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

Answer-to-Question-_1_

Report

From: Jane Doe CTA

To: Jeff Stones

Date: 9 November 2022

Subject: Tax matters in regards to ending your employment with Parsons Construction Ltd and other issues

Introduction

This Report is provided in responce to our meeting on 30 October 2022 and the additional information provided to me in regards to your termination contract and share award options letter.

This Report is intended for use by you only. Third parties can not rely on the information contained within to be relevant to themselves.

Under practice guidelines laid down by the CIOT, only firms authorised by the Financial Services Authority or members of a designated professional body can advise on 'regulated activities'. Regulated activities include investment and pension advice, therefore our advice is limited to the tax implications of pension contributions and share options available to you.

This Report will cover the following:

Section A: Taxation of the termination package

Section B: Share Award options available and the recommended time to exercise

Section C: Taxation of the bonus payment

Section D: Investments possible from the bonus paid

The following references are used in this Report:

"PC Ltd"	Parsons Construction Ltd
"CGT"	Capital Gains Tax
"NIC"	National Insurance Contributions
"PILON"	Payments in Leiu of Notice

Executive Summary

You will recieve a termination payment which will be made up on PILON of £25,000. This will be taxed as normal employement income and will suffer tax and NIC at the usual rates.

You will recive an ex-gracia payment if £62,500 duirng the

2022/23 tax year. £30,000 of this will fall under the termination payments exempt amount. The remianing £32,500 will be taxed an normal as it is in excess of the exempt amount and PC Ltd will also have to pay Class 1A NICs, however you will not have to pay NIC's on the amount.

You have the option to exercise an option over shares in PC Ltd through a non-tax advantaged share scheme.

As the vesting date has been brought forward on these options due to you being a good leaver, you should exercise these options as soon as possible on 1 January 2023.

These options will be chargable to income tax and NIC on the exercise as they are through a non-tax advantaged share shceme and are considered to be readily convertable assets as there is a market to sell the shares straight away and the shares hold no restirctions.

The charge will be equal to the market value of the shares at the date of exercise, this will then be incliuded as employment income on you for the year.

In order to exercise these options you have three options avilable to you. As you feel that the share price will fall over the next 6 months, you should excericse the options immediatley.

PC Ltd has given you options in order to excerise the options and pay the necessary tax and NIC's due. The most beneficial way to do this for your cash flow will be to ask the company to sell all the shares straight away and deduct the tax and NICs due, leaving you with a net cash income of £132,726.

This is as you feel the shares will fall in value, therefore it is better to sell the share straight away and if the company deal with the income tax and NIC's, you will not have to find the funds to do this before exercise.

The last option should be to let the share options lapse.

You will not pay CGT on the exercise of the shares as the sales price and market value charged to income tax should be the same, leaving you with a gain of nil.

You will make Pension contributions, EIS/VCT and gift aid donations based on the bonus you anticipate recieveing of £100,000.

This bonus will beincome during the 2023/24 tax year.

You should invest in an EIS company as the clawback IT relief will be removed after holding the shares for 3 years.

Your additional pension and gift aid contributions should be made during the 2023/24 tax year as the pension contributions will remove the abbatement of your personal allowance.

Section A: Taxation of the termination package

The tax treatment of termination payments depends on whether the payment falls within special rules dealing with the termination payments.

Generally, termination payments are only taxable if they are over the £30,000 exemption limit.

However as you will be recieveing an element of termination payment in order to leave your office straight away and not work out your notice period which is in your contract, the £25,000 PILON payment will be subject to tax and NIC in the same manner as normal earnings from employment.

The remaining £62,500 payment is a genuine payment for loss of office and will therefore partly come under the termination payment exemption of £30,000. This element of the payment will only be chargeable to NIC's on the employer. You will therefore not have a tax or NIC liability personally for this payment.

The remaining £32,500 will be taxed as earnings as it is above the exempt amoiunt and you will therefore incur a tax charge o the income, however only employer NIC's will be due on this amount.

Your employment income for the 2022/23 tax year will therefore be £132,50,0 (Appendix 1).

Section B: Share Award options available

As PC Ltd's share scheme does not have any restrictions on the issue and due to the nature of the companies trade, it does not fall under a tax advanatge scheme. The scheme is instead a non-tax advantaged share option scheme. This changes the tax treatment available on the exercise of the shares.

The vesting conditions on the shares awarded under the scheme will change in light of you being a good leaver of the company.

Due to the nature of the share scheme there will always be a charge to employment income based on the market value of the shares at the date of exercise.

You are able to exercise the grant over 20,543 shares from 1 January 2023, as this is the date you will be leaving the employment.

As the shares are readily convertable assets, e,g you will be able to sell the shares straight away, you will be subject to a charge on PAYE and NICs.

You have expressed your optinion that the shares will fall in value over the next 6 months. I have therefore take this into account when considering if you should exercise the shares and the tax implications of this drop. (Appendix 3)

If you exercise and sell the shares during the 2022/23 tax year then your position has been summarised below for each option available to you, based on the share price dropping:

Option 1 - Need cash of £116,050 to settle the tax and NIC before the shares are transfered to you. This could cause a cash flow issue for you as you will need to pay the tax and NIC before getting the shares and you only have savings of arund £50,000 in ISAs.

Option 2 - You will have shares to C/f of 10,960 as the balance will have been sold by the company to settle your tax and NIC bill. This is a valid option as you do not need to pay anything outright. You have however mentioned that you are not happy with the way the company is being run and expect the share price to drop, so you may not wish to have shares in the company.

Option 3 - PC Ltd will sell all of the shares and transfer you the balance of £132,726. This will then enable you to spend the money as you like. As the shares will have been exercised and sold at the same time, no charge to CGT will arise due to the share market value being charged to income tax at the date of exercise.

You have similar options available to you if you keep the shares until the 2023/23 tax year and then decide to exercise and sell the shares (See Appendix 3 table). However as you consider the share value to drop further, you will end up with slightly less as follows:

Option 1 - Need cash of £108,428 to settle tax and NIC

Option 2 -Shares to c/f of 10,887

Option 3 - Net cash of £122,270 with a no CGT due

As your employment income for the 2022/23 tax year already reduced your personal allowance to nil, it would be beneficial to exercise the options when your employment ends on 1 January 2023 and tale option 3.

As with any share grant, the least desirable option is to let the options lapse.

Section C: Taxation of the bonus payment

You have estimated that the bonus payment yopu recieve will be £100,000. I have therefore used this figure in our calculations in Appendix 2.

Bonus payments for Directors are charged on the earliest of three possible dates:

1 - date credited in the accounts (Dec 2023)
2 - date legally entitled to payment (Dec 2023)
3 - date earnings are determined.

As the bonus is relating the performance of the 3 years ended 30 June 2023, the earliest date is therefore 1 July 2023, not the 31 December 2023 as stated in the documents.

Section D: Investments possible from bonus paid

The bonus will be paid on 31 December 2023, however it will be deemed to be recieved by 1 July 2023 when you became entitled to the bonus.

I have included a calculation of your tax due in Appendix 2 based on your bonus payment of £100,000 and self employed contractor income of £20,000.

You will have a net tax liability of £39,432 before any relief and before any tax which has been deducted from your bonus payment through PAYE.

You mentioned 3 options in you letter regarding payments after you have recieved the funds.

(D1) Pension contributions

If you ask PC Ltd to make the pension contribution from your bonus, you will be in a better position during the 2023/23 tax year as you will retain your full entitlement to the personal allowance.

You also mentioned that you will not have an annaul allowance charge on the copntribution and I can see that this is as you have unused annual allowance from the previous three years throught forward.

As you income for the 2022/23 tax year will be in excess of the threshold and net income limits of £200,000 and £240,000, I would recommend making the payment during the 2023/24 tax year.

You will also have sole trader earnings which will qualify for income for the purpose of contributing in your pension.

Due to your age of 49 and your net income from the 2022/23 and 2023/24 tax years, if you have excess income going forwards, you may wish to make additonal contributions in order to utilise any unused annual allowance brought forward from the previous three years.

(D2) EIS/VCT investments

You also mention making an investment in an EIS or VCT company.

Both types of investments attract a tax reducer of 30% of the investment.

The type of invetsment you make will depend on the company which you make the investment in and it meeting the qualifying conditions for the relief.

The main difference between EIS and VCT invesments are that the EIS shares will need to be kept for a period of 3 years to retain the releif and any dividends will be taxable. The VCT shares need to be kept for 5 years to retain the income tax relief and the dividends on the first £200,000 invested in the year are tax free.

As you are investing £30,000, you will have income tax releif of £9,000. If this payment is made specifically oput of your bonus payment in 2023/23. Alternativley, if you wish to make the investment using other funds, you could claim releif earlier in the 2022/23 tax year by investing at an earlier date.

(D3) Gift aid contributions

If you wish to make a gift aid contibution from the income recieved in your bonus, you could make the contribution duirng the 2023/24 tax year as it will extend your basic rate band by the gross amount of £12,500. This will in effect save you tax of £2,500.

Appendix

Apendix 1:

2022/23 Income Tax Position:

		NSI	SI	DI	
PC Ltd Employment income	W1	132,500			
Net income					132,500
Less PA					0
NSI BRB		37,700	20%	7,540	
HRB		94,800	40%	37,920	
				45,460	
Say Share					

option 3 taken:					
Tax position changes to:					
Employment income		381,276			
No PA					
NSI BRB		37,700	20%	7,540	
HRB		112,300	40%	44,920	
ARB		231,276	45%	104,074	
Income tax due				156,534	
Less:		Amount company charged less NICs due		(111,074)	
Balance				45,460	

W1 - Employment income:

Employment income actually recieved
(100,000/12 x 7) = £75,000
PILON = £25,000
Ex gracia payment
(£62,500-£30,000) = £32,500

Total = £132,500

PILON - £25,000 for a 3 month notice period which was not worked due to the circumstances.

Ex-gracia - £30,000 exemption applies as genuine payment for loss of office

Apendix 2:

2023/24 Income Tax Position:

		NSI	SI	DI	

PC Ltd bonus	W1	100,000			
Sold trade income		20,000			
Net income					120,000
Personal allowance		12,570-((120,000-100,000)/2)			(2,570)
					117,430
NSI BRB		37,700	20%		7,540
		79,730	40%		31,892
					39,432
Amended					
for W2					
PC Ltd		80,000			
Sole trade		20,000			
Net income					100,000
Less PA					(12570)
NSI BRB		(37,700+12,500)	20%	10,040	
HRB		37,230	40%	14,892	
				24,932	
Less EIS		(30,000 x30%)		(9,000)	
tax due				15,932	

W1 - Bonus payment - Est at £100,000. As director, bonus recieved earlier of
1 - credited to accounts - 31/12/23
2 - date legally entitled - 31/12/23
3 - date earnings determined - 1/7/23

W2 - Bonus recieved: Investment options

Maximise Releif for payments from bonus

Pension contribution made during 23/24 £20,000
EIS investment 30% tax reducer £30,000 x 30% = £9,000

Gift aid donation of £10,000 net to green peace, extends BRB and reduces net income so additonal PA allowable.

Appendix 3:

Share option

	Pro rata shares	MV at 30/10/22 per share	Est MV W1	Amount charged to Income tax
	20,543	12.48		
Cost		Nil	Nil	Nil
Exercise 1/1/2023	20,543		12.11	248,776
Exercise 30/04/2023	20,543		11.23	230,698
	Employment income	Incom tax at max 45%	NIC 2%	Cost to Jeff through IT and NIC
22/23	248,776	111,949	4,976	116,925
23/24	230,698	103,814.10	4,614	108,428

W1 - You estimate that the share price is likely to fall between 5% - 10% between 30 October 2022 and 30 April 2023.

Assuming 10% evenly over next 6 months

MV at 1 January 2023 (3% decrease) = £12.11

MV at 30 April 2023 (full 10% decrease)= £11.23 per share

Option to pay for Income tax and NIC liability:

Option 1 - You pay tax and NIC before shares transfered to you

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Option 2 - PC Ltd sell enough shares to cover IT/NIC and transfer remainder

Option 3 - PC Ltd sell all shares and transfer you Proceeds minus IT and NIC

2022/23					
Option 1					
Add employement income		248,776			
HRB		17,500	40%		7,000
		231,276	45%		104,074
NIC 2%		248,776	2%		4,976
Actual cash needed:					116,050
Option 2:					
Need cash		116,050			
MV at exercise		12.11			
Need to sell at least		9583	shares		
Remainder shares		10,960	shares		
Option 3:					
Sell all shares					
MV at exercise		12.11			
Shares		20,543	12.11		248,776
Less: IT and NIC					(116,050)
Excess cash					132,726
NO CGT		SP - MV charges to IT			

2023/24					
Option 1					
Add employment income	230,698				
No PA					
HRB	30,000	40%		13,500	
ARB	200,698	45%		90,314	

NIC	230,698	2%		4,614	
Cash needed				108,428	
Option 2					
Need cash	108,428				
MV at exercise 30/4/23	11.23				
Sell		(108,428 /11.23)		9656	shares
Remainder shares				10,887	
Option 3:					
Comp sell shares					
MV at exericse	11.23				
Shares	20543			230,698	
Less	IT and NIC			(108,428)	
				122,270	
No CGT	SP - MV charged to IT			Nil	