Chartered Institute of Taxation
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# The Chartered Tax Adviser Examination

May 2017

Suggested solutions

## Application and Interaction
## Question 1 - Individuals, Trusts and Estates

REPORT TO JOHN BROOKES

May 2017

1. Introduction

This report is provided to John Brookes in response to his letter dated 1 May 2017. The contents are based on the information provided in that letter, the professional valuation dated 31 March 2017 and the information I have on my files.

2. Executive summary

(a) Your liability to UK Income Tax following your departure would depend on your residence status. As you only intend to spend eight weeks per annum in the UK following your departure and you will only have two 'ties' with the UK, you will be treated as non resident. This treatment will apply from 6 April following your departure.

(b) When you become non resident you will only pay UK tax on your UK property income, your UK pension and your dividend income. Your wife will pay UK tax on her pension.

(c) While you are resident in the UK the sale of either your share portfolio, Daisy House or Cassa Sun would be subject to Capital Gains Tax (CGT). CGT of £59,580 would arise on the disposal of your share portfolio, on the sale of Daisy House CGT of £61,012 would arise and on the sale of Cassa Sun CGT of £30,212 would arise.

(d) After you become non-resident you would not pay CGT on the sale of your share portfolio or Cassa Sun. You would pay CGT on the part of the gain on the disposal of Daisy House arising after 5 April 2015.

(e) You would be subject to UK Inheritance Tax (IHT) on your worldwide assets if you are considered domiciled in the UK at the relevant time. If you are domiciled outside of the UK broadly speaking you would only be liable to UK IHT on your UK assets.

(f) You will continue to be considered UK domiciled unless you acquire a domicile of choice outside the UK and would still be treated as being UK domiciled for a period under the deemed domicile rules.

(g) Due to the nature of her health problems a trust for your daughter Emily could qualify for special tax treatment.

(h) It will be important to consider the VAT implications of your departure and it will be advisable to ensure you have a UK agent managing your holiday accommodation in the UK to avoid the need for UK VAT registration.

(i) It will also be important to ensure that you register under the non resident landlord scheme to ensure that you continue to receive your UK rental income without the deduction of tax.

3. Residency Status

Generally individuals resident in the UK are taxable on their worldwide income arising in that year and taxpayers who are not resident in the UK are only taxable on their UK income arising in that year. To determine whether you will have a UK tax liability on your income it is therefore important to establish whether you will continue to be resident in the UK following your move abroad.

The UK has a Statutory Residence Test (SRT) which determines a taxpayer's residence status. This is based on the time spent in the UK in a tax year and the connections an individual has with the UK. The test has three parts as follows:

1. The ‘automatic overseas tests’ where if you meet any of these tests you will be conclusively non-UK resident for the tax year.

2. The ‘automatic residence tests’ where if you meet any of these tests you will be conclusively UK resident for the tax year.

3. The ‘sufficient ties test’ this contains other connection factors and day counting rules and will only need to be considered if your residence status is not determined by the first two tests. This test considers whether you have sufficient UK ties such that you are UK resident when taking into account the number of days you are present in the UK.

To meet the automatic overseas test and be conclusively not resident in the UK for a tax year you must either have been resident in the UK in one or more of the previous three tax years and present in the UK for fewer than 16 days in the year in question or have been not resident in the UK in all of the three previous tax years and present in the UK for fewer than 46 days in the tax year in question or meet the ‘work’ abroad’ condition. This latter is where you work abroad for an average of at least 35 hours a week, spend fewer than 91 days in the UK in a tax year and you do not work for more than three hours in the UK for more than 31 days during that tax year.

As you plan to return to the UK for eight weeks per annum and will not be working abroad you will not meet the automatic overseas test and it is necessary to consider the automatic residence test.

The automatic residence test stipulates that you will be conclusively resident in the UK in a tax year if you are present for 183 days or more in a tax year, if you have a ‘home’ in the UK or if you carry out full time work in the UK for a period of at least 365 days.

As you are only planning on returning to the UK for eight weeks per annum and will not be working here you will not meet either of these two tests. However, as you propose retaining your current UK home for your personal use on return visits it is necessary to consider whether you will have a home in the UK following your departure. You will be deemed to have a home in the UK if you have a home in the UK in the tax year in question, you are present in this for at least 30 days during the year and you do not have a home overseas or if you do have an overseas home you spend less than thirty days there. As you are planning to have an overseas home you will not be caught by this test provided you spend at least 30 days in that home in the tax year concerned.

As you will not meet the automatic UK or overseas test it is necessary to consider the sufficient ties test. This considers the number of days spent in the UK and the extent of your connection with the UK. There are five ties as follows:

1. Family tie, where you have a spouse or civil partner or common law partner who is resident in the UK or a minor child who is resident in the UK that you see for at least 61 days in the year

2. Accommodation tie, where you have a place to live in the UK which is available to you for at least 91 days and you spend at least one night there during the year

3. Work tie, where you work for 40 days or more in the UK in a year

4. UK presence, where you spend more than 90 days in the UK in either of the previous two tax years

5. Country tie, where you spend more days in the UK in the tax year than in any other single country.

As your wife is emigrating with you and your daughter is over 18 you will not have a family tie. However, you will have an accommodation tie as a result of your home here. You will not have a work tie but you will continue to have a UK presence tie for at least the first two tax years after emigration. Provided you will spend longer in Goldenstein than you will in the UK in a year you will not have a country tie.

You will therefore have two UK ties for two tax years after you emigrate. These must be considered in line with the number of days you will spend in the UK following your departure. On the basis that you only have two ties you will be able to spend up to 91 days in the UK without becoming resident. As you only plan to spend eight weeks in the UK in future you will be treated as non resident going forward.

The SRT is normally considered over the whole tax year however in 2017/18, your year of departure, you may be able to separate the year into resident and non resident parts under the spilt year rules. You will only be eligible for this treatment if you are UK resident in the year of departure and you fall within one of the three cases which apply to people leaving the UK. These are as follows:

1. Case 1 – starting to work overseas

2. Case 2 – accompanying a partner overseas (who is starting to work overseas)

3. Case 3 – ceasing to have a home in the UK

As neither you nor your wife will be starting to work overseas you will not fall under cases 1 or 2 and as you are retaining your UK home case 3 will also not apply thus you will not be able to split the tax year in your year of departure. Therefore, you will only be treated as non resident from 6 April 2018 and will continue to be taxed on your worldwide income until then.

When you are treated as being non resident you will only pay UK Income Tax on your UK source income. This is income which arises from a source in the UK. Rental income from property situated in the UK will usually always be taxable in the UK unless it is disregarded under a double taxation agreement. However the income from your overseas property will not be taxable in the UK. Your UK pension and dividend income will also be subject to UK tax but your foreign pension will not.

However, there is a limit on the UK Income Tax liability for individuals' not resident in the UK and the tax charge for non-residents on income which qualifies as 'disregarded income' arising in the UK is restricted to the amount of tax, if any, deducted at source. Disregarded income will include UK bank interest, dividends from UK companies and pension income but will not include your rental income. If the Income Tax charge is limited in this way, personal allowances will not be given against other income. The resulting liability calculated using these rules is then compared with the tax liability calculated the normal way and your overall Income Tax liability will be whichever is lowest.

4. Capital Gains Tax on sale of assets

Whilst you are still resident in the UK the sale of either of your share portfolio, Daisy House or Cassa Sun will constitute a capital disposal and you will be subject to Capital Gains Tax (CGT) on any gain.

Assuming a sale is made on an arms-length basis, the gain will be the funds received less any allowable expenditure. Allowable expenditure will include each asset's acquisition cost, any improvement expenditure and any expenses of acquisition or disposal. You will have an annual exemption (currently £11,100) and any brought forward capital losses will also be available to offset any realised gain.

Due to your level of income you will pay tax on your gain at the rate of 20% on a disposal of your share portfolio and 28% on a disposal of residential property.

As Cassa Sun has been a qualifying holiday let for the full time you have owned it you may be able to claim Entrepreneurs Relief which will reduce rate of CGT to 10%, subject to a life time limit of £10 million. However, to qualify for Entrepreneurs Relief a disposal must qualify as a disposal of a whole or part of a business and as you are retaining Cassa Sea and Cassa Sand it is unlikely that you will be seen to be disposing of a business. The disposal of a single asset used in a business will not qualify for relief.

I note that you have refurbished Daisy House and installed a new kitchen and bathroom. If this work resulted in an improvement to the property the costs incurred will be deductible from the gain arising on sale and will reduce the CGT payable. However, the replacement of the kitchen or bathroom with a modern equivalent of what was there before would not qualify as an improvement. To be treated as an improvement HM Revenue & Customs would expect to see a significant improvement e.g. an increased number of units in the kitchen. I have presumed this is not the case and thus no relief will be given. The cost of the extension on Cassa Sun will be allowable as capital gains deduction.

I have attached a projected CGT calculation at Appendix 1. This indicates that CGT of £59,580 would arise on the disposal of your share portfolio, leaving you with net proceeds of £649,420. On the sale of Daisy House CGT of £61,012 would arise leaving you with net proceeds of £717,988. On the sale of Cassa Sun CGT of £30,212 would arise leaving you with net proceeds of £688,788. In all cases I have estimated the costs of disposal as £1,000 and assumed that you have not otherwise used your annual CGT exemption.

From a tax perspective the least tax would arise on the sale of Cassa Sun however before you decide which asset to sell it is important to consider the situation if you were to sell following your move.

If a person is not UK resident they will not normally pay UK CGT although if they were to return to the UK they may face a tax charge under the temporary non-resident rules. These rules would apply if your period of non residence was for five years or less. The five year period runs from the day you lose UK residence to the day before UK residence is resumed.

However, a disposal of UK residential property by a non-UK resident has attracted UK CGT since April 2015. UK resident property means a dwelling house either used as a residence or suitable for use as such but does not apply to commercial properties.

Therefore, if you sell your share portfolio after you became non-resident you will not pay CGT on this. Additionally, as Cassa Sun is not situated in the UK you will not pay UK CGT on this once you become non-resident. You will however still pay UK CGT on the disposal of Daisy House following your departure but as the rules only apply from 6 April 2015, only the part of the gain arising after 5 April 2015 is chargeable. The gain can be calculated either by reference to its rebased value at 5 April 2015, or by time apportioning the gain calculated in the normal way whichever method produces the lowest figure.

I would therefore recommend that you sell either your share portfolio or Cassa Sun once you are considered non-resident for tax purposes, it may still be beneficial to sell Daisy House depending on its value at 6 April 2015 as your annual exemption could be deducted which may cover any gain.

## 5. Inheritance Tax position following emigration

You will still be subject to UK Inheritance Tax (IHT) following your departure, as individuals, irrespective of UK residence status, who are domiciled in the UK are liable to IHT on all of their worldwide assets. Individuals domiciled outside of the UK are only liable to UK IHT on their UK assets.

The location of your land and buildings and any chattels you own will be the place where they are physically situated. For cash in a bank account it will be located where the branch is located. Shares are located where the register of shares is kept and for UK listed companies this will be in the UK.

Domicile is a legal concept and does not have a specific definition for tax purposes. It is often defined as the place where a person has their permanent home. Under UK general law, an individual may have a UK domicile of origin, domicile of dependency or domicile of choice. Each individual must have a domicile and it is not possible to have more than one.

I understand that you have a UK domicile of origin and you will continue to be considered UK domiciled unless you acquire a domicile of choice in another location. This will apply if you change your personal circumstances in such a way as to lead HM Revenue and Customs to conclude that you are no longer domiciled in the UK. To lose a domicile of origin in the UK and establish a domicile in Goldenstein you must permanently settle in Goldenstein and, if challenged, HM Revenue and Customs will expect to see evidence that you have abandoned your ties with the UK and settled permanently abroad. This evidence could include the sale of UK property and the purchase of property abroad, moving your social and economic interests abroad, the place where your family and close relatives reside and if you have a Will by which law is it governed. To change domicile you must establish a settled intention to live permanently in Goldenstein.

Case law has established that in order to establish a domicile of choice, a taxpayer must be physically resident in the new place and show he intends to make it his home for the rest of his days. Where the person has homes in both countries, he can only acquire a domicile of choice in a new country if the residence established in that country is his chief residence.

However, even if you were to acquire a domicile of choice in Goldenstein you would still be treated as being UK domiciled under the deemed domicile rules for a limited period of time. Under these rules an individual is deemed to be domiciled in the UK if they have been resident in the UK for at least 17 of the 20 tax years before the tax year under consideration.

You will therefore retain a UK deemed domicile until there are more than three complete tax years out of the preceding 20 in which you had not been resident in the UK.

## 6. Trust for daughter

I understand you are considering establishing a trust for your daughter Emily. A trust is an equitable obligation binding persons (the trustees of the trust) to deal with the trust property for the benefit of certain persons known as the beneficiaries. The settlor of the trust is the person who establishes the trust or contributes to it.

The trustees will have control of the trust property and the beneficiaries will have the benefit of it. The trustees are under duty to hold the property for the benefit of beneficiaries.

A trust established during the settlor's lifetime is usually created by a written trust deed. Trustees are appointed by the trust deed and as a general rule there is no minimum number of trustees however I would recommend you do not have only one trustee. The powers and duties of the trustees are set out in law and in the trust deed, which is usually drawn up by a solicitor.

The beneficiaries of a trust may be named or ascertained by description and whilst I understand this is to be Emily alone the trust deed could be drawn to allow a wide variety of beneficiaries to benefit after Emily's interest ends, for example, current or future grandchildren. To avoid adverse tax consequences the settlor and the settlor's spouse should not be able to benefit from the trust during the settlor's lifetime.

Where an individual (the settlor) makes a declaration that certain property is to be held on trust for certain persons or class of persons it is known as an express private trust but to be valid it must satisfy certain requirements. There must be certainty of the intention and the words used must clearly show that the settlor is directing the property to be held on trust and indicate a trust was intended. There must be certainty of the subject matter of the trust and the property that is the subject of the trust must be identified and the interests of the beneficiaries in that property must be ascertainable. There must be certainty of objects which means it must be clear who the beneficiaries of the trust are.

The two main types of express private trust are a discretionary trust or interest in possession trust.

A discretionary trust is a flexible form of trust where no one beneficiary has an absolute immediate right to income or capital. Rather the trustees are given powers to exercise their discretion to pay or apply some or all or none of the trust income or capital for the benefit of the trust beneficiaries as the trustees think fit. It is normal for a settlor to express their intentions for the trust to the trustees in a letter of wishes which can be updated from time to time. This is not legally binding but will give the trustees a guide as to the settlor's wishes.

Under an interest in possession trust, the trustees cannot accumulate income within the trust but must pay out the income of the trust to the nominated beneficiary. The beneficiary is known as the life tenant (or the life renter in Scotland) and they are legally entitled to the net income of the trust, after taxes and expenses. This may not result in the trustees entirely relinquishing their discretion over the income as the interest in possession can be revocable if the powers in the trust deed provide.

When assets are transferred to trust there can be Inheritance Tax, Capital Gains Tax and Income Tax implications and I have discussed these below.

7. Tax consideration on setting up a trust

The UK tax treatment of the trust will depend on its residency status. A trust is UK resident for Income Tax and CGT purposes if all trustees are UK resident or at least one trustee is UK resident and the settlor, was either domiciled or resident in the UK when the trust was set up. As the proposed trustees are UK resident and you, as the settlor, are UK domiciled, the trust will be UK resident.

As Emily has a mental illness a trust for her benefit may qualify under the special rules for trusts set up for vulnerable persons. These rules apply where a beneficiary has a mental disorder within the meaning of the Mental Health Act 1983 which means they are incapable of administering their property or managing their affairs or are receiving certain welfare benefits indicating a physical or mental disability. This qualification will only apply if you as a settlor could not benefit from the trust and the terms of the trust must restrict the use of the capital and income in such a way that the disabled person receives virtually all of the benefit. There is an annual de minimis limit of the lower of £3,000 or 3% of the fund value.

For Income Tax purposes, the tax liability of the trustees will be as if the trust income arising had accrued directly to Emily and the trust will benefit from her personal allowance and rate of tax. However, income distributions made from a discretionary trust will still be treated as received net of a 45% tax credit and the trustees will need to maintain a pool of real tax paid by the trust on its income to frank this 45% charge.

In order to receive this treatment two claims must be made. A timely vulnerable person's election must be made which is a joint claim by the trustees and beneficiary (or guardian or legal representative) to confirm to HMRC that the trust is a qualifying trust and the beneficiary is a vulnerable beneficiary. The trustees must also claim (via the tax return) for the special tax treatment to apply but there is no requirement to claim this treatment if not beneficial and it can be decided on a year to year basis.

A trust for a vulnerable person can also benefit for a similar CGT advantage by reference to the vulnerable beneficiary's personal CGT position.

For IHT purposes a trust for a disabled person will constitute a qualifying interest and will be treated as being part of Emily's estate. This means that the trust will not be subject to IHT when assets leave the trust or on 10 year anniversaries. The transfer of assets to the trust would be a potentially exempt transfer and IHT would only potentially become chargeable if you died within seven years.

The choice between the two different types of trust will be influenced by Emily's income requirements. A discretionary form of disabled trust may be a better option as it provides greater flexibility when deciding on amounts to distribute. I would therefore recommend you set up a discretionary trust for her benefit.

8. VAT considerations

The letting of furnished holiday accommodation is within the scope of VAT. If the total turnover of a person running a furnished holiday accommodation business exceeds the VAT registration threshold (£83,000 per year from April 2016) it is compulsory to register the business for VAT.

Currently you are not required to register for VAT as although the turnover from your holiday letting business is over the VAT registration threshold, the turnover from your UK property is only £28,000 and under the registration limit. You do not need to include the turnover from the foreign properties when considering the threshold as this is a supply of services made outside the UK which is outside the scope of UK VAT. There may be the requirement to register for VAT locally in the country where the property is located and you may wish to confirm this with a local adviser.

This position may change when you become non-resident as for UK non-resident owners the UK VAT registration threshold is £1 where they have no 'permanent' business establishment in the UK. However, if the non-resident owner appoints a managing agent in the UK and this is the place where essential management decisions are made and the business's central administration is carried out, then the owner may have a UK establishment and the higher UK VAT registration threshold will apply.

The requirement to register for VAT will result in VAT at the standard rate of 20% being chargeable on the income from Poppy House which would no doubt affect the attractiveness of the property and hence profits. I would therefore recommend you appoint a UK managing agent.

9. Other considerations

There are special rules for landlords residing abroad and letting UK property. There is the requirement for the letting agent or tenant (if you do not appoint an agent and the rent is over £100 per week) to deduct basic rate tax, at 20%, from the rental income, after deduction of certain expenses. This applies equally to your UK residential properties and UK holiday lets.

If you live abroad for six months or more per year, you are classed as a 'non-resident landlord' by HM Revenue and Customs even if you are UK resident for tax purposes.

You can avoid having 20% tax deducted if you successfully register under the non-resident landlord scheme. Registration will be approved where your UK tax affairs are up to date, or you do not expect to be liable to pay UK tax in the year you apply. You will be required to fill in a NRL1 form to receive this treatment which I can prepare on your behalf.

10. Summary and conclusion

In summary, your UK tax liability going forward will depend on your residence status and you will be treated as non resident from 6 April following your departure. When you become non resident you will only pay UK Income Tax on UK property income, UK pension income and UK dividend income.

Whilst you are still resident in the UK the sale of your assets would be subject to CGT. However, if you were to sell your share portfolio or Cassa Sun after you became non-resident you will not pay CGT on the disposals in the UK. You will still pay UK CGT on the disposal of Daisy House following your departure but only on the part of the gain arising after 5 April 2015.

You will be subject to UK IHT on your worldwide assets if you are considered domiciled in the UK. If you are domiciled outside of the UK broadly speaking you will only be liable to UK IHT on your UK assets. You will continue to be considered UK domiciled unless you acquire a foreign domicile of choice. If you do acquire a foreign domicile of choice you will still be treated as being UK domiciled for a limited period of time under the deemed domicile rules.

A trust for your daughter Emily could receive special tax treatment under the rules for trusts with vulnerable beneficiaries.

It will also be important to consider the VAT implications of your departure and to ensure that you register under the non resident landlord scheme.

I hope this report is helpful in answering your queries. Please do not hesitate to contact me if you require any further explanations.

# APPENDIX 1

## John Brookes

### Disposal of share portfolio

| | £ |
|---|---:|
| Estimated sale proceeds | 710,000 |
| Estimated costs of disposal | (1,000) |
| | 709,000 |
| Less allowable costs: | |
| Value on father’s death | (400,000) |
| Capital Gain | 309,000 |
| Less Annual Exemption | (11,100) |
| Taxable Gain | 297,900 |
| | |
| CGT £297,900 x 20% | 59,580 |
| | |
| Net proceeds | 649,420 |

### Disposal of Daisy House

| | |
|---|---:|
| Estimated sale proceeds | 780,000 |
| Estimated costs of disposal | (1,000) |
| | 779,000 |
| Less allowable costs: | |
| Value on father death | (550,000) |
| Improvement works | 0 |
| Capital Gain | 229,000 |
| Less Annual Exemption | (11,100) |
| Taxable Gain | 217,900 |
| | |
| CGT £217,900 x 28% | 61,012 |
| | |
| Net proceeds | 717,988 |

### Disposal of Cassa Sun

| | |
|---|---:|
| Estimated sale proceeds | 720,000 |
| Estimated costs of disposal | (1,000) |
| | 719,000 |
| Less allowable costs: | |
| Value on father death | (550,000) |
| Improvement works | (50,000) |
| Capital Gain | 119,000 |
| Less Annual Exemption | (11,100) |
| Taxable Gain | 107,900 |
| | |
| CGT £107,900 x 28% | 30,212 |
| | |
| Net proceeds | 688,788 |

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