The Chartered Institute of Taxation

Application and Professional Skills

Taxation of Individuals

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Suggested solution

DRAFT REPORT FOR JUSTIN AND JENNY LIU

INTRODUCTION

This report considers Justin and Jenny Liu's UK tax residence, their liability to UK taxation, and planning opportunities to minimise that liability.

This report has been prepared for and is addressed to Justin and Jenny Liu, and is intended for use by them only. No responsibility is accepted for any reliance placed on the contents of this report by third parties. It is based on tax legislation as it applies at the time of writing and any changes to the legislation may affect the conclusions of this report.

EXECUTIVE SUMMARY

Residence

UK residents are taxed in the UK on their worldwide income and gains. Non-residents are taxable on UK-sourced income and, to a limited extent, on gains on the disposal of UK land and property.

Jenny will not be UK resident from 1 July 2022 when she starts employment in Ruritania, provided that she continues to work full-time overseas until 5 April 2024 with no significant break. These conditions are likely to be met if she takes the permanent contract. If the temporary contract is taken, the conditions can still be met if Jenny starts another full-time employment in Ruritania within 30 days of completing the contract.

Jenny should ensure she meets the conditions to not be UK resident from 1 July 2022 so that her employment income is taxed at lower Ruritanian rates, and to enable Justin and Jenny to take advantage of tax planning opportunities in relation to the transfer of assets.

Gifts to Mary

A gift to Mary will be deemed to take place at market value and subject to capital gains tax (CGT). Justin could claim Business Asset Disposal Relief (BADR) to reduce the tax rate on a gift of his shares to 10%, or gift relief to reduce tax on a gift of either the shares or Unit 4, Grey Building (Unit 4) to zero.

Transfers between spouses take place at no gain-no loss. Non-residents are only subject to UK CGT on the disposal of UK land and buildings, and only on gains accruing since 5 April 2015 for residential property, or since 5 April 2019 for non-residential property.

If Jenny is non-resident, the shares can be transferred to Jenny free of tax, then from Jenny free of tax. Unit 4 should not be transferred through Jenny because Justin's pre-5 April 2019 gains would become taxable in Jenny's hands.

If Jenny is non-resident, the shares should be transferred to Mary, through Jenny. Otherwise, Justin should wait until he is not UK resident and then transfer Unit 4, provided there is no expectation that its value will increase significantly before then.

Investment Income

A transfer or either Unit 4 or 53 Red Street from Justin to Jenny would cause all Justin's gains to become chargeable to CGT on a subsequent disposal by Jenny. Therefore, Justin should not transfer either of the buildings to Jenny.

Without the transfer of the buildings, there is little opportunity for tax savings just through the transfer of the shares to Jenny.

RESIDENCE

A person's UK tax residence is determined by statutory residence tests which must be applied, in prescribed order, to establish residency status.

<u>Jenny's Residence</u>

In the current 2022/23 tax year Jenny will remain UK tax resident because she will spend more than 90 days in the UK and has worked full-time in the UK for several years, including at least one UK workday in the 2022/23 tax year.

However, because Jenny is leaving the UK, it may be possible for her to split the year into a UK part and an overseas part.

Split year treatment will apply to Jenny if she meets the following conditions:

- she works overseas for at least 35 hours per week on average with no breaks from work of more than 30 days
- she spends no more than 67 (90 x 9/12) days (midnights) in the UK, and no more than 22 (30 x 9/12) days working in the UK (for more than 3 hours) during the remainder of the tax year after 1 July 2022
- she continues to work full-time overseas in the following 2023/24 tax year, spending no more than 90 days in the UK in that year, and a maximum of 30 workdays in the UK.

It appears that Jenny will meet the first two conditions, provided she does not return to the UK for more than 67 days in the overseas part of the tax year.

The third condition will also be met if Jenny takes the permanent contract in Ruritania and continues to work throughout 2023/24.

If Jenny takes the nine-month contract, the third condition could be met if she takes another full-time job in Ruritania within 30 days of the contract ending, but will not be met otherwise.

If all the conditions are met, Jenny will not be UK resident from 1 July 2022 when she starts work overseas. If not, Jenny will remain UK resident throughout the 2022/23 tax year.

<u>Justin's Residence</u>

Justin will remain UK resident throughout 2022/23 and 2023/24 as he will be living and working in the UK. Therefore, his worldwide income and gains are taxable in the UK.

<u>Future Years</u>

Jenny will remain non-resident while she continues to meet the conditions for full-time work overseas (no more than 90 days in the UK, no more than 30 UK workdays, no break of more than 30 days from overseas work, and working at least 35 hours a week overseas on average each tax year).

After Justin leaves the UK, he will also not be UK resident under the sufficient ties test (**APPENDIX 1**), provided he spends no more than 90 days in the UK each year, on the assumption that he has two ties, being the accommodation tie and the 90 day tie. For one year out of three Justin could increase his UK visits to 120 days without triggering residence as the 90 day tie will fall away. If he leaves part way through a tax year, the year will need to be reviewed to establish his residence status and split-year treatment for that year. The sufficient ties test will also apply to Jenny if she stops working overseas.

JENNY'S EMPLOYMENT INCOME

If Jenny is not UK resident, her employment income for work carried out in Ruritania will not be taxed in the UK.

Of the two employments, the temporary contract is preferable as the salary is higher, assuming that she is able to continue in employment after the contract ends. However, if taking this contract makes Jenny UK resident the additional salary will be wiped out by the additional UK tax due (£9,432 UK tax [from 21/22 return] vs £5,500 [10%] Ruritanian tax) and this contract will only be preferable if Jenny is confident that she can find further work in Ruritania within 30 days of the contract ending.

Recommendation

The optimum result would be for Jenny to take the temporary contract then ensure that her next full-time job in Ruritania starts within 30 days of the contract ending so that she meets the conditions to not be UK resident. This would mean her Ruritanian income is not taxable in the UK and also give opportunities to save tax on transfers to Mary, outlined below. Jenny will, of course, also need to take into account non-tax considerations when deciding which contract to take, particularly as the recommended contract is temporary.

GIFT TO MARY

For the purpose of CGT a gift is deemed to be a disposal at market value. Therefore, CGT will be charged on any increase in value since the asset was acquired, subject to reliefs which may be available.

Transfers between spouses (unless separated in circumstances likely to be permanent) take place at no gain-no loss, with the transferee taking on the asset at the same base cost as the transferor. This applies even if Justin and Jenny are not living in the same country.

If Jenny is not UK resident, it may be possible to reduce CGT by transferring assets from Justin to Jenny before disposal. Non-residents are not subject to UK CGT other than on disposals of UK land and property, and only on gains accruing since 5 April 2015 for residential property, or since 5 April 2019 for non-residential property (the value is 'rebased' to that date).

Disposals of UK land by UK residents where tax is due need to be reported to HMRC and the tax paid within 30 days. Disposals by non-residents need to be reported within 30 days regardless of whether any tax is due.

Shares in Industrious Ltd

A straightforward transfer from Justin to Mary would give rise to a gain of £216,500 (**APPENDIX 2**). Justin has held the shares for more than two years, works for the company, and holds more than 5% of the share capital, therefore BADR could be claimed so that the gain is taxed at 10%, resulting in tax due of £20,420.

A gift of the shares would also qualify for gift relief. If gift relief was claimed, no CGT would be charged, however on any future sale of the shares Mary would be taxed on the proceeds above Justin's original cost of £63,500. Mary could not claim BADR as she does not work for the company, her gains would be taxed at 10% so far as they fall within her basic rate tax band, then 20%.

Alternatively, Justin could first transfer the shares to Jenny at no gain-no loss, and Jenny could then give the shares to Mary. Provided Jenny is not UK resident at the time of the transfer from her to Mary, and does not become UK resident within five years of the transfer, no CGT would be charged.

Mary's base cost of the shares would then be their current market value of £280,000, meaning that if she sells them in future, she will only pay CGT on gains over £280,000, potentially saving at least £37,070 compared to if gift relief is claimed (CGT on £204,200: £37,700 x 10% plus £166,500, x 20%)

Unit 4, Grey Building

The transfer of Unit 4 to Mary would give rise to a gain of £200,000 (**APPENDIX 2**).

Provided the transfer is made while Justin still owns 5% of shares in Industrious Ltd, a transfer of the building for no consideration would qualify for gift relief because it is being used by Justin's personal trading company. This means that no CGT would be charged. However, Mary would inherit Justin's base cost, meaning that on a future sale she would be subject to CGT on the value over £80,000.

Unlike the shares, it would not be advantageous to transfer Unit 4 through Jenny because the benefits of rebasing would be lost. If Justin transfers Unit 4 to Jenny, she will have acquired it after 5 April 2019, therefore all the gain will be chargeable when Jenny then transfers the property to Mary, even if Jenny is not UK resident.

Justin could wait to transfer Unit 4 in two years' time when he is not UK resident. Only the gain over the value on 5 April 2019 would be subject to UK CGT. At the moment, this is the same as the current market value, so if there is no change no tax would be due. The advantage of this is that Mary would receive the building with a base cost of its market value at the time of transfer, which would save CGT of up to £40,000 (£200,000 x 20%) on a future disposal of the property by her. This is higher than the additional income tax Justin would pay over Mary's tax rate in the two years of additional ownership (£20,000 x 20% x 2 years = £8,000).

Recommendation

If Jenny is not UK resident the shares should be gifted through her. There will be no CGT, and Mary will receive the shares with a base cost of their current value.

If Jenny remains UK resident, either the shares or Unit 4 can be gifted now with no CGT due if gift relief is claimed, but Mary's base cost will be higher. Therefore, Justin should wait until he is non-resident and transfer Unit 4 to Mary then. There will then be no CGT provided its value has not risen above the April 2019 value plus the annual exempt amount. It will be preferable for Justin to retain the shares, because he has greater flexibility to transfer the shares to Jenny without an uplift in the base cost, or sell them free of CGT, but if the value of Unit 4 rises so that CGT would be due, the shares can be transferred to Mary instead.

INVESTMENT INCOME

If Jenny is UK resident

Assuming Justin's income were reduced by £20,000 due to the gift of Unit 4 to Mary, both Justin and Jenny would be higher rate taxpayers. There could nevertheless be the potential opportunity to save tax through restoring Justin's personal allowance by reducing his income below £100,000.

If Justin transferred all his assets to Mary and Jenny, his only income would be employment income of £100,000, and Jenny's income would also remain below £100,000. The saving which could be made is £5,028 p.a., which is tax at 40% on the personal allowance. Over two years until Justin retires, the maximum saving would be £10,056.

However, if either Unit 4 or 53 Red Street was transferred to Jenny, the opportunity to benefit from rebasing, which would apply to Justin once he is no longer UK resident, would be lost. The CGT savings on both Unit 4 and on 53 Red Street due to rebasing (**APPENDIX 3**) are higher than the income tax saving over two years through transferring the properties to Jenny. Therefore, it is not recommended that either of these properties are transferred.

If the shares are not given to Mary they could be transferred to Jenny. The savings from this transfer alone would be minimal, as Justin would still lose all or almost all of his personal allowance due to the rental income from 53 Red Street, and dividends are taxed at higher rate in either Justin or Jenny's hands.

If Jenny is not UK resident

It is not recommended that either property should be transferred to Jenny, because the loss of rebasing relief when the property is then sold would exceed the potential income tax saving from the transfer (the maximum income tax saving possible on the £43,000 income from both properties is £25,140 x 30% [60% UK tax - 30% Ruritanian tax] + £17,860 x 10% [40% UK tax - 30% Ruritanian tax] = £9,328 per year, or £18,656 over two years). This is because the effective rate of tax in the UK on income between £100,000 and £125,140 is 60% due to the loss of personal allowance.

Rebasing would not be an issue if the shares were transferred to Jenny. However, where an asset is transferred by a UK resident so that the income arising from the asset becomes the income of a person abroad, and the transferor retains the ability to benefit from the income generated, then that income remains chargeable on the transferor. It seems likely that this provision would apply to transfers made between Justin and Jenny, nullifying any saving which could be made , if the purpose of the transfer is simply for Jenny to receive the income more tax efficiently than Justin. This would not prevent the shares from being transferred to Mary through Jenny for capital gains tax purposes

Recommendation

Neither of the two properties should be transferred to Jenny, because of the loss of rebasing relief. Justin is better off accepting the tax charge on the rental income and waiting until he is non-resident to sell 53 Red Street.

If Jenny remains UK resident it may be possible to make a small saving by transferring the Industrious Ltd shares to her. The amount of the saving depends on the level of rental income Justin receives in the year, but is likely to be small.

17 YELLOW ROAD

Spouses can only have one main residence for CGT purposes, and it appears that 17 Yellow Road will remain Jenny's main residence over the next two years by virtue of Justin living there. If Jenny acquires a PPR in Ruritania, a formal nomination of 17 Yellow Road as Justin and Jenny's main residence should be made to ensure that this is the case.

Once both Jenny and Justin are no longer UK resident, it would be possible to nominate 17 Yellow Road as their main residence, but only if they spend more than 90 days there each year. As spending more than 90 days in the UK will in any case make them UK resident, this will not be advisable.

Therefore, gains attributable to the period after Justin and Jenny are both no longer UK resident will be subject to CGT if 17 Yellow Road is sold. The period when the property was Jenny or Justin's main residence, plus the last nine months of ownership, will remain covered by main residence relief.

INHERITANCE TAX

Justin and Jenny have both been resident in the UK for more than 15 of the previous 20 tax years, so are both deemed to be UK domiciled for Inheritance Tax (IHT) purposes, meaning their entire estate is subject to UK IHT. Once an individual has been tax resident outside the UK for four consecutive tax years ending with the year of transfer, they will lose their deemed UK domicile and only UK situs assets remain within the scope of UK IHT. Land and buildings in the UK, cash held in UK bank accounts, and shares in companies listed in the UK are UK situs assets.

Transfers between Justin and Jenny are exempt from IHT while they are both UK domiciled and also once they are both not UK domiciled. During any period when either Justin or Jenny is UK domiciled and the other non-domiciled the exemption on transfers to the non-domiciled partner is limited to £325,000, unless the non-domiciled spouse elects to be treated as UK domiciled

Justin is intending to dispose of all his UK properties and his shares in Industrious Ltd over the next two to three years. If he were to keep any of these, there would be an advantage in keeping the shares in Industrious Ltd, because they will receive 100% business property relief. Once owned for two years, shares in unlisted UK trading companies can qualify for 100% relief.

Assets are not exempt from IHT specifically due to being held within an ISA, therefore, once Justin has lost his UK domicile, UK listed stocks will remain liable to IHT. Stocks listed on an overseas exchange would not, so Justin should consider transferring his investments to overseas stocks to reduce his exposure to IHT.

Justin’s SIPP is not included in his estate for IHT. If he dies before the age of 75 it can be passed to the designated beneficiaries tax free. If he dies after 75, the beneficiaries may be liable to UK income tax on the inherited fund.

If Jenny retains 17 Yellow Road, it will be subject to UK IHT when she dies, if it is not left to Justin. A lifetime gift would escape IHT provided Jenny survives seven years after the date of gift.

Jenny’s cash in an ISA will be within the scope of UK IHT as long as it is held in the UK, therefore she should consider moving this overseas.

APPENDIX 1 - STATUTORY RESIDENCE TEST: THE SUFFICIENT TIES TEST

There are five possible ties:

Tie:	Applies if:
Family Tie	Your partner is UK resident in their own right
Accommodation Tie	You have a place to live in the UK available for more than 90 days and you spend at least one night there in the tax year
Work Tie	You work at least 3 hours in the UK on at least 40 days
90 Day Tie	You spent 90 days in the UK in either of the previous two tax years
Country Tie	You were UK resident in one of the previous 3 tax years and the UK is the country in which you spend the greatest number of days in the year

Residence is determined by the number of days spent in the UK, combined with the number ties which apply, as follows:

Days spent in the UK in the tax year:	Number of ties needed to be UK resident if UK resident in one of previous 3 tax years:	
16 – 45	At least 4	
46 – 90	At least 3	
91 - 120	At least 2	
Over 120	At least 1	

APPENDIX 2 – GAINS ON DISPOSAL OF SHARES IN INDUSTRIOUS LTD OR UNIT 4

	£
Shares in Industrious Ltd	
Market value	280,000
Cost	(63,500)

Gain	216,500
Annual Exempt Amount	(12,300)

Chargeable Gain	204,200
CGT @ 10%	20,420
Unit 4	
Market value	280,000
Cost	(80,000)

Gain	200,000

APPENDIX 3 – REBASING

	£
Unit 4	
Current market value	280,000
Market value on 5 April 2019	280,000
Cost	80,000
Gain without rebasing	200,000
Gain with rebasing to 5 April 2019	0
Maximum potential CGT saving (200,000 x 20%)	40,000
Minimum potential CGT saving (37,700 x 10% + 150,000 x 20%)	33,770
53 Red Street	
Current market value	550,000
Market value on 5 April 2015	450,000
Cost	120,000
Transfer to Jenny and subsequent disposal	
Gain without rebasing:	
Gain	430,000
Less PPR Relief (129 months / 289 months [estimated assuming sale May 2024)	(191,938)

Chargeable gain	238,062
Disposal by Justin while he is non-resident	
Gain with rebasing to 5 April 2015	100,000
Less PPR Relief (9 months / 109 months [estimated assuming sale May 2024])	(8,257)

	91,743
Potential CGT saving ([238,062 – 91,743] x 28%)	40,969
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