The Chartered Institute of Taxation

Advanced Technical

Taxation of Individuals

November 2021

Suggested solutions

Answer 1

	Non-Savings Income £	Interest £
Salary	45,500	
Optional Remuneration (W1)	6,000	
Beneficial Loan (W2)	nil	
Employment Related Securities (W3)	1,979	
Employer Pension Contribution (W4)	0	
Pension Income (W5)	0	
Treasury Stock Interest (W6)		1,837
Interest on Account Two (W7)		236
	53,479	2,073
Personal Allowance	(12,500)	
Taxable	**40,979**	**2,073**

Tax Due:

Non-Savings Income

37,725	(W8)	x	20%	7,545
3,254		x	40%	1,302
40,979				

Interest

500	x	0%	0
1,573	x	40%	629
2,073			

High Income Child Benefit Charge (W9)	570
Total Liability	**10,046**
Tax Deducted at Source	**(6.600)**
Balance Due	**3,446**

Working 1
Optional Remuneration

Car benefit: (22,650+565) x 25% = £5,804

Salary sacrificed: £6,000

Car benefit is lower than the amount sacrificed, therefore £6,000 is taxable.

Working 2
Loans

The loan to Peacock Ltd would appear to be a qualifying loan, assuming that Peacock Ltd is a close company and has used the funds for the purposes of its trade. This means that 75% of Ruby's loan from Flamingo Ltd is a qualifying loan as defined at s.180(5)(a) ITEPA 2003.

The maximum non qualifying loan outstanding during the year is therefore £18,500 x 25% = £4,625. This is less than £10,000 and so does not give rise to a taxable benefit in kind.

Working 3
Employment Related Securities

When the restriction is lifted, a tax charge arises. The amount to be taxed is a percentage of the market value of the shares immediately after the restriction is lifted.

The percentage subject to tax is the percentage of the unrestricted market value of the shares that was neither taxed nor paid for in November 2014.

November 2014:

				£
Market value	29	x	50	1,450
Market value of Ruby's Restricted Securities	15	x	50	750

Percentage taxed on award: 750/1,450 = 51.72%

November 2020:

Market value of Ruby's shares immediately after the restriction is lifted: 82 x 50 = £4,100

Taxable: £4,100 x (100% - 51.72%) = £1,979

Working 4
Employer Pension Contribution

The pension contribution made by Flamingo Ltd is not classed as income for tax purposes.

Ruby will have her full annual allowance of £40,000 available for the year. The lump sum that she has withdrawn from her pension does not trigger the money purchase annual allowance as the withdrawal was not an income withdrawal.

Working 5
Pension Withdrawal

The £5,000 that Ruby withdrew from her pension is within the overall 25% of the policy that is tax free. Therefore, no tax is due on this amount.

Working 6
Treasury Stock Interest

Receipts:

	£
31 October 2020	1,000
31 January 2021	1,000
Accrued Income	(163)
Taxable	1,837

Accrued Income:

Days since last interest payment	1 August 2020 – 15 August 2020	15	Days
Days in interest period	1 August 2020 to 31 October 2020	92	Days

Accrued income: 1,000 x 1/3 = £333 OR 0/3 = £nil

Working 7
Interest on Alfie's Bank Accounts

Ruby is subject to tax on the interest on Account Two as this exceeds £100 and she contributed the funds. She is not liable to tax on the interest on Account One as the funds were contributed by Alfie's Aunt.

Working 8
Basic Rate Band

	£
	37,500
Gift Aid £180 x 100/80	225
	37,725

Working 9
High Income Child Benefit Charge

	£		
Total Income	55,552		
Gift Aid	(225)		
	55,327		
	(50,000)		
	5,327	Round down to nearest 100:	5,300
		=	53%

Child Benefit: 20.70 x 52 = £1,076

HICBC: £1,076 x 53% = £570

MARKING GUIDE

TOPIC	**MARKS**
Include salary as part of taxable income	½
Calculate car benefit	1
Tax salary sacrificed rather than car benefit	1
Explain treatment of loan from employer	2
Calculate taxable amount in respect of the restricted securities	3
Employer pension contribution does not give rise to taxable income	1
Explain why the pension lump sum is not taxable.	1
Explain that pension withdrawal does not trigger the MPAA	1
Calculate treasury stock interest	3
Interest on Account One not taxable	½
Interest on Account Two taxable	½
Calculate high income child benefit charge	2½
Deduct personal allowance	½
Calculate basic rate band	**1**
Personal savings allowance	**1**
Balance of interest at 40%	½
TOTAL	**20**

Answer 2

Sarah’s tax position

As Sarah is UK tax resident and UK domiciled, she is subject to Income Tax on all of her income, irrespective of whether this is remitted to the UK.

Her foreign interest would therefore be subject to Income Tax and should have been declared on her 2015/16 return and on any subsequent returns if necessary.

When Sarah disposed of her units in the offshore non-reporting fund, any profit on sale should have been charged to Income Tax as non-savings income and declared on her 2015/16 return.

Sarah would have been allocated a share of the fund's reported income each year. This share is taxable income, regardless of whether it is distributed to Sarah or not. This should have been declared on Sarah’s return each year from 2016/17.

Sarah’s income in respect of the offshore reporting funds is that of the underlying investments. Therefore, interest received by the fund is taxed as interest, and dividends received by the fund are taxed as dividends.

Failure to Correct

The Requirement To Correct (RTC) regime required taxpayers to notify HMRC of any offshore tax non-compliance where tax linked to offshore matters or transfers was underdeclared. It only applies if the non-compliance was committed on or before 5 April 2017.

It will therefore apply to Sarah’s 2015/16 return as this was due to be submitted before 6 April 2017.

It will not apply to Sarah’s tax returns for each year from 2016/17.

Taxpayers with undeclared offshore tax liabilities were required to disclose such matters by 30 September 2018. Anyone who failed to comply with the deadline is now subject to “Failure to Correct” (FTC) penalties.

Whilst FTC penalties can be reduced if a taxpayer has a “reasonable excuse” that will not apply here. Sarah has submitted an inaccurate return based on a misunderstanding that the income was not taxable in the UK. She did not seek professional advice to confirm the position. HMRC do not accept that ignorance of the law is a reasonable excuse.

The FTC penalty that will apply to Sarah will be a penalty of between 100% and 200% of the uncorrected tax. The penalty can be mitigated to reflect the taxpayer’s co-operation with HMRC in correcting the error (specifically by telling them about it, giving them reasonable help, and allowing access to records).

The penalty cannot be reduced to below 100% or below 150% in prompted cases.

Sarah needs to notify HMRC of the underpaid tax and pay this alongside any interest and penalties due.

Penalties for incorrect returns can still apply in respect of Sarah’s returns from 2016/17 onwards.

The maximum penalty that will apply for the 2016/17 tax years onward for a careless error will be 30% of the unpaid tax. This can be reduced to 15% for a prompted disclosure or 0% for an unprompted disclosure. The precise penalty will depend on which category the overseas territory falls in.

Sarah has until 31 January 2022 to amend her 2019/20 tax return but must make a separate voluntary disclosure (for example, under the Worldwide Disclosure Facility) to HMRC in respect of the liabilities arising from 2016/17 to 2018/19.

MARKING GUIDE

TOPIC	MARKS
As a UK resident and UK domiciled individual, Sarah is taxable on worldwide income	½
Foreign interest should have been declared on return and subject to UK tax	½
Disposal of an offshore non-reporting fund will trigger a taxable offshore income gain subject to income tax	½
Offshore reporting funds are treated as transparent and therefore should have been subject to tax on her allocated share of the fund irrespective of whether funds distributed	½
Sarah's income is that of the underlying investments, so any interest in her allocation of the fund will be taxed on her as interest and any dividends will be taxed as dividends	½
Requirement to correct applies in respect of offshore tax non-compliance committed before 6 April 2017	½
If the RTC deadline of 30 September 2018 is not met, FTC applies	½
Application to scenario: FTC applies to 2015/16 year but not 2016/17 year	½
No reasonable excuse, with explanation	½
Standard penalty of between 100% and 200% of the uncorrected tax	½
Penalty can be mitigated by co-operation (telling, helping giving)	1
Penalty cannot be reduced to below 100% of the tax	½
HMRC do not reduce penalty to less than 150% if prompted disclosure	½
Sarah needs to make a disclosure and payment, including penalties for incorrect returns for years after 2015/16	½
The maximum penalty for careless disclosure for years after 2015/16 would be 30%, which can be reduced to 15% or 0%, depending on co-operation.	1
The category of the territory will also affect the rate	½
Has until 31 January 2022 to amend the 2019/20 return but must make a separate disclosure for any earlier years	½
Presentation and Higher Skills	½
TOTAL	**10**

Answer 3

The basic position is that the two share sales would be disposals for Capital Gain Tax purposes. However, when an individual is party to a “transaction in securities” there is a set of anti-avoidance rules that need to be considered.

These rules apply when:

1) an individual is party to a “transaction in securities”;

2) the main purpose (or one of the main purposes) of the transaction is to obtain an income tax advantage; and

3) that individual (or any other person) obtains an income tax advantage as a result of the transaction

The sale of shares is classed as a “transaction in securities” for the purposes of these rules.

In the case of a share sale, the rules apply in a situation where a relevant person receives consideration in respect of a transaction in securities involving two or more close companies and does not pay income tax on that consideration.

Consideration can include anything that represents the value of assets which are available for distribution by a close company.

There is an exemption in the legislation for situations where there is a “fundamental change” in ownership of the company that continues for at least two years.

A “fundamental change” is where, as a result of the transaction, the original shareholder (together with their associates) does not directly or indirectly hold more than 25% of the ordinary share capital of the company. Nor must the original shareholder be entitled to more than 25% of the voting rights or distributions made.

It would appear that the sale of Ayesha’s shares in Avocado Ltd will not be caught by the anti-avoidance rules due to the fundamental change in ownership exemption.

In calculating the taxable gain on the sale of her Avocado Ltd shares, Ayesha can deduct the original cost of the shares and any purchase and sale costs.

Ayesha can use her annual exempt amount against this gain if she has made no other disposals in the same tax year.

If the sale takes place prior to 5 April 2022, the gain will need to be declared on Ayesha’s 2021/22 tax return. Capital Gains Tax at 20% will be due for payment on 31 January 2023.

The situation with regard to the sale of the Mango Ltd shares is not so straightforward as the exemption will not apply to this transaction.

Taxpayers are able to make a clearance application to HMRC to find out if a proposed transaction is caught by the anti-avoidance rule.

All the information that is relevant to the transaction should be supplied to HMRC as part of the clearance application. If HMRC grant clearance that the transaction is not caught by the anti-avoidance rules but later discover that the taxpayer did not provide them with all the information relevant to the transaction, they can declare the clearance to be void and subsequently issue a counteraction notice.

In this case it would be advisable for Ayesha to seek clearance. It would appear that clearance is unlikely to be granted based on the facts of the proposal. Firstly, Ayesha would be receiving consideration, that has not been subject to Income Tax, in respect of a transaction in securities involving two close companies. It can also be argued that the main purpose, or one of the main purposes, of the transaction is to obtain an Income Tax advantage; if this amount had been paid to Ayesha by Coconut Ltd as a dividend, it would have been subject to Income Tax at the additional rate, which is far higher than the Capital Gains Tax rate.

If clearance is refused as expected, Ayesha should be advised not to go ahead with the transaction.

If Ayesha goes ahead with the transaction without seeking clearance and subsequently declares the transaction as a capital gain on her tax return, an officer of HMRC may open an enquiry.

If HMRC determine that the anti-avoidance rules apply, they can issue a counteraction notice. The notice will set out the adjustments required to remove the Income Tax advantage. In this case, that would mean taxing the £346,000 as a dividend at 38.1% and raising an assessment for the difference between this figure and the Capital Gains Tax already paid at 20%.

Interest would run on the assessment amount from the original due date for the Income Tax, which would be 31 January 2023 if the transaction takes place during the year ended 5 April 2022.

MARKING GUIDE

TOPIC	**MARKS**
Identify that the disposals give rise to gains but that the Transactions in Securities rules may apply	1
Three conditions that must be met	1½
Sale of shares is a transaction in securities & when rules apply	1½
Exemption for "fundamental change"	½
Definition of a fundamental change in ownership	1
Avocado Ltd sale not caught by anti-avoidance rule	½
Allowable expenditure	½
Annual exempt amount	½
Declare gain on tax return	½
Due date for tax payment	½
Clearance procedure available	½
Clearance process	1
Sale of Mango Ltd Shares likely to be caught	1
Advise Ayesha not to go ahead if caught	½
Consequences of going ahead without clearance	2
Interest and due date	1
Presentation and higher skills	1
TOTAL	**15**

Answer 4

UK tax payable assuming NO claim is made under s.809B

All income is taxed on the arising basis.

			NS	Interest	Dividends
			£	£	£
Employment income			75,000		
Interest				2,450	
Dividends					2,320
Overseas rents		(W1)	35,650		
Personal allowance		(W2)	(6,665)		
Taxable income			103,985		
41,250 (W3)	@ 20%		8,250		
62,735	@ 40%		25,094		
500	@ 0%		0		
1,950	@ 40%		780		
2,000	@ 0%		0		
320	@ 32.5%		104		
Income tax			34,228		
Chargeable gains	(W4)				
197,700	@ 28% (res prop)		55,356		
Less: PAYE			(14,500)		
Total payable			**75,084**		

Workings:

(W1) Rental income on cash basis

Rents	£		£
		45,000 x 7/12	26,250
		60,000 x 5/12	25,000
Income			51,250
Expenses:			
Letting fees	7,400		
Water	1,200		
Insurance	7,000		
			(15,600)
Rental profit			35,650

(W2) Personal Allowance

Income	£	
Salary	75,000	
Overseas rents	35,650	
Interest	2,450	
Dividends	2,320	
Less pension contributions	(3,750)	(3,000 x 100/80)
Total	111,670	
Personal allowance	12,500	
Less	(5,835)	(111,670-100,000)1/2
Personal allowance given	6,665	

(W3) Basic Rate Band

	£	
Basic rate band	37,500	
Gross pension contributions	3,750	(3,000 x 100/80)
Basic rate band available	41,250	

(W4) Chargeable gains

	£	
Proceeds	250,000	
Cost	(40,000)	(rebasing not available as not a qualifying individual)
Capital gain	210,000	
Annual exempt amount	(12,300)	
Taxable gain	197,700	

UK tax payable assuming claim is made under s.809B

Oscar is non-UK domiciled and has been resident in the UK for the following tax years:

2011/12

2012/13

2013/14

2014/15

2017/18

2018/19

2019/20

2020/21

2020/21 is the 8th year of residence. As he was resident for 7 of the preceding 9 tax years, he is subject to the RBC of £30,000.

No remittances in the year as no overseas income or gains have been remitted to the UK.

	NS	Interest	Dividends
	£	£	£
Employment Income	75,000		
Interest		2,450	
Dividends			2,320
No Personal allowance available			

41,250 (W3)	@ 20%	8,250
33,750	@ 40%	13,500
500	@ 0%	0
1,950	@ 40%	780
2,000	@ 0%	0
320	@ 32.5%	104
Income tax		22,634
Remittance basis charge		30,000
Less: PAYE		(14,500)
Total payable		**38,134**

As £38,134 is less than £75,084 Oscar should therefore make a claim under s809B to be taxed on the remittance basis, subject to Oscar's future plans as to whether remit further amounts.

Transfers from offshore accounts

When Oscar transferred the funds from Account B to make a transfer to his daughter, this was not a remittance. The gift itself is not a remittance as this was made overseas. His daughter is not a 'relevant person' for determining whether a remittance has taken place, as she is over 18. As such, when his daughter brought the monies to the UK, there was no deemed remittance of the property as the property is only to be used by his daughter and not a relevant person.

When Oscar transferred £12,000 from Account C to Account D, he did not trigger a remittance. However, as Account C is a mixed fund, the transfer is deemed to consist of the 'appropriate proportion' of each and every amount of each kind of income and capital contained in the mixed fund immediately before this transfer. Thus all the elements of the mixed fund reduce by the same proportion.

The term appropriate proportion means the actual amount transferred (or the market value of an asset) divided by the value of the fund at the time of the transfer.

This transfer therefore consists of:

£		
4,000	(12,000/ 60,000) x 20,000	Relevant foreign income subject to tax from 2019/20
8,000	(12,000/ 60,000) x 40,000	Relevant foreign income not subject to tax from 2018/19
12,000		

Remittance to the UK

When Oscar remits money from any offshore accounts to the UK he will be deemed to bring funds to the UK in the following order, from the current year first, and then each previous year in turn:

1. Untaxed foreign income

2. Untaxed foreign gains

3. Foreign income and gains on which foreign tax has been paid

4. Capital and other income

After the transfer from Account C to Account D, the composition of the mixed fund in Account C will be as follows:

£		
16,000	(20,000 – 4,000)	Relevant foreign income subject to tax from 2019/20
<u>32,000</u>	(40,000 – 8,000)	Relevant foreign income not subject to tax from 2018/19
48,000		

The composition of the mixed fund in Account D will be as follows:

£	
4,000	Relevant foreign income subject to tax from 2019/20
8,000	Relevant foreign income not subject to tax from 2018/19
30,000	Relevant foreign income not subject to tax from 2014
60,000	Gift from 2016

If Oscar transfers £30,000 from Account C to the UK, this will be treated as coming from £16,000 of the relevant foreign income subject to tax from 2019/20 and £14,000 of relevant foreign income not subject to tax from 2018/19.

Oscar would be subject to tax on all of the £30,000. This would be taxed at non savings rate. Assuming Oscar is still a higher rate taxpayer, this would be taxed at 40% (i.e. £12,000). Oscar would be able to claim relief for £4,000 of the foreign tax suffered (i.e. £16,000/£20,000* £5,000). This leaves a net liability of £8,000.

If Oscar transfers £30,000 from Account D to the UK, this will be treated as coming from £4,000 of relevant foreign income subject to tax from 2019/20, £8,000 of relevant foreign income not subject to tax from 2018/19 and £18,000 of the gift from 2016, which is clean capital. Oscar would be subject to tax on £12,000. The balance of £18,000 of this amount will not be subject to tax.

The £12,000 would be taxed at non savings rate. Assuming Oscar is still currently a higher rate taxpayer, this would be taxed at 40% (i.e. £4,800). Oscar would be able to claim relief for £1,000 of the foreign tax suffered (i.e. £4,000/£20,000* £5,000). This leaves a net liability of £3,800.

Oscar should therefore make a remittance from Account D.

MARKING GUIDE

TOPIC	MARKS
PART A	
Rental gross income calculation	½
Rental expenses	½
Adjusting net income for gross pension contributions	½
Adjusting personal allowance	½
Calculation of tax on Non savings income	1
Adjust basic rate band for gross pension contributions	½
Personal savings allowance	½
Calculation of tax on interest income	½
Dividend allowance	½
Calculation of tax on dividend income	½
Calculation of gain	½
Annual exempt amount	½
Calculation of CGT due	½
Remittance basis calc: stating UK residence for 7/9 years	1
Remittance basis calc: RBC of 30,000	½
No Personal Allowance for remittance basis	½
Advising remittance basis is better	1
PART B	
No remittance on transfer from Account B as the gift is made overseas	½
Daughter is not a relevant person as she is over 18	½
No remittance on the acquisition of the property as relevant person is not using the house	½
No remittance on transfer from Account C to Account D	½
Appropriate proportion explanation	1
Application to scenario	1
PART C	
Year by year basis	1 1/2
Application to scenario if remittance is made from Account C	1
Application to scenario if remittance is made from Account D	1
Double taxation relief if remit from Account C and net liability	½
Double taxation relief if remit from Account D and net liability	½
Recommendation to remit from Account D with explanation	1
Presentation and Higher Skills	½
TOTAL	**20**

Answer 5

Henry's CGT liability

	£
Sales proceeds (£400,000 x 50%)	200,000
Less cost (£100,000 x 50%)	(50,000)
	150,000
Less PPR (note 1)	(92,763)
Chargeable gain before AEA	57,237
Less: AEA	(12,300)
Chargeable gain after AEA	44,937
CGT liability (£44,937 x 28%)	£12,582

Dorothy's CGT liability

We are not told whether Dorothy is tax resident for the 2021/22 tax year.

If she is tax resident for 2021/22

	£
Sales proceeds (£400,000 x 50%)	200,000
Less cost (£100,000 x 50%)	(50,000)
	150,000
Less PPR (note 2)	(61,184)
Chargeable gain before AEA	88,816
Less: AEA	(12,300)
Chargeable gain after AEA	76,516
CGT liability (note 3)	£17,674

If she is non-resident for 2021/22

	£
Sales proceeds (£400,000 x 50%)	200,000
Less 5 April 2015 market value (note 4)	(175,000)
	25,000
Less PPR (note 5)	(2,679)
Chargeable gain before AEA	22,321
Less: AEA	(12,300)
Chargeable gain after AEA	10,021
CGT liability (£10,021 x 18%)	£1,804

Note 1
Henry's PPR

Henry's total period of ownership assuming he sells 5 April 2022	19 years
Periods eligible for private residence relief:	
Original stay in property	1 years
Period of absence not exceeding 3 years	3 years
Second stay in property	2 years
Absence in consequence of situation of place of work	2 years
Job-related accommodation in an overseas country	2 years
Third stay in property	1 year
Last 9 months	0.75 years
Total	11.75 years

Therefore, PPR is 150,000 x 11.75/19 = 92,763

Note 2
Dorothy's PPR if tax resident

Between 5 April 2009 to 5 April 2011, and 5 April 2011 to 5 April 2013 Dorothy was absent from Grasslands due to Henry's work in the UK and overseas.

As she was neither Henry's spouse nor his civil partner, those periods are not eligible for PPR.

Dorothy's total period of ownership assuming she sells 5 April 2022	19 years
Periods eligible for private residence relief:	
Original stay in property	1 years
Period of absence not exceeding 3 years	3 years
Second stay in property	2 years
Third stay in property	1 year
Last 9 months	0.75 years
Total	7.75 years

Therefore, PPR is 150,000 x 7.75/19 = 61,184

Note 3
Dorothy's CGT liability if tax resident

Dorothy has no income

Chargeable gains after AE above basic rate limit 76,516 -37,500 = 39,016

	£
CGT on chargeable gains up to basic rate limit 37,500 x 18%	6,750
CGT on chargeable gains above basic rate limit 39,016 x 28%	10,924
Total CGT liability	£17,674

Note 4

Rebasing provisions if Dorothy non-resident

Dorothy owned her share of Grasslands before 5 April 2015, hence the rebasing provisions in s. 36A TCGA 1992 and Sch 4AA TCGA 1992 must be considered.

Retrospective basis

As Dorothy will not make a loss from selling Grasslands, an election for the retrospective basis cannot be preferable for her, so is irrelevant here.

Straight-line time apportionment basis

	£
Sale proceeds	200,000
Cost	(50,000)
Gain before straight-line apportionment	150,000

Straight-line apportionment:

Total period of ownership (assuming she sells 5 April 2022) 19 years

5 April 2015 to 5 April 2022 7 years

Hence Dorothy's gain before PPR on straight-line apportionment basis is £150,000 x 7/19 = £55,263.

Default rule basis

	£
Sale proceeds	200,000
50% x 5 April 2015 market value	(175,000)
Hence her gain before PPR under default rule	£25,000

Conclusion

As Dorothy's entitlement to PPR is the same proportion under the straight-line apportionment basis or the default rule basis (see note 5) it does not affect her decision about whether to elect for the straight-line basis.

Her gain before PPR is lower under the default rule. Therefore the market value of £175,000 will be used to calculate her gain

Note 5

Dorothy's PPR if non-resident

Dorothy did not occupy Grasslands after 5 April 2015. Hence she does not qualify for PPR, except for the last 9 months of her period of ownership –s.223(2)(a) TCGA 1992.

This is because for the purposes of s 223 TCGA 1992, Dorothy's period of ownership excludes any period prior to 5 April 2015 – see s.223(7)(b) TCGA 1992.

This is the case whether the default rule or straight-line basis applies to her under the rebasing provisions.

Hence her PPR is 9 months/7 years (or 0.75/7) x £25,000 = £2,679.

.

MARKING GUIDE

TOPIC	MARKS
Henry's original stay in property eligible for PPR	½
Period of absence not exceeding 3 years	1
Second stay in property eligible for PPR	½
Absence re situation of place of work	1
Job-related accommodation in an overseas property	1
Third stay in property eligible for PPR	½
Last 9 months	½
Calculate Henry's unrelieved gain	1
Calculate CGT liability	½
If Dorothy is tax resident, original stay in property eligible for PPR	1
Period of absence not exceeding 3 years	1
Second stay in property eligible for PPR	½
Dorothy ineligible re Henry's situation of place of work	1
Dorothy ineligible re Henry's job-related accommodation overseas	1
Third stay in property eligible for PPR	½
Last 9 months	½
Calculate Dorothy's unrelieved gain	1
Calculate CGT liability	½
If Dorothy is non-resident, rebasing might apply	1
Retrospective basis not applicable	1
Straight-line apportionment basis gain	1
Whether straight-line apportionment or default basis will apply	1
PPR re last 9 months only on either basis	1
Calculation of gain	1
Calculate CGT liability	½
TOTAL	**20**

Answer 6

Sean has two property rental businesses:

- a UK business (the London, Peak District and Edinburgh properties) and
- an overseas business (the Portuguese villas).

Rental profits are calculated as gross income less allowable expenses and are subject to Income Tax. Sean is an additional rate taxpayer, so his rental profits will be taxed at 45%. By default, the 2020/21 profits of Sean's UK and overseas rental businesses will both be calculated on the cash basis because the total gross property income from each was below £150,000. This £150,000 limit applies to UK and overseas businesses separately. A taxpayer can make an election to use the accruals basis if preferred, by the first anniversary of 31 January following the tax year end.

It will be beneficial for Sean to make an election to use the accruals basis for his UK business by 31 January 2023. This will result in the allowable proportion of the £30,000 payment relating to repair works completed in 2020/21 but paid in 2021/22 to be deducted in calculating his total profits in 2020/21. This will accelerate tax relief which will be particularly beneficial as he his income will be significantly lower in 2021/22 which means he is likely to pay tax at a lower rate in this year.

A property qualifies for tax advantages if it is a Furnished Holiday Letting (FHL), including unrestricted relief for mortgage interest paid and capital gains tax reliefs such as gift relief, rollover relief and business asset disposal relief. FHL profits are also treated as earned income, increasing the amount the owner can contribute to his pension. To qualify as an FHL, the property must meet the following conditions:

- fully furnished, let on a commercial basis with a view to profit;
- located in the UK or European Economic Area (EEA);
- available for letting for at least 210 days of the tax year;
- actually let for at least 105 days for short term stays (fewer than 31 days); and
- not be occupied for periods of longer term occupation (more than 31 days) for more than 155 days in a tax year.

Sean's London flat is a long-term letting and does not qualify as an FHL.

The Edinburgh apartment and two Portuguese villas met all of the above conditions in 2020/21 and are therefore qualifying FHLs.

The Peak District cottage does not automatically qualify as an FHL in 2020/21 because it failed the 'let for at least 105 days' condition.

There are two elections available where a property usually qualifying as an FHL does not meet the letting condition in a particular tax year.

The period of grace election under s.326A ITTOIA 2005, treats a property as continuing to qualify in a year in which it does not meet the letting condition. The owner must have a genuine intention to meet the FHL conditions, have met them in the previous tax year and make an election by 31 January 2023 on his tax return or by writing to HMRC.

The averaging election under s.326 ITTOIA 2005, allows the owner to average the day counts for days let across multiple properties. A mixture of UK and overseas properties cannot be averaged in this way; separate elections would be needed for groups of UK properties and overseas properties respectively.

If Sean makes either election in 2020/21, the Peak District cottage will qualify for FHL treatment. It would be more beneficial for Sean to make an averaging election as this would give him flexibility to make a period of grace election in the following two years if the conditions are failed again.

Expenses

Revenue expenses are deductible in calculating rental profits if they are incurred wholly and exclusively for the purpose of the letting business.

Capital expenditure is not deductible but qualifies for capital allowances in some circumstances.

Costs relating to the improvement of the property are capital, whereas maintenance and repairs are usually revenue.

The initial cost of furnishings and furniture is capital, but Replacement Domestic Items Relief is available for the replacement of certain domestic items in residential properties. This relief is not available for FHLs who have the option of claiming capital allowances instead.

Full relief for mortgage interest is available for FHLs whereas relief is restricted for residential properties.

For the Peak District cottage, the insurance proceeds received could be considered a capital receipt under s.22 TCGA, triggering a part disposal for CGT purposes. However, it would appear that Sean spent the entire proceeds on rebuilding and redecorating the indoor and outdoor walls which constitute repairs. These costs are revenue and are deductible in calculating Sean's rental profit. The cash received from the insurance company is therefore treated as a receipt of the rental business, reducing the total deductible revenue expenses.

The patio extension and doors are considered improvements, so costs are capital and are not deductible. A proportion of the cost will therefore not be allowable.

To the extent it's not covered by the insurance proceeds replacement of furniture in the property will be deductible if profits are calculated on the cash basis. If Sean elects to use the accruals basis, these costs will qualify for capital allowances instead, since the property is an FHL. Relief will be at 100% as the Annual Investment Allowance (AIA) will apply.

If Sean makes an averaging election in 2020/21, mortgage interest is allowable as a full deduction since the property is a qualifying FHL.

Losses

Losses are ringfenced in the UK and overseas businesses respectively.

In his UK business, Sean has realised profits on the London flat (rental income) and the Edinburgh apartment (FHL profit). The FHL loss realised on the Peak District cottage will be automatically set against the FHL profit on the Edinburgh apartment. It cannot be set against normal rental income so the remaining unused loss will be carried forward for use against future UK FHL profits.

Sean could possibly improve his tax position by choosing not to make the averaging election for FHL treatment on the Peak District cottage. This would allow the loss to be set against the London rental profit, reducing his overall taxable profit. Again this may be advantageous as the loss will be relieved in a year where he is subject to tax at a higher rate. However, Sean would lose access to other advantages of FHL treatment and there may be a knock-on effect on meeting the conditions in future years.

In the overseas business, the loss made on one Algarve villa will be set against the profit made on the other, reducing the overall profit subject to taxation.

MARKING GUIDE

TOPIC	MARKS
Basis of taxation of each property	
UK and overseas properties considered two separate businesses	0.5
UK normal rental and FHL properties form part of one business when assessing cash or accrual basis but overseas properties considered separately.	0.5
Cash basis by default as gross income <£150,000	0.5
Can elect to use accruals basis by first anniversary 31 January after tax year	0.5
Accrual basis beneficial to accelerate relief when income reducing	0.5
Furnished Holiday Letting	
Conditions: - Furnished and UK or EEA - Available at least 210 days & actually let for 105 days - Long term let >31 days not qualifying - Not occupied for long-term of more than 155 days	 0.5 0.5 0.5 0.5
Edinburgh apartment & Algarve villas meet conditions	0.5
London flat not an FHL as let on long-term basis	0.5
Peak District cottage doesn't meet letting day count condition	0.5
Elections	
Averaging election: - Explain average days any/all properties - Separate election for UK props and for overseas props - Time limit – first anniversary 31 January following tax year	 0.5 0.5 0.5
Grace period election: - Explain election continue to treat as FHL - Genuine intention to meet conditions - Time limit – first anniversary 31 January following tax year	 0.5 0.5 0.5
Sean can make either election	0.5
Best option is averaging election so that period of grace election available in two future years	0.5
Expenses / Capital allowances	
"wholly and exclusively"	0.5
Capital vs revenue expenditure	0.5
Patio extension & patio doors = capital, not deductible	0.5
Rebuilding & redecorating indoor & outdoor walls = revenue, allowable	0.5
Replacing furniture = deductible on cash basis or capital allowances as FHL Relief at 100% as AIA available	0.5 0.5
Mortgage interest allowed in full against FHL property income	0.5
Losses	
Peak District loss not allowed against normal UK property profit. Carried forward	0.5
Algarve villa loss allowed against profit on other Algarve villa	0.5
It may be beneficial to not make averaging claim so loss can be allowed against UK property	0.5
Presentation and higher skills	0.5
TOTAL	**15**