The Chartered Tax Adviser Examination

May 2017

Suggested answers

Taxation of Individuals

Advisory Paper

QUESTION 1

	Workings	Non-savings	Interest	Dividends
Employment income		90,000		
Offshore income gain	1	11,550		
Bank interest			200	
UK Dividends				2,500
German Dividends				10,000
Net income		101,550	200	12,500
Less personal allowance	2	(11,000)		
Taxable income		90,550	200	12,500
Tax on taxable income				
Tax on non-savings income 90,550 @ 20%	3			18,110
Tax on savings income 200 @ 0%	4			0
Tax on dividends 5,000 @ 0%				0
7,500 @ 7.5%	5			562
				18,672
Less marriage allowance	6			(220)
Income tax liability				18,452
Less foreign tax credit	7			(5,063)
Income tax liability				13,389
Less tax deducted at source				(21,238)
Tax repayable				(7,849)

Workings

1. The gain on the offshore fund is liable to income tax as the fund does not have reporting status.

£21,550 - £10,000 = £11,550

2. There is no restriction to the personal allowance as the adjusted net income is less than £100,000:

£114,250	Total income
£87,500	Less gross pension contributions
£26,750	Adjusted net income

3. The basic rate band is calculated as follows:

£32,000 + £70,000 x 100/80 = £119,500. All non-savings income is liable to 20% tax

4. As a basic rate taxpayer a £1,000 savings allowance is available. This exceeds the total savings income.

5. After deducting the £5,000 dividend allowance the balance taxable at 7.5% is £12,500 - £5,000 = £7,500

6. As they are both neither higher rate nor additional rate taxpayers, the marriage allowance can be claimed. This is 20% of 10% of the personal allowance, £220 (20% x £11,000 x 10%)

7. The foreign tax credit is calculated as follows:

Tax rate on employment income = £10,000/(£90,000 x 58 days/232 days) = 44.44%. Tax credit restricted to 20% tax paid = £4,500

Tax rate on German dividends = 15%. Restricted to tax paid on dividends £563

Total foreign tax credit £4,500 + £563= £5,063

8. The tax paid on the Zebraland rental income should be claimed as a deduction creating a loss for the year. Carrying the loss forward will reduce the potential tax liability in a future tax year, assuming future profits on overseas property.

Profit £200 - £400 tax = £200 loss

This £200 loss is carried forward to set against future profits from this business. It cannot be offset against the UK rental profit.

9. The withdrawal from the offshore insurance bond is within the tax free 5% annual withdrawals so is not reportable.

Maximum 5% withdrawal per year = £5,000 (£100,000 x 5%).

The number of years since investment = 8 (January 2009 to January 2017).

Maximum tax free withdrawal = £5,000 x 8 = £40,000.

10. Mr Zandy is not liable to tax on the junior ISA income.

11. There is no relief available in respect of the shares given to charity as the charity is registered in the United States of America.

12. There is no clawback of child benefit as adjusted net income does not exceed £50,000.

MARKING GUIDE

TOPIC	MARKS
Taxable UK dividends	½
Taxable foreign dividends	½
Taxable income	1
Tax liability before deductions	1
Tax due	1
Offshore income gain	1
Calculation of adjusted net income	1
No restriction to personal allowance	1
Basic rate band	1
£1,000 savings allowance	1
£5,000 dividend allowance	1
Marriage allowance	1
Maximum FTC on employment income	1
Restriction to UK tax on foreign employment income	1
FTC on German dividends	1
Zebraland tax on rental income as deduction	1
Correct loss to be carried forward	1
Calculation of maximum tax free withdrawal available on offshore bond	1
Offshore bond within 5%	1
Junior ISA income not taxable	½
No relief for donation to charity	½
No clawback of child benefit	1
TOTAL	**20**

QUESTION 2

Ms J Weeks
1 London Way
London
SW1 2AB

10 Central Avenue
London
SW1 3CD

Date

Dear Jane

Thank you for your letter.

Different tax treatments will apply to the three plans and I will cover each in turn.

Share purchase scheme

There will be no income tax implications for the purchase of shares as you are acquiring them for their full market value from your net salary.

However, the additional award at the end of the year will have tax implications. As there is a restriction preventing the immediate sale of the shares, on the date of the award, income tax and Class 1 National Insurance will be due on the restricted value of the shares at that date. The restricted value is the proceeds you might reasonably be expected to receive if the shares were sold with these restrictions on the open market. This would be collected through your payroll and so you may need to take the lower net salary into account.

On the date the restriction is lifted there will be a further liability to income tax and Class 1 National Insurance. The charge will be calculated based on the market value immediately following the lifting of the restriction multiplied by the percentage of the initial unrestricted value of the shares that was not taxed on award. For example, if the restricted value on award was 90% of the unrestricted value, then 10% of the market value on the date the restriction was lifted would be liable to income tax and Class 1 National Insurance.

Provided your employer is willing to enter into a joint election, you can choose to dis-apply the rules above and have full unrestricted value of the shares taxed (and subject to Class 1 National Insurance) on acquisition. There would be no tax charge on the date the restrictions are lifted which gives an advantage where it is expected that the share price will increase. The election must be made within the 14 days following the award and is irrevocable. The election does not need to be submitted to HMRC.

Making the election will however mean that there will be a greater gain liable to capital gains tax on a subsequent sale due to the lower amount liable to income tax.

Share options

There will have been no tax implications on the date of grant. When you exercise the options, there will be an income tax and Class 1 National Insurance liability on the difference between the market value of the shares on the exercise date and the exercise price.

It is possible that under the terms of the option, your employer will require you to also pay the employer Class 1 National Insurance. This would reduce the amount liable to income tax.

Capital gains tax

The base cost added to the pool for the monthly purchases through the share purchase scheme will be the actual purchase price. The base cost for the restricted shares and the shares acquired through the

share option exercise will be the price paid for the shares plus the amount liable to income tax. The amount liable to income tax is the amount before any deduction for employer National Insurance, if this is payable by the employee.

As the shares are all the same class, for capital gains purposes any disposal will be subject to the usual pooling calculations.

It is therefore likely that any sale is likely to be matched first against the following monthly purchase, unless there is also a purchase on the same date. After that the sale will be matched with the share pool as at that date.

Employee shareholder shares

As you correctly state, provided employee shareholder shares meet certain qualifying conditions there would have been no tax liability when you received them. The ending of the employment does not change the tax position of these shares and there will therefore be no tax liability at this stage.

When you sell the employee shareholder shares, any gain is likely to be exempt from capital gains tax. Tax may arise if the shares were awarded after 16 March 2016 and the proceeds on sale exceed £100,000.

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

Yours sincerely

Mrs B Pais

MARKING GUIDE

TOPIC	**MARKS**
Share purchase scheme	
No tax on shares purchased through share purchase scheme	1
Restricted share award	
Income tax and national insurance on the shares on award date based on restricted value	1
Further charge on date restrictions lifted	1
Calculated based on % of market value on date lifted. % calculated based on % of initial unrestricted value not taxed on award	1
Joint election to dis-apply	1
Election within 14 days of award and is irrevocable	1
Income tax and national insurance payable on award based on unrestricted value	1
Reduced base cost for capital gains tax purposes	1
Share options	
Income tax and national insurance charge based on difference between market value and exercise price	1
Employee can also pay employer national insurance	1
Base cost of shares, purchase price for monthly purchases and market value for restricted shares and options	1
Correct explanation of share pooling	1
Employee shareholder shares	
No tax charges on employee shareholder shares as a result of leaving employment	1
Exemption for the gain on employee shares	1
Presentation	1
TOTAL	**15**

QUESTION 3

Briefing note for Tax Partner
Meeting with Arthur, Debbie and Charles from Alphabet Ltd

General Position
If a company purchases its own shares from a shareholder, the default position is that the excess of the price paid over the original subscription price of the shares is treated as a distribution and subject to income tax in the same way as a dividend.

Where the income treatment applies, the original subscription price will be treated as the disposal proceeds in the capital gains tax (CGT) calculation. If the shareholder was the original subscriber, then there will be no capital gain or loss on the disposal. If, however, the shares were purchased from a third party, the actual cost will be deducted and this could give rise to a capital loss even though the selling shareholder is facing an income tax charge.

If the conditions in s.1033 CTA 2010 are met, the repurchase will instead be treated as a capital transaction. Generally, a higher rate taxpayer will prefer the transaction to be treated as a capital transaction due to the lower rates of CGT and the potential offset of the annual exemption. Depending on the size of the gain (i.e. whether covered by the annual exemption) and the availability of the dividend allowance, a basic rate taxpayer may or may not prefer income treatment. However, the taxpayer does not have a choice of treatment: if the conditions are met it will be a capital transaction and if they are not it will be an income transaction.

In order for the capital treatment to apply, the transaction must be wholly or mainly for the purpose of benefitting the trade of the company and must not form part of a scheme of arrangement designed to avoid tax.

In addition, the selling shareholder must

i. be UK resident on the date of the transaction;
ii. have owned the shares for at least 5 years (reduced to 3 if acquired as a result of death, including the period owned by the deceased person). Where the shares were previously owned by the spouse, this period can be counted;
iii. must not be connected with the company following the buyback, so must own 30% or less of the total shares after the transaction; and
iv. there must be a “substantial reduction” in the vendor’s shareholding, so the vendor must hold less than or equal to 75% of their previous holding following the transaction. Unless the shareholding is reduced to less than 5% of the share capital however, HM Revenue & Customs (HMRC) will not usually accept that the trade benefit test has been met.

The company must be an unquoted trading company, so Alphabet Ltd fulfils this requirement.

Turning to each shareholder in turn:

Arthur Jones

The sale of shares by Arthur will qualify as being for the benefit of the trade because he wants to retire. HMRC specifically mention the retirement of a controlling director as being for the benefit of the trade in their guidance. Arthur has owned the shares for more than five years and is resident in the UK, so the sale of his shares will qualify for capital treatment. He will qualify for entrepreneurs’ relief as he will have owned more than 5% of the shares and have been a director/employee of the company for the twelve months to the date of sale.

Arthur's tax position		£
Proceeds	7,000 x £20	140,000
Acquisition costs	5000 x £1 + 2000 x £5	(15,000)
Gain		125,000
CGT annual exemption		(11,100)
Gain qualifying for entrepreneurs' relief		113,900
Capital gains tax at 10%		£11,390

Debbie Davies

Debbie inherited her shares from her husband Brian, who had owned them for more than three years (reduced time limit as acquired as a result of death). She will also qualify for capital treatment as "benefitting the trade" includes the situation where a shareholder dies and the beneficiaries do not want to keep the shares. She is also UK resident.

Her capital gain will be calculated as the increase in value of shares since Brian died.

Debbie's position		£
Proceeds	7,000 x £20	140,000
Cost – probate value	7,000 x £19	(133,000)
Capital gain		7,000
CGT annual exemption		(11,100)
Gain liable to tax		0

Charles Roberts

Charles has not owned the shares for five years and therefore his proceeds will be treated as an income distribution. His distribution will be calculated as the consideration received less the subscription price of the shares

Charles' tax position		£
Consideration received	2,000 x £20	40,000
Subscription price of shares	2,000 x £8	(16,000)
Distribution		24,000
Dividend allowance	£5,000 at 0%	0
Income tax at additional rate	£19,000 at 38.1%	7,239
Total income tax due		7,239
Capital Loss		
Original subscription price	2,000 x £8	16,000
Less: price paid by Charles	2,000 x £14	(28,000)
Capital loss		(12,000)

MARKING GUIDE

TOPIC	**MARKS**
Purchase of own shares will be a distribution unless qualifies for capital treatment	1
Must meet conditions of s1033 CTA 2010 – benefit trade and no tax avoidance	1
Company must be unquoted trading company	1
Arthur – capital treatment as owned for more than 5 years	1
And for the benefit of the trade as wishes to retire	1
Calculation of Arthur's gain	1
Eligible for entrepreneurs' relief	1
Correct CGT payable	1
Debbie – capital treatment as inherited from husband who had owned for more than 3 years	1
And benefits the trade as beneficiary who does not wish to keep her shares	1
Calculation of Debbie's tax liability	1
Charles – income treatment as owned for less than 5 years	1
Calculation of Charles' distribution	1
Calculation of Charles' income tax liability	1
Calculation of Charles' capital loss	1
TOTAL	**15**

QUESTION 4

Jones and Co
High Street
Brighton

Mr P Adams
20 Downs Road
Brighton

6 May 2017

Dear Paul

Thank you for meeting with me today.

Your capital gains tax (CGT) liability will depend on a number of factors. When a property is or has at some point been your main residence, you can claim principal private residence (PPR) relief to reduce or eliminate the gain. If a house is not your main residence for the whole period of ownership, part of the gain will be liable to CGT when you sell it.

If a property has been your main residence at some stage, during the last 18 months of ownership the property will be deemed to have been your PPR even if you were not living there during that time.

Transfers between husband and wife are usually on a "no gain/no loss" basis, which means that no capital gain or loss arises on the transfer. So when you originally transferred half of the property to Frances, she acquired half of the property at half of your original cost and no tax was payable.

Sale of the Property Now

Because you transferred half of the property to Frances just before it became your main residence, for the purposes of calculating the PPR relief, Frances will be treated as having owned it only from May 2012. For the whole period of ownership for Frances, the property has been her main residence and as long as she sells her share within 18 months of moving out, she will have no CGT as her entire gain will be covered by PPR relief.

For you, there will be a CGT liability if you were to sell the property today because the property has not been your main residence for the whole period of your ownership. The fraction of gain which will be taxable is calculated as follows:

Period for which property is treated as your main residence		
Election to treat as main residence	May 2002 – May 2004	2 yrs/24m
Actual residence	May 2012 – May 2017	5 yrs/60m
Total period of residence		7 yrs/84m
Period when not your main residence	May 2004 – May 2012	8 yrs/96 m
Total period of ownership		15 yrs/180m

If you were to dispose of the property today, your capital gains tax liability would be calculated as follows:

	£
Current value	750,000
Purchase price	(300,000)
Cost of extension	(50,000)
Gain before relief	400,000

Your share of the gain – 50% of the above		200,000
PPR relief	7/15 x £200,000	(93,333)
Annual exemption		(11,100)
Liable to capital gains tax		95,567
Capital gains tax at 28%		26,759

The cost of the conservatory and its demolition are not deductible costs as they are not reflected in the value of the house today.

If You Keep the Property for Three More Years

As you are now separated, and you separated in a previous tax year, transfers between you and Frances will not be on a "no gain/no loss" basis. The transfer will be at market value. This is to your advantage as Frances could transfer her half of the property to you now, resulting in no CGT liability for her as detailed above, and you would then be deemed to acquire her half of the house at today's market value, which will increase your base cost.

Your base cost to be deducted from a future disposal will therefore be calculated as follows:

		£
50% of original cost plus extension	£(300,000 + 50,000) x 50%	175,000
50% of market value on transfer	£750,000 x 50%	375,000
Base cost		550,000

If you were to sell the house in three years' time for £775,000 you will have owned the property for a total of 18 years/216 months and the house will have been your main residence for 10 years/120 months. Your CGT liability would then be as follows:

		£
Sales proceeds		775,000
Base cost		(550,000)
Gain before reliefs		225,000
PPR relief	10/18 x £225,000	(125,000)
Annual exemption	Assume no other gains	(11,100)
Liable to capital gains tax		88,900
Tax at 28%		24,892

Conclusion

If you retain the property, the PPR proportion will increase and therefore reduce your taxable gain. This is the case even though the value of the property has increased. Unless there is a significant increase in the price of the property, the tax liability will continue to diminish with continued occupation of the property as your main residence.

I hope that you have found this summary useful. If you have any further questions, please do not hesitate to contact me.

Yours sincerely
Tax manager

MARKING GUIDE

TOPIC	MARKS
Presentation & higher skills	1
Initial transfer is at no loss no gain	1
Frances period of ownership starts in May 2012	1
Frances will have no gain if sells within 18m of moving out/last 18m is deemed occupation	1
Cost of conservatory not deductible	1
PPR relief will be available for actual and deemed occupation	1
Calculation of PPR fraction now	1
Correct base cost of property today	1
Calculation of gain if sold today	1
Calculation of tax liability if sold today	1
Transfer of asset after year of separation is at market value	1
Calculation of Paul's base cost if he acquires Frances' share	1
Calculation of correct PPR fraction in 3 years' time	1
Calculation of gain if sold in 3 years	1
Conclusion/apply to Paul's situation	1
TOTAL	**15**

QUESTION 5

NOTES FOR MEETING WITH JUDY

1) Termination payment

Each aspect of a termination payment must be considered separately. The termination payment provisions will only apply if the receipt is not taxable under any other provision and so all other possibilities must be excluded first.

If the receipt is taxable under the termination provisions, the first £30,000 of any receipt is not taxable**.** Amounts taxable under the termination provisions do not attract National Insurance Contributions (NICs).

The treatment of a payment in lieu of notice (PILON) depends on whether the employment contract allows for this to be paid. If not, then it is not treated as normal earnings and so can fall within the termination provisions. If the employer always pays a PILON then HMRC might argue it is in effect a contractual payment. In this case, as it is non-contractual and there is no previous behaviour, then it is treated as a termination payment.

The £20,000 ex-gratia payment will be a termination payment as long as it is not earnings.

If, for example, it is in lieu of a bonus to which the individual is entitled, then it is taxed as earnings. Here it would not appear to be as compensation for any specific earnings so would be a termination payment.

Any amount which is treated as a termination payment may be eligible for foreign service relief where the employee has worked abroad. If one of three conditions are met, then the sum will be completely exempt from UK tax:

- If foreign service is at least ¾ of total service
- If the total service exceeded 10 years and the last 10 years has been spent abroad
- If the total service has exceeded 20 years and at least half of total service has been spent abroad, including any 10 out of the last 20 years

It is clear that none of these conditions are met. However, a partial exemption is available on the foreign service part of the termination payment.

If this was instead paid as a pension contribution it would be exempt from tax as an employers' contribution**.** As long as the total pension contributions for the year did not exceed the annual allowance, then there would be no tax implications of making such a contribution**.**

The legal fees for advice are specifically excluded as being a benefit as long as they are paid directly to the adviser.

If the ex-gratia payment is made in cash, then the total taxable amount would be £7,000 (the amount in excess of the £30,000) less the amount relating to the foreign service with no NICs to be paid; taxed as top slice of income**.**

The employer should operate a 0T code on the payment if paid after the P45 has been issued or the normal code if before.

If the pension contribution was made instead, there would be no tax to pay as the contribution would be exempt and the PILON payment covered by the termination payment exempt amount**.**

2) Tax and compliance aspects of renting out a room

An individual who is renting a room out would normally be subject to tax on the rent received as this is property income. However, there is a relief available called rent-a-room relief which can apply where an individual is renting out a room in their own home to a lodger. As long as the income does not exceed £7,500, then the income is exempt from tax. If it is above this figure then the taxable amount is either the

amount which exceeds this limit or the profit calculated using normal principles and it is possible to choose the most favourable.

An individual who is not currently receiving a tax return (or where a notice to file a tax return has been issued and then withdrawn) must notify chargeability to income tax to HMRC. This would include a case where the individual starts to receive property income. The time limit for notifying chargeability is 6 months after the end of the year of assessment in which the source of income first arises and there is a penalty for failing to notify within this time limit. If the income commences in 2017/18 then Judy will have until 6 October 2018 to notify chargeability.

HMRC will then issue Judy with a tax return which has to be completed and filed within the time limit. The time limit for filing online is 31 January following the end of the tax year with paper returns having to be filed by 31 October following the end of the tax year. Again a penalty is due for failure to file the return within the time limit.

If tax is due and payable, this has to be paid by 31 January following the end of the tax year to which it relates with a payment on account of the tax for each year being due on 31 January and 31 July. No payment on account is due if the tax due for the year is less than £1,000 and whilst the initial payment on account is calculated according to half of the previous year's liability, a claim can be made to reduce the figure.

MARKING GUIDE

TOPIC	**MARKS**
Termination payment	
TP provisions only if not taxed elsewhere	½
First 30K exempt and no NI	1
PILON	2
Ex-gratia payment	1
Foreign service exemption	2
Pension not part of termination provisions	1
Legal fees	½
Tax on total	1
Tax if take as pension	1
Compliance on renting out room	
Property income and rent a room relief	2
Notify chargeability	1
Tax return process	1
Tax payment regime	1
TOTAL	**15**

QUESTION 6

XYZ Accountancy
The Manse
Toytown

Mr M Jones
Overseas Island
Utopia

Date

Dear Michael

Thank you for your instruction to provide advice regarding your UK tax position.

Income from property

An individual with UK source income, including rented property, remains potentially liable to tax in the UK on that income regardless of residency status.

In principle, the income from property is subject to deduction of tax at source. Tax should be deducted by the agent or tenant with the final settling of the tax bill under self-assessment. The agent can net off the allowable expenses before deducting basic rate tax from the net amount. Those expenses would be the same as could be deducted by a UK resident person in calculating income from property.

This tax should be submitted to HMRC along with a quarterly return as well as an annual return being required. The deadline is 30 days from each quarter date.

Interest is payable on tax paid late. There are penalties for failure to register and make returns.

HMRC can issue assessments to collect tax which has not been deducted.

There is something called the non-resident landlords scheme. It is possible to apply to HMRC to receive the rent gross with all tax then being dealt with under self-assessment. Approval should be given if the landlord's UK tax affairs are up to date, they have never had any tax obligations or they are not expecting to have any tax to pay in the year when the application is made.

The landlord must agree to fully comply with all UK tax obligations.

If there is no authority to pay gross, Jason will be treated as an agent for the purposes of the scheme and he will have the relevant compliance obligations outlined above.

I recommend that an application be made for gross payment as soon as possible and we can assist you in doing that.

Tax liability

Non-resident individuals are taxable on any UK source income. However, there is a provision which limits the liability to income tax on those non-residents.

The liability is a maximum of the sum of the following figures:

A: any amount of tax deducted from disregarded income for the tax year plus any tax treated as deducted or shown as tax credit.

B: any amount of tax that would be the liability to income tax ignoring the disregarded income but removing any entitlement to allowances such as the personal allowance.

Disregarded income is defined as:

Savings and investment income (including interest and dividends from UK companies), annual payments such as royalties from Intellectual Property, pension income and social security income.

Your UK income derives from 3 sources: the property income, interest and dividends.

Property income

	Note	£	£
Gross rent			66,000
Less			
Wages		9,000	
Payment to Jason	1	15,000	
Insurance		2,362	
Repairs		8,211	(34,573)
Net income			31,427

Note

1. Assuming HMRC accept that this is a commercial level of pay for the work done.

Total income

	£
Property income	31,427
Interest	1,726
Dividends	9,100
Total	42,253

Operation of provisions to restrict liability

Total tax to pay without restriction

	Non-savings income (£)	Savings (£)	Dividends (£)
Property income	31,427		
Interest		1,726	
Dividends			9,100
Personal allowance	(11,000)		
	20,427	1,726	9,100

A personal allowance is available as you are a British citizen.

Tax	£
20,427x 20%	4,085
1,000 x 0%	0
726 x 20%	145
5,000 x 0%	0
4,100 x 7.5%	308
Total	4,538

With restriction

'A' – no tax has actually been deducted at source but the dividends are treated as being taxed at 7.5% so this would be £682 (being £9,100 x 7.5%)

'B' – the only other income is the property income and the tax on this without the availability of the PA is 31,427 x 20% = £6,285. The total of A + B = £6,967

It is therefore not beneficial to apply the restriction so the normal calculation will apply

If tax had been deducted at source from the rent, this would not affect the overall computation but you would get credit for the tax deducted.

Please do not hesitate to contact me if we can be of any further assistance to you.

Yours sincerely

Tax Manager

MARKING GUIDE

TOPIC	**MARKS**
Property income	
Tax deducted at source by agent	1
Can net off expenses	1
Returns and general compliance	2
Can apply for NRLS	1
Must comply with UK tax	1
Recommend that apply now	1
Tax liability	
UK source income taxed subject to s811	1
S811	1
Disregarded income	1
Property income calculation	2
Total income	1
Tax without s811	2
PA available	½
With s811	1
Do not apply s811	1
Tax if deducted	½
Presentation and higher skills	2
TOTAL	**20**