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

Answer-to-Question-_1_

To: Justin and Jenny Liu

From: Chartered Tax Advisers

Date: 12 May 2022

Subject: The tax implications of your proposed plans and further tax planning actions.

Introduction

This report contains the analysis of your residence and domicile status and the effect this has on your exposure to UK tax.

It contains consideration of both employment contracts offered to Jenny.

We have also considered the most tax efficient gift to Mary and further tax planning on your jointly held assets.

Contents

A) Residence and Domicile status

B) Jenny's employment contracts

C) Gift to Mary

D) Transfer of asset to Jenny

E) Further recommendations

Abbreviations

Capital Gains Tax - "CGT"

Inheritance Tax - "IHT"

Business Asset Disposal Relief - "BADR"

Gift Relief - "GR"

Potentially Exempt Transfer - "PET"

Business Property Relief - "BPR"

Nil Rate Band - "NRB"

Non-Resident Capital Gains Tax - "NRCGT"

Executive Summary

Jenny will be treated as UK resident for the 2022/23 tax year under the third autmomatic UK test.

Jenny will qualify for split year treatment under Case 1 and will be treated as non-UK resident from 1 July 2022 provided that she spends less than 68 days in the UK between 1 July 2022 and 5 April 2023.

Justin will continue to be UK resident under the 2024/25 tax year from when he will become non-UK resident under the first automatic overseas tests if he spends less than 16 days in the UK.

The employment income from both Jenny's contract offers will be taxed in Ruritania. We reccomend that Jenny accepts the employment in the hospital in Ruritania as this offers long-term security.

Justin should transfer the Unit 4 building to Mary in the 2024/25 tax year when he becomes non-UK resident. The transfer will not result in a CGT liability as the market value and the value at 5 April 2019 are equal.

The transfer results in a £20,000 income reduction for Justin. This income would have been taxable on Justin even once he became non-UK resident.

You should consider taking out insurance on your gift to prevent the possibility of an IHT charge. Please seek an Independent Financial Advisor for this matter.

Justin will transfer the shares in Industrious Ltd to Jenny which will be an exempt transfer for CGT and IHT purposes.

Jenny will now received £20,000 of dividend income from the shares. As Jenny is non-UK resident from 1 July 2022, the income will not be taxable in the UK.

The transfer of 53 Red Street will be an exempt transfer to CGT and IHT purposes.

Jenny should sell the property as soon as she becomes non-UK resident to make full use of the PPR relief.

The funds can be invested in existing ISA's in the meantime before they are required to help fund their life in Ruritania.

To provide further funds for the move to Ruritania, both Justin and Jenny can make tax free withdrawals from their ISA's.

Justin can also withdraw up to 25% of his SIPP tax free. The remaining income can be taken on an annual basis to utilise his basic rate band ocne he has retired.

Main Report

A) Residence and Domicile status

To determine your exposure to Income Tax and Capital Gains Tax ("CGT") we must first look at your residence and domicile statuses on your departures from the UK in the 2022/23 and 2023/24 tax years.

Residence

Your tax residence status is determined using the Statutory Residence Test. Based on the information provided, you have both been UK resident in at least one of the three previous tax years. Therefore, we are required to look at the 'leavers' tests. Each test must be considered in order.

Automatic overseas tests

If you meet any of the following tests, then you will be treated as non-UK resident for the tax year.

a) You spend fewer than 16 days in the UK during the tax year. A day being where you are in the UK at midnight.

b) You work full-time overseas and spend fewer than 91 days in the UK, of which fewer than 31 days are UK workdays. Full-time is at least 35 hours a week. A workday is at least 3 hours.

Automatic UK tests

If you meet any of the following tests, you will be treated as UK resident for the tax year.

a) You spend at least 183 days in the UK during the tax year.

b) You have a home in the UK and are present there for at least 30 days. For a period of at least 91 consecutive days you either have no overseas home or spend fewer than 30 days in that overseas home.

c) You carry out full-time work in the UK for a period of at least 365 days, with no sigificant breaks and at least one UK workday falls into the tax year.

<u>Sufficient ties test</u>

This test takes into consideration the number of days you spend in the UK and the number of 'ties' you have with the UK. The five ties which need to be considered are:

a) Family- a spouse, a partner that you are living with, or your minor child is UK resident.

b) Accommodation - a place is available to be used for at least 91 days.

c) Work - you work at least 40 days in the UK.

d) 90-day - you spent at least 90 days in the UK in either of the two previous tax years.

e) Country - you spend more time in the UK that any other country.

We will now consider each of your residence statuses in turn as you are both leaving the UK at different dates.

<u>Justin's residence status</u>

We understand that Justin will remain in the UK until 31 March 2024 when he plans to retire and move to Ruritania.

You will be UK resident in the 2022/23 and 2023/24 tax years under the first automatic UK test and you will have spent at least 183 days in the UK. You will be subject to UK tax on your worldwide income and gains.

You will be non-UK resident from the 2024/25 tax year. If you spend less than 16 days in the UK in the tax year you will be non-UK resident under the first automatic test, however we would require further information to confirm this.

If not you will most likely be non-UK resident under the sufficient ties tests.

Jenny's residence status

We understand that Jenny intends to leave the UK to start overseas employment on 1 July 2022. Therefore, Jenny will spend at least 87 days in the UK during the 2022/23 tax year.

Based on the above tests you will meet the third automatic UK test and you will have carried out full-time work in the UK for at least 365 days, and at least one of those workdays falls into the 2022/23 tax year. You will be subject to UK tax on your worldwide income and gains.

However, as you are leaving the UK part way through the tax year, you may qualify for split year treatment.

Split year

If a split year applies, your tax year will be split into a UK part for which you will be taxed as a UK resident, and a non-UK part for which you will be treated as a non-UK resident.

The Case which applies in your situation is Case 1 - starting full-time work overseas.

This is on the basis that you do not spend more than 68 days in the UK from 1 July 2022 to the end of the tax year on 5 April 2023. Please let us know if this is not the case.

The overseas part of the year will start on your first day of overseas employment. Therefore, you will be treated as non-UK resident from 1 July 2022. Split year applies automatically so no formal claim is required.

Domicile

You were both born in Ruritania and acquired a Ruritanian domicile. A non-UK domiciled individual can claim the remittance basis whilst they are UK resident. This means that you are only subject to UK tax on your foreign income and gains when they are brought to or enjoyed in the UK.

However, you both became deemed UK domiciled from 6 April 2017 when the rules were first introduced, as you have been UK resident for at least 15 of the previous 20 tax years prior to that date.

As a deemed UK domiciled individual, you are both subject to UK tax on the same basis as a taxpayer who is UK domiciled under general law. You are both therefore subject to UK tax on an arising basis.

From an Inheritance Tax ("IHT") perspective, you are subject to

IHT on your worldwide assets. IHT will be charged at 40% on your death estate.

On the death of the first spouse, your estate is to pass to the surviving spouse. This is an exempt transfer for IHT purposes and will not result in an IHT liability.

To break the deemed domiciled status for Income Tax and CGT purposes, you must become non-UK resident for at least 6 years.

The rules are different for IHT. Instead, you need to be non-UK resident in that tax year and the 3 previous tax years to be no longer treated as deemed UK domiciled.

B) Jenny's employment contracts

Based on the previous analysis, Jenny is UK resident for the 2022/23 tax year but qualifies for split year treatment. You are treated as a non-UK resident from 1 July 2022 to the end of the tax year. This means that you are subject to Income Tax on your UK income only.

We will look at the tax implications of accepting either of the contracts presented.

UK development agency

If you decide to accept the contract with the UK developent agency, there could be tax implications in both the UK and Ruritania.

This is a UK employer but the duties are carried out in the UK. To determine which country has taxing rights over the income the OECD model treaty needs to be considered.

The treaty states that any employment income derived by a UK resident will be taxed in the UK unless the employment is exercised in Ruritania. If the employment is exercised in Ruritania, it will be taxed there.

The only occassion that the income would be taxed in the UK is if you spent less than 183 days in Ruritania and the income is paid from an employer who is not resident in the UK.

As you will most likely be spending more than 183 days in Ruritania during the 2022/23 tax year, Ruritania will have taxing rights on your employment income.

Therefore you would be subject to Ruritanian tax of 10% on your employment income. Please contact your Ruritanian tax adviser for further information on this matter.

Hospital in Ruritania

If you instead accept the contract with the hospital, this is a foreign employer and you will not be subject to UK Income Tax.

The full employment income will be subject to Ruritanian tax at 10%.

Recommendations

There is no difference in the tax implications on the receipt of employment income from either of the employment contracts.

Ruritania has taxing rights for both contracts so employment income will be taxed in Ruritania based on their current level of taxation.

The second employment contract will offer more stability in the future as it is a full-time contract, therefore we reccommend that you accept the contract in the hospital in Ruritania.

Please contact your qualified Ruritanian tax adviser for further assistance.

C) Gift to Mary

We note from our recent meeting that Justin intends to gift either his shares in Industrious Ltd or Unit 4 to Mary to provide her with additional income.

We have considered the tax implications of both options.

Industrious Ltd shares- whilst UK resident

CGT implications

If you gift the shares to Mary whilst you are UK resident, this would be a disposal at market value for CGT purposes as Mary is treated as a connected person.

The gift will qualify for Business Asset Disposal Relief ("BADR") as they are shares in a personal trading company. This means that Justin has been an employee and owned at least 5% of the share capital for at least 2 years prior to disposal.

We note that the company's only assets are used for the purpose of its trade, so the company will be treated as a qualifying trading company.

BADR reduces the CGT rate to 10% up to a lifetime limit of £1 million worth of gains. The claim must be made by the first anniversay of 31 January following the end of the tax year.

The CGT payable will be £20,420. Please see Appendix 1. You will be entitled to an annual exemption of £12,300 to reduce your chargeable gains.

The transfer of shares can alternatively qualify for Gift Relief ("GR") as shares in an unquoted trading company are a qualifying business asset. The effect of the claim is to reduce the chargeable gain to nil and instead defer the gain against the base cost of the shares.

Please see Appendix 2. Mary's base cost will be £63,500 which will result in a higher CGT liability when she eventually disposes of the shares.

GR must be a joint claim made within 4 years from the end of the tax year of gift.

Stamp Duty implications

The transfer of shares will not result in a Stamp Duty charge payable by Mary as the gift is made for no consideration.

Income Tax implications

You will no longer receive dividend income of £20,000 from the shareholding as a result of the transfer. You will have an Income Tax saving of £6,578. Please see Appendix 3.

IHT implications

A gift is treated as a Potentially Exempt Transfer ("PET") for IHT purposes. This is chargeable to IHT at 40% if you were to pass away within 7 years from the date of gift.

Taper relief is available to reduce the IHT rate by 20% for every year between 3 and 7 years from the date of gift.

However, when there is a gift of unquoted shares in a trading company, Business Property Relief ("BPR") is available. The transfer will be reduced to nil. BPR applies automatically so no formal claim is required.

If you were to pass away within 7 years of the gift, BPR is still available on the shares if Mary still holds the shares at your death, or if she has sold them and reinvested the proceeds in other qualifying business property within 3 years.

<u>Unit 4 - whilst UK resident</u>

<u>CGT implications</u>

The gift of the building is a disposal for CGT at 20% on the difference between the market value at gift and the base cost.

BADR is not available on the transfer as you have charged the company full market rent for the use of the building.

The gift will however qualify for GR as it is a qualifying business asset used in your personal trading company. This means that you own at least 5% of the share capital.

No CGT would be payable on the transfer but it will reduce the base cost for Mary on the eventual sale of the building. The revised base cost will be £80,000. Please see Appendix 4.

Income Tax implications

You will no longer receive £20,000 of rental income from the building as a result of the transfer. You will have an Income Tax saving of £9,928. Please see Appendix 5.

IHT implications

The transfer is a PET for IHT purposes and will become chargeable if you were to pass aways within 7 years of gift.

IHT will be charged at 40% and will be reduced by your available Nil Rate Band ("NRB") of £325,000. Taper relief is available if you were to pass away within 3 and 7 years from the date of gift.

Industrious Ltd shares- whilst non-UK resident

A transfer of shares whilst you are non-UK resident is not a chargeable transfer for CGT purposes. The only event when the shares would become chargeable is if the temporary non-residence rules are met.

As there is no expectation that you plan to return to the UK, this will not be applicable.

There is also no CGT payable in Ruritania based on the OECD model treaty.

The dividends are not subject to Income Tax whilst you are non-UK resident as they are considered to be disregarded income. Non-UK residents do not pay tax on disregarded income. You will therefore have no Income Tax savings as a result of the transfer.

Unit 4 - whilst non-UK resident

A transfer of UK land and property whilst you are non-UK resident is subject to CGT under the Non-Resident Capital Gains Tax ("NRCGT") rules.

The NRCGT rules brought non-residential property into the regime from 5 April 2019. The disposal will be calculated using one of two methods:

- Default method- current maret value less the market value at 5 April 2019.

- Retrospective method - current market value less cost.

As the current market value and the value at 5 April 2019 is £280,000, the default method would prove to be more beneficial. The gift will result in a chargeable gain of nil.

You will make the same Income Tax as if you were a UK resident, as UK rental income is subject to Income Tax on non-UK residents.

Recommendations

As there is no indication in our recent meeting of an urgency to transfer the asset over to Mary, we believe that you should transfer the Unit 4 building to Mary when you become non-UK resident in the 2024/25 tax year.

The transfer does not result in a CGT liability as the current market value is the same as the value at 5 April 2019. However, please note there may be a slight increase in the building between now and the date of transfer.

You will no longer receive rental income of £20,000 which will have continued to be taxed in the UK even once you become non-UK resident.

The rental income would also have been taxable on Justin in Ruritania at 30% which would have created a double taxation.

Foreign tax credit would have been available.

The building would have been subject to IHT at 40% on your death estate if you have not gifted it to Mary. You should consider taking out insurance on your gift to prevent the possibility of an IHT charge if you were to pass away within 7 years. Please seek an Independent Financial Advisor for this matter.

D) Transfer of asset to Jenny

Justin is considering transferring the shares or the Unit 4 building and 53 Red Street to Jenny. As we believe the building should be transferred to Mary, we will only consider the tax implications on the transfer of both the shares and 53 Red Street.

<u>Transfer of shares</u>

A transfer of an asset to a spouse takes place at no gain no loss for CGT purposes. This means that no CGT is payable on the transfer.

The transfer is also covered by the spousal exemption for IHT purposes.

Justin will be removing £20,000 of dividend income from his taxable earnings which will instead be taxed on Jenny.

The income will be taxed at 32.5% in the hand of Jenny and will qualify for the £2,000 dividend allowance.

No Stamp Duty is payable on the transfer as no consideration has been received.

Transfer of 53 Red Street

As with the transfer of shares, the transfer of 53 Red Street takes place at no gain no loss for CGT purposes and is covered by the spousal exemption for IHT purposes.

When the property is disposed of by Jenny, there will be a CGT liability.

The property was Justin's made residence from 6 April 2000 to 5 April 2010. Principal Private Residence ("PPR") relief is available to reduce the CGT payable based on the period of occupation in the property.

When the property is transferred to Jenny, she will acquire the deemed periods of ownership from Justin.

As the property will be sold whilst Jenny is non-UK resident, the disposal falls within the NRCGT regime.

The disposal is calculated using one of the three following methods:

- Deafult method - sale proceeds less the market value at 5 April 2015.
- Time apportionment method - sale proceeds less the original cost. Only the gain which relates to the period after 5 April 2015 is taxed.
- Retrospective method- sale proceeds less the original cost.

If the default or time apportionment method is used, the property is deemed to be acquired at 5 April 2015 for PPR relief purposes. The last 9 months will be treated as deemed occupation as the property was occupied at some point before 5 April 2015.

The default method will result in a gain of £100,000, whereas the time apportionment method results in a gain of £136,818. The retrospective method is not beneficial as it will create a gain of £430,000. Therefore the default method should be applied.

Assuming the property is sold on 6 April 2024, the CGT payable by Jenny will be £25,667. Please see Appenidix 6. Jenny is not entitled to an annual exemption as she will not be UK resident or a UK national at that point. CGT will be payable at 28% based on Jenny's level of earnings.

The disposal must be reported on an online property disposal return within 30 days of completion.

Recommendations

The transfer of shares should take place now as there is no tax implications of a transfer of assets between spouses.

As Jenny will be treated as a non-UK resident from 1 July 2022, she will not be subject to UK Income Tax on the dividend income as this is considered to be disregarded income for non-UK residents.

Justin should also transfer 53 Red Street to Jenny now which will not result in any tax implications.

The sale of the property should be made as soon as Jenny becomes non-UK resident instead of waiting in 2 years time. We understand that the property is not currently being used by yourselves and Justin will make an Income Tax savings on the rental income of £23,000 which will no longer be received.

The reason why the property should be sold as soon as Jenny is non-UK resident is to make full use of PPR relief. By waiting another 2 years this will further reduce the PPR relief available which will create a higher CGT liability.

The funds can be invested in the exisiting ISA held in the meantime before it is required to help fund your life in Ruritania.

E) Further recommendations

To help fund your move to Ruritania, you could conisder withdrawing funds from your ISA's. The withdrawal would not be taxable for Income Tax or CGT purposes.

The funds from Justin's SIPP can be withdrawn as Justin is over the age of 55. The first 25% of the fund can be taken take free. Justin could then take annual income from the fund to utilise his basic rate band once he has retired.

If you would like to reduce your chargeable estate for IHT purposes, you can consider utilising your annual exemption of £3,000 a year. You can make cash gifts of up to £3,000 a year, to Mary for example, and this would be exempt for IHT purposes.

Any small gifts of up to £250 a year per recipient can also be made free of IHT.

Appendicies

Appendix 1

Market value	280,000		
Less: cost	(63,500)		
Gain	216,500		
Less: annual exemption	(12,300)		
Taxable gain	204,200		
CGT @ 10%	20,420		

Appendix 2

Justin's CGT liability:

Market value	280,000		
Less: cost	(63,500)		
Gain	216,500		
Less: gift relief	(216,500)		
Taxable gain	Nil		

Mary's base cost:

Market value of shares	280,000		
Less: gift relief	(216,500)		
Base cost	63,500		

Appendix 3

	NSI		
Employment	100,000		
UK property	43,000		
	143,000		

NSI			
37,700 x 20%	7,540		
105,300 x 40%	42,120		
Tax liability	49,660		

56,238 - 49,660 = 6,578

Appendix 4

Justin's CGT liability:

Market value of building	280,000		
Less: cost	(80,000)		
Gain	200,000		
Less: gift relief	(200,000)		
Taxable gain	Nil		

Mary's base cost:

Market value of building	280,000		
Less: gift relief	(200,000)		
Base cost	80,000		

Appendix 5

	NSI	DIV	
Salary	100,000		
UK property	20,000		
Dividends		20,000	
	120,000	20,000	

NSI			
37,700 x 20%	7,540		
82,300 x 40%	32,920		
DIV			
2,000 x 0%	0		
18,000 x 32.5%	5,850		
	46,310		

56,238 - 46,310 = 9,928

Appendix 6

Default method:

Sale proceeds	550,000		
Less: market value at 5 April 2015	(450,000)		

Gain	100,000		

Time apportionment method:

Sale proceeds	550,000		
Less: cost	(120,000)		
Gain	430,000		
Gain post 5 April 2015 (x 7/22)	136,818		

Retrospective method:

Sale proceeds	550,000		
Less: cost	(120,000)		
Gain	430,000		

PPR relief:

	Occupation	Absence	
5 Apri 2015 - 5 July 2023		99	
6 July 2023 - 6 April 2024	9		

Gain	100,000		
Less: PPR relief (100,000 x 9/108)	(8,333)		
Taxable gain	91,667		
CGT @ 28%	25,666		