimbursed within the 45p deductible amount allowed by HMRC.

The deduction is allowed because you spend less that 40% of your working time in the Coventry office, so it is not considered part of your normal commute.

Beyond this point, HMRC's mileage rate reduces to 25p per mile, so if your employer reimburses you at 45p, the additional 20p per mile will be taxable.

Assuming you travel 100 miles each way, once a week, that is 10,400 miles a year.

Therefore a charge may arise on 400 miles at 20p = £80 at your marginal tax rate (59%). Tax £47.

However, if your Coventry work is not for a limited duration, then the deduction will not be allowable and the full reimbursement of 45p for 10,400 miles, will be taxable (£4,680).

Conclusion: If you take the round sum allowance, you will be subject to income tax and NICs on the payment. You will also begin to lose some of your child benefit.

Steven will also receive £6,000 less in rent per year.

<u>B2) Employer pays for hotel and Steven receives additional rental income</u>

The additional rental income received by Steven will be tax-free because of his personal allowance.

Also, the payment of your accommodation expenses by your employer will also be tax-free, because the expense is wholly, exclusively and necessarily incurred in the course of your employment duties.

No income tax or NICs will arise.

A small tax charge may arise, as above, on the mileage in excess of HMRC's allowable rate. Charge would be at 20% on £80 assuming your work in Coventry is temporary and you have no further income. Tax £16.

Conclusion: We recommend that you continue to allow your employer to pay for a hotel and do not stay at the Coventry property.

This will save NICs at 12%, plus income tax and a HICBC amounting to £3,597 on the round sum allowance.

It will also avoid the potential POAT charge (or ensure that the Coventry property remains outside of your estate for IHT).

C) Which property to mortgage and advice regarding Orchard Road

You are planning to take out a mortgage of £200,000 to pay towards the refurbishment of Orchard Road and the purchase of the Coventry property.

Per appendix 3, the interest charge that will arise on the mortgage will be £10,000 per year (£50,000) across 5 years.

C1) Orchard Road - mortgage and FHL conditions

If Orchard Road is rented on short-term lets to holidaymakers, it may qualify as a 'furnished holiday let' ("FHL").

In order to qualify as an FHL, it must meet the following conditions:

1) It is furnished
2) It is available for rent for at least 210 days in the year
3) It is actually let for at least 105 days in the year
4) Longer-term occupation (defined as a continuous period of at least 31 days), does not arise for more than 155 days in total.

If Orchard Road qualifies as an FHL in the first year, but does not meet condition 3 in the second year, it is possible to make an election to treat the property as an FHL in the second (or third year if necessary), provided that there is a an intention to meet the letting condition.

We recommend that you ensure that the FHL conditions are met, because an FHL property has a number of advantages. The relevant ones being:

1) An FHL property can deduct mortgage interest in full against the income. However, please note that the mortgage must be wholly and exclusively for the purpose of the business.

2) Capital gains tax reliefs are available on the sale of the property (rollover relief, gift relief and business asset disposal relief ("BADR")).

3) Deductions against income are available for capital expenditure in respect of furniture, fixtures and fittings.

Therefore we recommend that the mortgage is obtained against Orchard Road in preference to the Coventry property. The reason is that full mortgage interest relief will be available.

If the mortgage was taken on the Coventry property, the tax relief would be in the form of a basic rate tax credit.

Because the Coventry income will be reported on Steven's return and will fall within his personal allowance, there will be no use for the basic rate tax credit.

Maximum advantage can be obtained if the mortgage is taken out on Orchard Road, as you can reduce your taxable income by the interest expense.

Assuming the mortgage is used entirely to re-furbish Orchard Road - and is therefore used for business purposes - the full expense can offset against your rental profits. Your rental profits will reduce from £7,000 per annum, to a loss of £3,000. The loss can be carried forward against future profits from Orchard Road.

The tax saving (per appendix 3), will be 20% on £10,000 which is £2,000 per year.

If the mortgage is taken against Orchard Road, the cost of the mortgage reduces from £50,000 over 5 years, to £40,000 because of the tax relief available.

Conclusion: We advise that you secure the mortgage against 2 Orchard Road.

C2) Orchard Road: Other considerations and advice

Assuming the property does qualify as a furnished holiday let, we recommend that you in fact purchase the furniture, rather than hire it.

This is because, as above, furnished holiday lets can obtain tax relief for expenditure on furniture, fixtures and equipment.

Therefore, on any amount that you spend you will receive a 20% tax credit.

It is also important to ensure that Orchard Road meets the FHL qualifying conditions that are outlined above because of the potential capital gains tax saving.

When the property is sold, it will give rise to a capital gain.

The expected gain (based on projected market values) is £250,000 (after deducting the renovation costs of £200,000).

In general, the gain on the sale of residential properties is taxable at 28% (tax charge would be £70,000).

However, if Orchard Road qualifies as an FHL, it is entitled to the following CGT reliefs:

1) Rollover relief (a deferral of the gain if another FHL property is purchased within 36 months of disposal); or

2) Gift relief (a deferral of the gain if the asset is gifted); or

3) Business asset disposal relief ("BADR") which is the ability to tax the gain at 18%, and save tax at 10% on the sale.

If you are looking to repay the mortgage following the sale of Orchard Road, then it is likely that you will not use gift relief or rollover relief.

Therefore BADR will be the most advantageous for you and will represent a saving of £25,000 in tax.

Your proceeds after paying the tax will be approximately £505,000. Which will leave you with £305,000 remaining after the mortgage has been repaid.

BADR needs to be claimed by the anniversary of 31 January following the sale of Orchard Road. We will assist you with this.

The CGT will be payable 30 days following the completion of the sale.

Conclusion: We recommend that you ensure the FHL conditions are met and that you make a claim for BADR on the eventual sale of Orchard Road.

We also recommend that the furniture is purchased, rather than hired, as this will work out cheaper in the long-run and it will also benefit from tax relief.

Appendix 1

Take round sum allowance and stay in Coventry room:

Rental income £6,000 * 2 =	£12,000
Less: expenses	(£3,000)
Rental profits	9,000

£500 * 12 = £6,000 annual round sum allowance.

Assuming existing income of £41,300 + £7000 = 48,300

Tax

Income in excess of £50k taxed at 40%, plus 19% high income child benefit charge (59%)

1,700 @ 20% = 340
7,300 @ 59% = 4,307
6,000 @ 59% = 3,540

NICs: 6,000 @ 12% = 720

Total: 8,907

If Steven receives rental income, charge on round sum:

1,700 @ 20% = 340
4,300 @ 59% = 2,537
NICs: 6,000 @ 12% = 720

Total 3,597

Appendix 2

Decline round sum allowance and rent additional Coventry room:

Tax on employer payments for accommodation/travel: Nil

Tax on rental income from 3 rooms:

Rental income £6,000 * 3 =	£18,000
Less: expenses	(£3,000)
Rental profits	15,000

Assuming existing income of £41,300 + £7000 = 48,300

Tax

Income in excess of £50k taxed at 40%, plus 19% high income child benefit charge (59%)

1,700 @ 20% = 340
13,300 @ 59% = 7,847

Total 8,187

NICs: nil

Appendix 3

Child benefit received in 2021/22

21.05*52 = 1,095
13.95*52 = 725
13.95*52/12/5 = 86

Total 1,906

High income child benefit charge results in additional effective tax rate of 19%.

Estimated future gain on 2 Orchard Road:

	£	
Proceeds	550,000	
Enhancement	(200,000)	
Cost	(100,000)	
Gain	250,000	
Tax 18%	45,000	(with business asset disposal relief)

Net proceeds: 505,000

Mortgage expense:

200,000*5% = 10,000 per year

Total across 5 years: £50,000

Tax saving at 20% = (10,000)

Cost after tax saving: £40,000

Stamp duty on purchase of 7 High Street Coventry:

If you purchase property directly:

125,000 @ 3% = 3,750
125,000 @ 5% = 6,250

Total 10,000

Stamp duty if Steven purchases the property:

250,000 @ 0% = 0