The Chartered Institute of Taxation

Advanced Technical

Taxation of Individuals

May 2021

Suggested answers

ANSWER 1

An Individual's residence status for a tax year is determined by the conditions laid out in the Statutory Residence Test.

An individual is either UK resident or non-UK resident for a full tax year. However, it is possible for a tax year to be split in if the criteria laid out the legislation are met. There are 8 sets of split year criteria, known as cases, each with their own detailed set of rules. Case 1 will be relevant to Jason and I have set out the criteria below:

For 2021/22 Jason will qualify for split year treatment if all of the following criteria (labelled A to D) are met:

A) He must be UK resident for the year 2021/22.

As he will have been present in the UK for the entire period from 6 April 2021 until his departure in December, other than three week absence, he will satisfy this requirement as he will have spent 183 days in the UK in the tax year.

B) He must have been UK resident for the year 2020/21.

This is met as he has always been UK resident.

C) He must satisfy the overseas work criteria for the "relevant period".

He will satisfy the overseas work criteria if he meets four conditions:

Firstly, he must work full-time overseas during the relevant period. Secondly, he must have no significant breaks from overseas work during that period.

Thirdly, he must not work for more than 3 hours in the UK on more than the permitted limit of days during the relevant period. Finally, he must ensure that he does not spend more than a certain number of days in the UK during the relevant period.

For the purposes of this test, a day in the UK is any day when he is present in the UK at midnight at the end of the day.

The date on which the relevant period starts is the first day when Jason works for more than three hours in Australia and will end on 5 April 2022. As he is leaving in December, he cannot work in the UK on more than 10 days during the relevant period or be present in the UK for more than 30 days.

Full-time work is defined as averaging 35 hours per week across the relevant period. The period can be reduced for days Jason is unavailable for work for various reasons e.g. periods of annual leave, sickness, any days on which he works for more than three hours in the UK and a permitted number of days between employments as long as no work is done on those days. For an individual leaving the UK in December the permitted number of days between employments is 10.

Jason will be classed as having a significant break from overseas work if at least 31 days go by and not one of those days is a day on which he works for more than three hours overseas, or would have worked for more than three hours overseas but he does not do so because he is on annual leave, sick leave or on parenting leave.

D) Jason must be non-UK resident in 2022/23 by virtue of the Third Automatic Overseas Test which he is already aware of.

If Jason satisfies all of the criteria, the 2021/22 tax year will be split into a UK part and an overseas part. The overseas part will start on the first day of the relevant period. This would mean that he would not be liable to UK tax on his overseas income with effect from the start of the overseas part of the tax year.

He will need to complete the relevant boxes on the Residence page of his self assessment tax return for 2021/22 to show that he qualifies for split year treatment.

Jason should ensure that he keeps detailed records of both his visits to the UK and his working hours whilst in Australia.

Jason will need to register as a non-resident landlord in order to continue to receive rents gross. Otherwise his letting agent or tenant is required to deduct tax at 20% from the rents before paying them over to Jason. This can be done by submitting form NRL1 to HMRC.

Once HMRC have processed the NRL1 Jason will receive a registration number, which he should provide to his letting agent or tenant. He will need to continue to declare his UK rental income and expenditure on his tax return each year. He would be entitled to a UK Personal Allowance as a British citizen.

Any tax deducted by Jason's agent or tenant can be offset against Jason's total UK Income Tax liability for the year. If the tax deducted exceeds his liability, a repayment can be claimed.

Non UK residents are not usually liable to UK Capital Gains Tax, however there are certain exceptions, including sales of UK property.

If Jason sells 31 Brooke Street, , he is required to notify HMRC of the sale within thirty days of the date of completion by submitting an online Capital Gains Tax return. If there is any Capital Gains Tax due this will need to be paid within the same thirty day period.

He will be entitled to a UK annual exempt amount for Capital Gains Tax.

Jason should also seek tax advice in Australia to ensure that he is meeting all of his tax obligations there.

MARKING GUIDE

TOPIC	**MARKS**
Presentation and higher skills	1
Individual is either resident or non-UK resident for a full tax year	½
Tax year can be split in year of departure and return	½
Identify relevant split year case	½
Explain criteria A & apply to client's situation	1
Explain criteria B & apply to client's situation	½
Explain criteria C conditions	1½
Definition of a day in the UK	½
Explanation of full-time work calculation	1½
Explanation of when a significant break occurs	½
Apply criteria C to client leaving the UK in December	1
Explain criteria D & apply to client's situation	½
Explain effects of qualifying for split-year treatment	½
Advice regarding Non Resident Landlords scheme	1
Still required to declare rents on self assessment tax return	½
Can offset tax deducted against total liability	½
Entitled to UK Personal Allowance	½
Non-UK residents liable to UK Capital Gains Tax on Sale of UK Property	½
Advice regarding the Capital Gains Tax Return requirements and deadline	½
Deadline for payment of UK Capital Gains Tax on sale of property	½
Will qualify for UK annual exempt amount	½
Advise client to seek advice in Australia	½
TOTAL	**15**

ANSWER 2

	Working	Non-savings	Savings	Dividend
		£	£	£
Employment income		200,000		
UK interest			14,000	
Foreign dividends	1			2,000
		-----------	---------	----------
		200,000	14,000	2,000
Personal allowance	2	0		
		-----------	--------	--------
Taxable income		200,000	14,000	2,000
		=====	====	====
Total				216,000

Tax payable

Non-savings income	**Working**		**£**
£41,250	3	20%	8,250
£112,500		40%	45,000
£46,250		45%	20,813
Savings income			
£0		0%	0
£14,000		45%	6,300
Dividend income			
£2,000		0%	0

			80,363
Excess pension charge	4		36,000
Tax underpayment from earlier year			1,000
HICBC	5		1095

Total tax liability			118,458
FTCR	1		(300)
PAYE deducted at source			(78,000)

Tax payable			40,158
			=====

Tax is payable by 31/1/2022

Payments on account of £20,079 each will also be payable by 31 January 2022 and 31 July 2022

Polly can elect for £21,300 of the tax charge on the excess pension contribution to be paid from the pension scheme ("scheme pays" - W6). As the tax would then be less than 80% of the total tax due for the year, no payment on account would be due.

This election must be made by 31 July 2022.

Workings

1 Foreign dividends

Additional tax due as a result of foreign dividends

		£
Increase in excess pension contributions due to foreign dividends	£(2,000/2) at 45%	450
Additional tax due		450
FTCR restricted to lower of		
UK tax on dividends	As above	450
Foreign tax paid		400
OR tax at the treaty rate	£2,000 x 15%	300

2 Personal allowance

Adjusted net income: £200,000 +14,000 + 2,000 – (3000x100/80) = £212,250

Therefore no personal allowance is due

3 Basic and Higher rate bands

Basic rate band	37,500
Gift aid £3000 x 100/80	3,750

Adjusted basic rate band	41,250
	=====
Adjusted higher rate band	
150,000 + 3,750	153,750

4 Pension

	No of years		£
At 5/4/20	13	13/60 x £195,000 x 16	676,000
At 5/4/21	14	14/60 x £205,000 x 16	765,333

Pension input amount			89,333
Threshold income – exceeds £200k		£200,000 + £14,000 + £2,000	216,000

Adjusted income			305,333
			======
Excess income		£305,333 - £240,000	65,333
			=====
Restriction to pension contributions		£65,333 / 2	32,667
			=====
Tapered annual allowance		£40,000 – £32,667	7,333
			=====
Excess pension contributions		Pension input amount	89,333
		Max permitted	7,333
		Surplus b/fwd	2,000

		Excess contribution	80,000
Excess pension charge	at 45%		36,000
			=====

5. High Income Child Benefit Charge

As Polly is the higher earner, even though the child is not hers and she did not receive the money, the child benefit will be clawed back from her.

6. Scheme Pays

Polly can elect for the tax charge on excess contributions to be paid from the pension scheme to the extent that the contribution exceeds the £40,000 annual allowance before tapering reduction.

		£
Excess contribution	W4	80,000
Less: annual allowance restriction	W4	32,667
Available for "scheme pays"		47,333
		=====
Maximum "scheme pays" tax	At 45%	21,300
Tax liability as calculated above		40,158
Revised tax payable		18,858
		=====
Revised Total liability £80,363 + (£36,000 - £21,300) + £1000 + 1095		97,158
Tax payable as a % of total tax due		19.4%

MARKING GUIDE

TOPIC	**MARKS**
No personal allowance	1
No savings allowance / savings all taxable	1
Dividend allowance	1
Correct basic and higher rate band	1
Correct tax rates on main calculation	1
Correct threshold income	1
Pension input amount	1
Correct adjusted income	1
Tapered annual allowance	1
Deduct surplus contributions b/fwd	1
Correct excess pension contributions	1
Correct tax on excess pension contributions	1
Adjust for HICBC	1
Adjust for tax underpayment brought forward	1
UK tax on foreign dividend	1
FTCR on dividend restricted to treaty rate	1
Tax payable	1
Part of pension charge could be paid from pension – "scheme pays"	1
Calculation of amount payable from scheme	1
Date of election for "scheme pays"	1
TOTAL	**20**

ANSWER 3

During 2021/2022, the tax payable on Panos's employment income will depend on where his employment duties are performed. Earnings for duties performed in the UK are taxable in the UK when received. Duties performed outside the UK will not be subject to UK tax. As his employer has a tax presence in the UK, in the form of a UK branch, they will deduct tax via PAYE, from his UK earnings.

In 2022/2023, Panos will be subject to UK tax on his worldwide income and gains with credit for tax paid on foreign income.

Remittance basis

As Panos is a non UK domiciled individual, he can claim the remittance basis. Foreign income would only be taxed in the UK if brought into the UK or used or enjoyed in the UK. Panos must be able to determine the source and location of his income and gains by separating out UK source income and gains from non-UK source income and gains. This will require the use of separate bank accounts.

A claim must be made each tax year and Panos can opt in and out of this basis of taxation. Further information will be required to determine if this is beneficial each year.

If the remittance basis is claimed, users are not entitled to a tax free personal allowance for Income Tax or an annual exempt amount for Capital Gains Tax. There would be no remittance basis charge as Panos has not been resident in the UK for 7 out of the previous 9 tax years.

Overseas workdays

Overseas workday relief (OWR) allows earnings from employment duties performed outside the UK to be taxed on the remittance basis if the employee is a remittance basis user for the tax year in which the duties are performed. To use OWR, an employee must have been non-UK resident for three consecutive tax years and the year in concern is any of the three tax years immediately following that period of non-residence.

Therefore, OWR will be available to Panos in 2022/23. This is despite the fact that Panos has been on secondment to the UK previously as the number of times an individual can claim OWR is not limited and there has been a break of at least three full tax years between secondments.

Panos will only pay UK tax on earnings from employment duties performed outside the UK if those earnings are remitted to the UK. His earnings will be apportioned between UK and non-UK duties on a just and reasonable basis. As his duties are performed under his overseas employment contract, this will be based on the number of UK and overseas workdays in the tax year.

Earnings that relate to non-UK duties should be paid into a non-UK bank account and retained outside the UK. Any earnings remitted in a later year would be taxed in the year of remittance, irrespective of whether Panos is a remittance basis user for that later tax year.

Cool Albania is required to withhold foreign tax from Panos's non-UK earnings as he is a UK resident employee working in the UK and abroad whose employer has a tax presence in the UK. Panos will have tax withheld in two countries. Cool Albania can make an application to HMRC to use the 'net of foreign tax credit scheme'. Under this scheme HMRC will set any overseas tax deducted from Panos's earnings against his UK PAYE to prevent overpayment of tax.

National Insurance Contributions (NICs)

Panos is not required to pay NICs for the first year of the secondment. This is on the basis that he is not ordinarily resident or ordinarily employed in the UK and duties performed in the UK are in pursuance of an employment whose main object is fulfilled outside the UK for an employer outside the UK, and your presence in the UK is "for a time", i.e. it is not permanent.

After one year, Panos will begin to pay NICs. This will be deducted by Cool Albania and paid to HMRC on his behalf.

Flat purchase

Once Panos has become UK resident, consideration should be given to how the Albanian bank loan will be serviced. If the remittance basis is claimed and Panos uses foreign income or gains that arose whilst he is a remittance basis user to repay the bank loan and pay the interest, then this income will be taxed in the UK as it will be deemed to be remitted to the UK.

However, Panos can repay the bank loan and pay the interest with clean capital or taxed UK employment income without any tax charge. Cash held prior to becoming UK resident is known as 'clean capital'. It can be brought to the UK without any UK tax implications and should be kept separately from any new income or capital gains that arise after he becomes UK resident.

MARKING GUIDE

TOPIC	MARKS
2020/21 Income Tax position	
UK tax on UK source income only	1
Tax deducted through PAYE	½
2021/22 Income Tax position	
Automatic position - UK tax on worldwide income as it arises	½
Foreign tax credits available	½
Can make a claim for the remittance basis	½
Under the remittance basis, foreign income and gains are taxed only if they are brought in to or used or enjoyed in the UK.	½
Must re-assess the position and make a claim if beneficial each year	½
Remittance basis users do not receive a personal allowance or annual exempt amount for CGT	½
Need to track foreign income and gains taxed under the remittance basis, use of separate bank accounts	½
Cool Albania Ltd employment income	
Overseas workday relief available	1
Must make a claim for the remittance basis for OWR to be available	½
Available for the first 3 years of tax residence	½
Must not have been resident in previous three years and prior secondment not an issue	1
Same employment contract - apportioned according to actual workdays	1
Earnings for non-UK duties should be retained outside the UK and will be taxed if remitted	1
Potential for tax to be withheld in both countries and available for foreign tax credit against PAYE	1
UK NICs	
Albanian contract - no UK NICs for 52 weeks	½
Conditions for exemption	1
Flat purchase	
Repayment of the loan from untaxed foreign income could result in a tax charge	1
Meaning of clean capital	½
Can repay with clean capital or taxed employment income with no charge	½
Presentation and higher skills	½
TOTAL	**15**

ANSWER 4

Capital Gains Tax

Assets brought to the UK which derive their value from foreign income and gains are generally treated as remittances, and so can give rise to a UK tax liability.

Suzie's jewellery has been acquired using foreign gains on which she has claimed the remittance basis and have not been subject to UK tax, i.e. relevant foreign gains.

However, there is no remittance if "exempt property" is brought into the UK. Jewellery that has been acquired from an individual's foreign income or gains and is for the personal use in the UK of the individual, the individual's spouse / civil partner (including unmarried couples living together as spouses / civil partners), or a minor child or grandchild is exempt property.

A remittance occurs if property which was exempt property ceases to be exempt property. This includes the gifting of the property in the UK to an adult child.

The relevant foreign gains of £10,000 which have been used to acquire the jewellery will become chargeable as a result of the gift at a rate of 20%.

As Suzie claims the remittance basis she will not be able to claim an annual exempt amount against the gain.

When the gift was made, Suzie was treated as selling the jewellery at full market value. However, no gain will arise on the basis that the jewellery has not gone up in value since the date it was acquired by Suzie.

Transfer of Assets Abroad

The transfer of assets abroad legislation can apply when there is a transfer of assets as a result of which income becomes payable to a person abroad.

"Person abroad" means a person who is resident or domiciled outside the UK, which includes the offshore trust and "Person" includes Trustees. A gift of assets by a UK individual to a non-resident trust would therefore be a "relevant transfer", potentially subject to a tax charge under s.720 ITA 2007.

A relevant transfer can include assets situated outside the UK (despite the description, a "transfer of assets abroad" does not confine itself to transfers of UK assets).

Condition A is that a transferor (or his spouse / civil partner) must have "the power to enjoy the income of a person abroad as a result of the relevant transfer".

"Power to enjoy" includes an ability to otherwise control the application of the trust property.

"Power to control" could also extend to a non-settlor interested trust where the Trustees invested in shares in an offshore company and the settlor of the trust was a director of the company. In this case the settlor would have a power of control over the trust income by virtue of her position as a director. S.720 would then apply even though the settlor was not a beneficiary of the trust.

Condition B in s.721 is that "income would be chargeable to income tax if it were the individual's and received by the individual in the UK". This is satisfied in this case, as the income received by Oak Ltd would be taxable if received by Suzie as it is UK sourced income.

Condition C is that the transferor must be resident in the UK when the income arises and she would therefore be chargeable to tax on the income received by her. This condition is satisfied as Suzie is resident in the UK.

There is a motive defence which applies when the transfer has not been undertaken with a view to avoid UK tax, but there does not appear to be evidence to suggest that it applies in this case.

The transfer of asset abroad rules can only apply if the income is not subject to UK tax under other provisions. As such the transfer of asset abroad rules can apply.

As the transfer of asset abroad provisions apply, Suzie would be subject to tax on the income received by the company.

She would not be able to claim the remittance basis, as the income received by the non-UK company is UK income.

The income is transparent in the hands of the transferor, so will be taxed at dividend rates of 38.1%. It will qualify for the Dividend Allowance.

There is no relief for any professional expenses charged against the dividend income.

Mark Scheme

TOPIC	MARKS
Jewellery	
Presentation and higher skills	1
Assets brought to the UK which are brought with relevant foreign gains usually taxable remittance	½
Identifying relevant foreign gains have been used to acquire the jewellery	1
Exemption for jewellery for personal use, and conditions for that exemption	1
Remittance becomes chargeable if conditions for exemption no longer met	1
Application to client: Adult child not covered by the exemption	½
Application to client: the relevant foreign gains become chargeable on the gift	½
CGT – gift at market value	1
CGT – rate of tax	½
Annual Exempt Amount not available for remittance basis user	1
Transfer of asset abroad definition	1
Transfer to non-resident trust is a relevant transfer	½
Doesn't matter that assets were not UK assets to begin with	1
Condition A	½
Power to enjoy includes power to control	1
A director can control, therefore it applies here	1
Condition B and confirmation it applies here	1
Condition C and confirmation it applies here	1
Motive defence and no reason to suggest it applies here	1½
TOAA can only apply if income not taxed under other provisions	½
As TOAA applies, tax on Suzie	½
Taxed at dividend rates, dividend allowance	1
No remittance basis as its UK income	1
No relief for portfolio expenses	½
TOTAL	**20**

ANSWER 5

Daffodil Ltd

		£	
June 2020	Cash proceeds	1,500,000	
	Value of right to receive deferred consideration 3,575,000 x 15%	536,250	Note 1
January 2000	Cost	(100)	
	Net gain	£2,036,150	

Poppy Ltd

		£
August 2020	Proceeds (100 x 1,782)	178,200
June 2016	Cost (100 x 550)	(55,000)
	Net gain	£123,200

Ivy Cottage

		£	
September 2020	Proceeds	135,000	
	Costs of sale	(2.700)	
July 2007	Probate value	(98,000)	
August 2015	Demolition costs	(325)	Note 2
	New outbuilding	(6,500)	
	Net gain	27,475	

Tax Due:

	£	£
Daffodil Ltd	2,036,150	
Poppy Ltd	123,200	
Ivy Cottage		27,475
Annual Exemption		(12,300)
Taxable:	2,159,350	15,175

			£	
Daffodil Ltd	1,000,000	10%	100,000	Note 3
	1,036,150	20%	207,230	
Poppy Ltd	123,200	10%	12,320	Note 4
Ivy Cottage	15,175	28%	4,249	Note 5
			£323,799	Due 31 January 2022

Note 1

For Capital Gains Tax purposes, the amount due in December 2021 is known as deferred consideration. The tax treatment of deferred consideration varies depending on whether or not it is ascertainable on the date of sale. In this instance the deferred consideration is unascertainable as it is dependent on Daffodil Ltd's performance for the year ending on 30 September 2021. As this is the case the value of the right to receive this future payment needs to be valued and included in the disposal consideration when the capital gains tax liability for the year ended 5 April 2021 is calculated. In the calculation above the value of the right has been set at 15% of the expected profit figure but there is a risk that Steve will actually receive less than this.

In December 2021 when the deferred consideration is received this is treated as a disposal of the right. The "cost" of the right, which can be set against these proceeds, will be £536,250.

If there is a loss on the disposal of the right, this can be carried back and off-set against the gain made in 2020/21.

Note 2

As the costs of demolishing the old outbuilding are small in relation to the costs of constructing the new outbuilding these costs are allowable.

Note 3

Steve was the director of the company during the twenty-four months prior to the date of sale and owned at least 5% of the shares, which gave him more than 5% of the voting rights. He was also entitled to at least 5% of the profits available for distribution and at least 5% of the assets on a winding up. This means that the gain on the shares in Daffodil Ltd will qualify for Business Asset Disposal Relief as long as the company is classed as a trading company throughout the twenty-four months ending with the date of sale.

The company will be a trading company if HMRC are satisfied that the company's non-trading activities are not "substantial". Substantial in this context means more than 20% and HMRC will consider a number of factors, such as income levels, the company's asset base and the amount of time spent by the company's officers and employees undertaking the non-trading activities. As the income from letting the unit is comparatively small we assume that this condition will be met.

Therefore, as long as the trading company definition is met, this gain will qualify for Business Asset Disposal Relief.

Note 4

The gain on the shares in Poppy Ltd will qualify for Investor's Relief. Steve subscribed for ordinary shares after 17 March 2016 and held them for at least three years. The company is an unlisted trading company.

Steve was not an employee or director of the company and nor was anyone connected with him.

The shares were fully paid up and the subscription was not made for the purposes of tax avoidance.

The deadline for both reliefs to be claimed is 31 January 2023.

Note 5

The gain on the disposal of Ivy Cottage should have been declared to HMRC within 30 days of the date of completion and an estimate of the tax liability paid within the same timescale. Any under or overpayment would then be adjusted through Steve's self assessment tax return following the end of the tax year when his overall tax position is known.

MARKING GUIDE

TOPIC	MARKS
Calculate the gain on the shares in Daffodil Ltd	1
Calculate the gain on the shares in Poppy Ltd	½
Calculate the gain on Ivy Cottage	1
Claim Annual Exemption against Ivy Cottage gain	1
Calculate total Capital Gains Tax liability	1½
State due date of Capital Gains Tax on Share Disposals	½
Identify that the deferred consideration is unascertainable & explain tax treatment for 2020/21	2
Explain tax treatment on receipt of deferred consideration	1
Ivy Cottage demolition costs are allowable	½
Explain why Daffodil Ltd gain qualifies for Business Asset Disposal Relief	2
Explain why Poppy Ltd gain qualifies for Investor's Relief	2
Deadlines for claiming Business Asset Disposal Relief and Investor's Relief	1
Deadline for declaring Ivy Cottage gain and paying the tax	½
State that the gains qualifying for Business Asset Disposal Relief & Investor's Relief utilise the basic rate band in priority to other gains	½
TOTAL	**15**

ANSWER 6

There should be no Capital Gains Tax payable as a result of Large Co Ltd defaulting on the loan notes.

Tax implications of Large Co Ltd defaulting on the loan notes

When Large Co Ltd became insolvent and defaulted on the loan notes, they became worthless. Rupert is able to make a negligible value claim under s.24 TCGA 1992 to use the loss arising on the loan notes of £100,000.

The loss is available Rupert to use to reduce capital gains arising in 2020/21 or future tax years. The loss could also be carried back for up to 2 tax years if the loan notes had become of negligible value at or before the date to which the loss is carried back.

General Anti-Abuse Rule

The General Anti-Abuse Rule ('GAAR') applies to tax arrangements which are abusive. A tax arrangement is any arrangement which has the main purpose or one of the main purposes of obtaining a tax advantage. Rupert's question is whether the decision to take non-QCBs and to be able to claim a loss when Large Co Ltd defaulted would be within the GAAR.

The definition of arrangement is widely drawn but the definition of abusive is restricted.

An arrangement is abusive if the course of action cannot reasonably be regarded as reasonable in relation to the relevant tax provisions, considering the circumstances, including whether the arrangements are consistent with the principles on which they are based and the objectives of the provisions.

When the GAAR applies, the tax advantage is counteracted by HMRC who will make such adjustments as are just and reasonable. Rupert should be made aware that it is his responsibility to self-assess whether the GAAR applies and that there is a penalty of 60% of the counteracted tax if there is a counteraction adjustment under the GAAR.

Application of the GAAR to your circumstances

The tax consequences of the share sale are consistent with the principles of the tax provisions in TCGA 1992. Rupert has paid Capital Gains Tax on the cash proceeds received at the time of the sale and, as Large Co Ltd became insolvent and defaulted on the loan notes, he is able to claim an allowable loss.

However, when he requested that the loan notes were non-QCBs, Large Co Ltd ensured that the notes were not QCBs by including a provision that he could redeem the loan notes in a foreign currency. This provision was very restricted, and it is unlikely that he would have been able to utilise the provision. This is a contrived step to create a desired tax effect.

The UK tax rules allow taxpayers to make choices about how they conduct their affairs and differing tax results arise dependent on the choice made by the taxpayer. The GAAR will counteract this choice if the arrangement is considered abusive.

It is irrelevant when considering the application of the GAAR to Rupert that no advance clearance was sought.

It is likely that the transaction will fall within the definition of an 'arrangement' as the contrived step allowed Rupert to a reduction in the amount of tax assessed. If the loan notes were structured as QCBs rather than non-QCBs, the deferred capital gain of £400,000 would have been calculated at the time of the sale and the capital gain would have crystallised when the loan notes were redeemed, even if he did not receive payment. Obtaining a tax advantage was one of the main reasons for entering into the arrangement.

It is unlikely that the arrangement will be deemed to be abusive as it is established practice, that loan notes can be structured as either QCBs or non-QCBs by using a foreign exchange redemption provision and that an allowable loss can arise on non-QCBs.

I therefore conclude that the GAAR is unlikely to apply to this transaction and HMRC will not seek to counteract the tax results of Large Co Ltd defaulting on the loan notes.

MARKING GUIDE

TOPIC	MARKS
Tax implications of Large Co Ltd defaulting on the loan notes	
Negligible value claim	½
Calculation of capital loss	½
Capital loss is available to use in 2020/21 or against future gains	1
Capital loss can be carried back up to 2 tax years if the loan notes were of negligible value by that date	1
Anti-abuse legislation	
GAAR definitions (tax arrangement, tax advantage, abusive, double reasonableness test)	3
It is the taxpayer's responsibility to self-assess	1
Implications if GAAR applies (counteraction, penalties)	1
Application of the GAAR to Rupert:	
Tax consequences of the transaction are consistent with the principals of legislation	1
Including a provision to allow you to redeem in a foreign currency is a contrived step to produce a desired tax effect	1
Likely to fall into the definition of a tax arrangement – reduction in tax assessed	1
Abusive?	
Obtaining a tax advantage was one of the main reasons for the arrangement	1
Is not abusive as it is established HMRC practice	1
Conclusion – GAAR will not apply, no Capital Gains Tax payable	1
Presentation and higher skills	1
TOTAL	**15**