THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Human Capital Taxes

May 2022

TIME ALLOWED

3 HOURS 30 MINUTES

- 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 in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 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.

1. Palm Ltd is a company with 250 employees. A benefits provider has recently approached them with a proposal to increase the benefit offering to employees. The following benefits in kind via salary sacrifice arrangements have been recommended:

<u>Pension contributions</u>

Palm Ltd currently operates a Group Personal Pension Plan, which is administered by a third party pension administrator. Palm Ltd makes the minimum contributions under the auto-enrolment legislation, on a qualifying earnings basis. All employees are members of the scheme. No employee exceeds their annual or lifetime allowances.

Palm Ltd wishes to keep the same total contribution levels, but the benefits provider has suggested that they change the contribution method of the scheme, so employee pension contributions are made via a salary sacrifice arrangement.

<u>Cycle to work scheme</u>

The benefits provider is offering bicycles valued at £750 each (inclusive of VAT) to Palm Ltd to lend to employees for 24 months. Employees would sacrifice £31.25 a month of their gross salary in exchange for use of the bicycle. The bicycles would be returned to the benefits provider at the end of the 24 month period. Palm Ltd would make a payment to the benefits provider each month for £31.25 (inclusive of VAT) for each bicycle.

The majority of employees travel to work by car as the workplace is based on an industrial site, about three miles from the nearest public transport links.

<u>Private medical insurance</u>

The benefits provider will offer private medical insurance to employees at an annual cost to Palm Ltd of £750 per employee. To help fund this benefit, employees would sacrifice £500 of their annual salary.

<u>On-site car parking</u>

The current annual cost to an employee to purchase a permit from Palm Ltd to use the on-site car park is £500 per annum. The actual cost to Palm Ltd is negligible as they own the leasehold for the car park site. To increase take up Palm Ltd would like to reduce the cost of the permit for employees to £400. The benefits provider has suggested they do this via a salary sacrifice arrangement.

The average employee salary at Palm Ltd is £28,000. All employees are basic rate taxpayers and undertake their employment duties in the UK. No apprentices are employed by Palm Ltd.

Palm Ltd pays Corporation Tax at the main rate of 19%. The lower level of qualifying earnings for auto-enrolment is £6,240 per annum. Minimum pension contribution levels for auto-enrolment are 5% for the employee and 3% for the employer.

Requirement:

Explain the Income Tax, National Insurance and Apprenticeship Levy impact of the proposals and provide recommendations to Palm Ltd on whether to implement the suggestions.

You are NOT required to discuss National Minimum Wage considerations. (15)

2. Minecomp Ltd is a UK resident company, based in Reading. It creates software for the mining industry and its biggest market is in Georgia. It is owned equally by:

Adrian, the Managing Director
Henry, the Finance Director
Verity, the Sales Director

It is important for Minecomp Ltd to have an office and senior representative in Georgia. Therefore, Kolya was recruited as a director and the Georgian office was opened on 1 November 2021. Kolya is a Georgian national, who is tax resident and domiciled in Georgia.

The only work Kolya undertakes for Minecomp Ltd is director's duties as follows:

1) He holds meetings with customers and government officials in the Georgian office. In the 2021/22 tax year he worked 11 half-days in respect of these duties and in 2022/23 he expects to work eight half-days.

2) In addition, Minecomp Ltd holds four board meetings each year at its offices in Reading. The July, October and January meetings are shorter meetings lasting a day. They discuss the previous quarter's results and plans for the next quarter. Kolya attends these via video-conferencing from the Georgian office. He also spends a half day preparing for these meetings. The April meeting is a strategic board meeting, held after the annual accounts have been prepared. The meeting takes place over seven days, usually Monday to Friday of the first week and Monday to Tuesday of the second week. Kolya is expected to attend in person at Reading.

For the April 2022 meeting, Kolya arrived in the UK on the evening of Sunday 10th, together with his wife. Kolya spent the five-hour flight preparing for the meeting. They stayed in London so that his wife could be close to friends. He took the train to Reading each day for the board meeting. They left the UK on the morning of Wednesday 20th. Minecomp Ltd paid the following expenses during Kolya's visit:

	£
First class return flights for Kolya and his wife	3,780 each
10-night stay in London hotel including breakfast	10,400
Evening meal for Kolya and his wife for 10 nights	2,600
First class weekly return train ticket to Reading	230
Two days first class return train ticket to Reading	195
Taxi to and from London station	70
Taxi to and from Reading station	90

Minecomp Ltd is due to pay Kolya the following sums in respect of his directorship, direct to his bank account offshore:

1) £25,000 for the period 1 November 2021 to 31 March 2022, payable on 30 May 2022.

2) £65,000 being his annual fee for the year to 31 March 2023. Kolya has asked for this sum to also be paid on 30 May 2022.

The company has agreed to protect Kolya from any UK tax and National Insurance costs on his annual fee to the extent they exceed the Georgian rates of 20% and 0% respectively. They will also pay any UK tax and National Insurance on all expenses.

Kolya is not expected to become UK tax resident.

Requirement:

Explain the PAYE and National Insurance implications for Minecomp Ltd in respect of Kolya, including possible changes to the timing of Kolya's fee for the year to 31 March 2023. (15)

<u>Extracts from the UK-Georgia Double Tax Treaty 2004</u>

<u>Article 14</u>
<u>Income from employment</u>

1. Subject to the provisions of Articles 15, 17, 19 and 20 of this Convention, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph (1) of this Article, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if

   a. the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days within any twelve-month period commencing or ending in the fiscal year concerned; and

   b. the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

   c. the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

<u>Article 15</u>
<u>Directors' fees</u>

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

<u>Article 25</u>
<u>Non-discrimination</u>

6. Nothing contained in this Article shall be construed as obliging either Contracting State to grant to individuals not resident in that State any of the personal allowances, reliefs and reductions for tax purposes which are granted to individuals so resident or to its nationals.

End of Question

3. TH Cuisine Ltd operates three restaurants in London, Edinburgh and Manchester and employs 90 employees as waiting staff in the restaurants. The waiting staff are paid weekly depending on the hours worked. Pay for the waiting staff working in the restaurant includes basic pay equal to the National Minimum Wage / National Living Wage for their age, and overtime payable at 1.5 times their normal hourly rate.

Under their employment contract, £5 per week is deducted from the waiting staff's net pay to cover the cost of uniforms and locker space provided in the restaurants. Some of the waiting staff undertake training at a local college for NVQ level qualifications in food hygiene and other employment related courses. The employees are contractually obliged to attend the courses and are paid their normal hourly rate for this time. In the event an employee refuses to attend, this is considered misconduct and TH Cuisine Ltd can issue penalties to the employee, which are recovered as a weekly net pay deduction.

Some waiting staff at the restaurant are entitled to receive tips or service charges from customers, which form an important part of their remuneration.

Payment of the tips and service charge varies across each restaurant as follows:

1) At the London restaurant, no service charges are included on bills and no tips are collected by card payment. Customers pay cash tips directly to waiting staff at their discretion. TH Cuisine Ltd has no record of the amount of cash tips received by each waiter.

2) At the Manchester restaurant, no service charges are included on bills and no tips are collected by card payment. Instead, all cash tips are collected by the restaurant manager who then transfers 20% of them to TH Cuisine Ltd. TH Cuisine Ltd then distributes this amount equally to the team of chefs at the restaurant. The restaurant manager distributes the remaining 80% of the tips to the waiting staff at her discretion.

3) At the Edinburgh restaurant, a mandatory 10% service charge is included on all bills for parties of more than six people. TH Cuisine Ltd collects this and pays an equal amount to each of the waiting staff working in the restaurant on that day.

   Customers at the Edinburgh restaurant can also pay tips. These are either made by cash direct to the employee who has served the customer or via card payment. Where tips are made by card payment, TH Cuisine Ltd deducts 5% to cover card charges. It then transfers the balance to the restaurant manager who then allocates this at their discretion to those employees who have passed their probationary period.

Requirement:

1) Explain the Income Tax and National Insurance Contribution implications of the tips and service charges. (10)

2) Explain any National Minimum Wage / National Living Wage implications which may arise. (5)

Total (15)

4. Nocha SA is a private limited company resident in Switzerland. Three of its employees – Emma, Frank and Lucas – have recently been seconded to its subsidiary, Nocha Ltd, near Dumfries in Scotland. All are Swiss nationals.

The secondments started on Monday 4 April 2022 and will last for three years. They will have portable A1 documents keeping them in the Swiss social security system and they will not be liable to National Insurance.

Emma is single and she arrived on Sunday 3 April having never previously visited the UK. She has been staying in a hotel in Dumfries, which Nocha Ltd has paid for at a cost of £75 per night. She has just found a flat in Carlisle, across the border in England and 30 miles from the factory. She will move in on 14 May.

Frank is single. He was a student at Edinburgh University for four years up to June 2020. He visited Scotland for 10 days in February 2022 and found a flat in Dumfries that he could rent during his secondment. He moved into the flat on his arrival in the UK on 2 April.

Frank has a student loan from when he was at Edinburgh University. He has been paying a fixed amount of £280 per month to the Student Loans Company from his Swiss bank account since he started work for Nocha SA. His current outstanding loan is £14,000.

Emma and Frank will not remain tax resident in Switzerland during their secondments.

Lucas is Frank's brother and he has never visited the UK before. He is married with a young child and his family will remain in Switzerland. He will work only in the UK but will return to Switzerland every other weekend. He will stay with Frank when he is in the UK and has agreed to pay half the rent. As Lucas' family is still in living in Switzerland, he is regarded as still Swiss tax resident under Swiss law.

The assignments will be on a tax-equalised basis. Each will receive a guaranteed net salary of £50,000 per annum and a net mobility premium of £800 per month. Nocha Ltd will not, however, equalise the student loan repayments. The assignees will be paid on or around the 23rd of the month, three weeks in arrears and one week in advance.

Requirement:

1) Calculate, with explanations, the annual UK tax cost for 2021/22 and 2022/23 for Nocha Ltd.

2) Discuss the impact on Frank's student loan repayments.

(20)

<u>UK/Switzerland Double tax Treaty</u>

<u>Article 4 – Resident</u>

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 tax 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 State in respect only of income from sources in that State. In the case of Switzerland, the term includes a partnership created or organised under Swiss law.

2. Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States, then this status shall be determined as follows:

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

   b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either 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 States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

   d) if he is a national of both 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 State in which its place of effective management is situated. In cases of doubt, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the State in which the person's place of effective management is exercised, and in doing so shall take into account all relevant factors. In the absence of such agreement, that person shall not be entitled to claim any benefits provided by this Convention except those provided by paragraph 1 of Article 22 (Elimination of double taxation), Article 23 (Non-discrimination) and Article 24 (Mutual agreement procedure).

End of Question

5. Digital Lessons Ltd is a privately owned company specialising in e-learning applications. On 1 March 2021, the shareholders entered into negotiations to sell all 500,000 ordinary shares to E-Learn plc for £50 million in cash. A sale was agreed on 1 August 2021 for £55 million in cash. Following a period of due diligence, the transaction completed on 1 October 2021. After this date, Digital Lessons Ltd continued to trade as a subsidiary of E-Learn plc and the former shareholders ceased to be employed by the company.

Immediately prior to the sale, there were 500,000 £0.001 ordinary shares in Digital Lessons Ltd, held as follows:

1) 485,000 ordinary shares held by Mr and Mrs Jones, who were the founders of the business. They bought a shell company from an unconnected company formation agent for £500 and had grown the company to the point of disposal.

2) 10,000 ordinary shares held by Sarah Gregory, the Managing Director of Digital Lessons Ltd. These shares were bought from Mr and Mrs Jones in May 2018, when Sarah was recruited into the company. She paid £50 per share. This price was the unrestricted market value as determined by an independent valuation expert. At the same time, Sarah and Digital Lessons Ltd entered into a side agreement providing that the shares could not be sold or transferred outside of a defined Exit Event (being a trade sale or flotation on a recognised market). The same valuation experts agreed that the effect of the side agreement would be to reduce the market value of the shares by 10%. No elections were made to disregard any or all of the restrictions for tax purposes.

3) 5,000 ordinary shares held by Martin Bass, the Finance Director of Digital Lessons Ltd. Martin began negotiating with Mr and Mrs Jones to acquire an interest in the company in July 2018, shortly after Sarah joined the company. However, it wasn't until 15 March 2021, that Martin bought the shares. The purchase price was £75 per share. Martin and Digital Lessons Ltd also entered into a side agreement providing for the same terms as for Sarah above. Although no tax valuation exercise was undertaken at the time, subsequent advice received by the purchaser is that, in determining the initial unrestricted market value, it would be appropriate to discount the initial offer price of £100 per share by 10% to reflect the restrictions in the side letter, on top of the 10% discount for the risk the sale didn't go ahead and minority rights. On 31 March 2021, Digital Lessons Ltd and Martin also agreed to disregard all restrictions on the shares for tax purposes.

Digital Lessons Ltd did not operate PAYE or NIC withholding on any of the above purchases or disposals. Furthermore, Digital Lessons Ltd did not have a legal right to sell the shares on employees' behalf outside an exit nor does the side agreement contain a tax indemnity clause.

Sarah Gregory and Martin Bass were paid a gross salary of £250,000 and £170,000 respectively in 2020/21 and each received a bonus of £3 million in January 2021. The salaries were paid in equal instalments on the last working day of the calendar month. They receive £12,000 and £8,500 a month after all deductions, respectively.

Requirement:

Explain, with calculations, the employment Income Tax and National Insurance consequences for Digital Lessons Ltd of the above transactions. (20)

6. Carbon Cancel Ltd is a firm of architects specialising in the design of carbon-neutral buildings throughout Europe. It is UK resident and has one wholly owned subsidiary, Carbon Cancel (Gib) Ltd, which is resident in Gibraltar and has no place of business in the UK. The UK company carries out most of the design work but uses the following two individuals for design adjustments on site.

Javier is a Portuguese national, who is resident in Spain. He lives close to the border with Gibraltar. He is an employee of Carbon Cancel (Gib) Ltd and works for this company in the Gibraltar office. This takes up 60% of his time. For the remainder of his time, he is helping the UK company on site in Spain (25% of his time) and in the UK (15% of his time – 36 days).

Javier is paid wholly on the Carbon Cancel (Gib) Ltd payroll into a Gibraltar bank account. No recharge of salary is made to Carbon Cancel Ltd. Carbon Cancel (Gib) Ltd withholds local tax and social security. Under the Spanish/Gibraltar reciprocal agreement, the social security deductions are credited to the Spanish system and Javier is therefore insured under the Spanish social security system.

Maria is a Portuguese national and lives in Portugal. She covers design issues on Carbon Cancel Ltd's Portuguese projects. As there isn't a Portuguese office, she is employed by Carbon Cancel Ltd, although her employment terms and conditions are compliant with Portuguese law. Her salary is paid in Euro via a local payroll bureau, who manage the Portuguese tax and social security contributions. She typically spends 85% of her time working on site or from home in Portugal and 15% (36 days) in the UK.

Their 36 days in the UK comprise monthly visits to the UK office of two to three days each to discuss design issues with the UK team plus an annual visit of seven days to be on the company's trade stand at the industry exhibition at the Birmingham NEC.

They each earn the equivalent of £60,000 per year. Carbon Cancel Ltd pays for the flights to the UK and hotel accommodation and a hire car during the UK visits. The UK company also reimburses Maria £600 per year for costs incurred kennelling her dog in Portugal while she is in the UK.

You should assume that all countries concerned have a double tax treaty with the UK based on the 2017 OECD Model Tax Convention.

Requirement:

Explain the UK PAYE and National Insurance requirements for Carbon Cancel Ltd in respect of Javier and Maria. (15)