



The Chartered Tax Adviser Examination

May 2018

Human Capital Taxes

Advisory Paper

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer booklet.
- Unless otherwise indicated by the provision of additional table information, you may assume that 2017/18 rates and allowances continue to apply for 2018/19 and future years. Candidates referring to actual or pending rates and allowances for 2018/19 and future years will not be penalised.

1. You are Louise Marshall and you are a tax manager in the UK office of an international firm of accountants. You have received the following email from Tobias Weber, who is a tax manager in your firm's Dusseldorf office.

To: Louise Marshall
From: Tobias Weber
Date: 6 April 2018
Subject: Engineers attending customer site

Dear Mrs Marshall

One of our clients, Solpan GmbH, is a German engineering company with specialist knowledge of the solar panel industry. Solpan GmbH has recently won a project to supply and install solar panels at a customer site near Birmingham. The project will commence on 1 June 2018 and will be completed by 31 August 2019. Our colleagues have already established that this will create a permanent establishment for Solpan GmbH in the UK and the company will need to register for VAT in the UK.

Solpan GmbH is now seeking advice on the UK Income Tax treatment of the engineers who will be required to attend the customer site. The Personnel Manager at Solpan GmbH has identified the following staffing requirements for the project.

- 1) A project manager, who will be involved for the whole project period. He will work full-time at the customer site, although he will be required to attend monthly update meetings back at the Dusseldorf office. Solpan GmbH will pay for a flight home every second weekend. The intention is that the monthly update meeting will be held either on a Friday or a Monday to coincide with the weekend home.
- 2) Three skilled engineers, who will work at the customer site as and when required during specific stages of the installation and commissioning. Solpan GmbH anticipates that they will spend the months of June, July and November 2018 and January, April and August 2019 in the UK. Again, Solpan GmbH will pay for one flight home during each month spent in the UK.
- 3) A Specialist Solar Engineer, who will spend most of the project period at the customer site. He will have to visit the Dusseldorf office on a few days and may also have to attend some of the monthly update meetings in Dusseldorf. Solpan GmbH will also provide one flight home per month.

The individuals in categories 1) and 2) above are existing staff of Solpan GmbH. The Specialist Solar Engineer in 3) above is an engineer who Solpan GmbH have used in the past on a freelance basis. In order to secure his services for this project, they are proposing to employ him on a 13-month contract from 1 August 2018 to 31 August 2019. All the individuals are German nationals and will be paid from the German payroll during their assignments to the UK. They will remain German tax residents as they will maintain their current homes in Germany where they have spouses and children, who will stay in Germany.

There are no special enhancements to the salary package as it is standard practice for all Solpan GmbH's engineers to work at customer sites throughout Europe as part of their contractual terms. However, under German law, fixed daily allowances are paid to staff working in another country. These are £36 for a full 24-hour period and £24 for a period of less than 24 hours. These allowances are tax-free under German law but only for the first three months of the total assignment period. Thereafter they continue to be paid but are taxed in Germany. Overtime is payable if the individual works at a weekend or on a night-shift. Such overtime is tax-free in Germany. Solpan GmbH will tax-equalise the individuals if they are liable to UK tax.

Continued

1. Continuation

Solpan GmbH will provide each of the individuals with a serviced apartment during the periods they are in the UK. In addition to the flights described above, and those at the beginning and end of the assignments, Solpan GmbH will also pay for associated travel costs to and from Birmingham.

It will be possible to ask the German Tax Authority for exemption from salary withholding tax in Germany for the Project Manager and the Specialist Solar Engineer. We may be able to request a reduction in German withholding tax for the other engineers, if we can prove that the UK equivalent is payable.

Can you please advise us on the UK Income Tax implications of the proposed assignments and remuneration packages? The individuals will all have A1 certificates to remain in the German social security system and be exempt from the UK equivalent, so no advice regarding social security is required.

If you need any further information, please let me know.

Best regards

Tobias Weber

You are required to write an email reply to Tobias Weber advising on the UK Income Tax implications of the proposed assignments and remuneration packages.

(20)

NOTE: Relevant Articles from the UK-Germany Double Tax Treaty are provided.

UK - GERMANY DOUBLE TAX TREATY EXTRACT

Article 4 Resident

- 1) *For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority of a "Land" or a Contracting State. This term, however, does not include any person who is liable to tax in that Contracting State only if he derives income or capital gains from sources therein or capital situated therein.*
- 2) *Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:*
 - a) *he shall be deemed to be a resident only of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident only of the Contracting State with which his personal and economic relations are closer (centre of vital interests);*
 - b) *if the Contracting State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either Contracting State, he shall be deemed to be a resident only of the Contracting State in which he has an habitual abode;*

Continued

1. Continuation

c) *if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident only of the Contracting State of which he is a national;*

d) *if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.*

Article 7 Business profits

1) *The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.*

2) *Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.*

3) *In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the Contracting State in which the permanent establishment is situated or elsewhere.*

Article 14 Income from employment

1) *Subject to the provisions of Articles 15, 17, 18 and 19 salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.*

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

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

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

c) *the remuneration is not borne by a permanent establishment which the employer has in the other State.*

End of Question

2. You are a tax manager in a firm of Chartered Tax Advisers and you have received the following email from one of your clients.

To: Anthony Byars
From: Evelyn Wright
Date: 24 April 2018
Subject: Company Cars

Dear Anthony

As you know, Malcolm has left the company and as a result I have taken over the management of the company's pool car which is a small petrol car (list price of £14,200 and CO₂ of 110g/km) and for which we provide all fuel. Malcolm always kept the key to the car in his office and he also kept a log of who used the car and why. In order to familiarise myself with the system, I have done a review of the log book and one or two things concern me.

Firstly, the car is frequently taken by the same person, Ed, our supplies foreman. It seems that we have many occasions when he has to fetch or deliver urgent parts. The journeys are genuine. However, the frequency is such that sometimes he has used the car every day for several weeks at a time, although he does not take the car home.

Secondly, on three occasions last year, the car was taken home on Friday evening by an employee as they had to leave early on the Monday morning to go to Carlisle. It would not have been practical to go to the office on Monday morning to pick up the car as they left at about 6am. We checked the mileage and the car wasn't used over the weekend.

Thirdly, on one occasion, one employee used the car to take another employee to the hospital because they collapsed in the office.

Should we be reporting a company car benefit on the P11Ds for these employees?

Finally, I would also like your advice on another car issue. Malcolm's replacement, Derek, starts next week. He is entitled to a company car and it is normal company policy to give him Malcolm's former company car, because it still has nearly a year to run under the lease hire agreement. If we don't, we will still be paying the lease hire costs and the car is being wasted parked at the office. This car has a list price of £27,400, CO₂ of 178g/km and a diesel engine. Once the lease runs out, Derek can choose his own car. Derek will cover a lot of business miles and expects to make very little private use of the car so he isn't happy as he wants to have something with a far lower benefit in kind. However, we need to make good use of Malcolm's old car. He is that upset by it, he has said he will not join the company if this cannot be resolved, so we need a solution.

Thanks for your help.

Best regards

Evelyn
HR Manager
Dreve Ltd

You are required to write an email to Evelyn in response to her queries. (10)

3. You are a tax manager in a firm of Chartered Accountants. The Tax Partner has asked you to draft an email to one of the firm's clients in response to the email, which he received below.

Date: 2 May 2018
 From: Helena Jackson
 To: Terry Barker
 Subject: 25th Anniversary Celebration

Dear Terry

We are just about to reach 25 years in business and the directors thought it would be a good idea to celebrate. We have had a difficult few years, as you know, but we feel we have turned a corner and we should do something for the staff who have helped us through that difficult period. However, the Finance Director recalled that there were some tax rules involved, so we thought we would ask your advice.

This is what we are planning:

- 1) A party for all staff and their partners. We used to have an annual summer party but stopped it when the business was struggling. This will be a re-launch of the summer party to mark the start of a new more positive era. We have 14 staff and probably 11 of these will bring a partner. Then there are three directors and their three spouses.

We plan to go to a local boutique hotel. They can provide an evening party, including food and a DJ. We will also provide a limited amount of drinks. Attendees can also choose to stay overnight and we will pay for room and breakfast. Our budget is £4,500.

- 2) We want to recognise staff who have stuck with us during the bad times too. We will do this with a long service award in three categories:

	£
Five to 10 years' service	600
10 to 15 years' service	800
15 plus years' service	1,000

We do not intend however to give this as cash. We thought that we would ask each recipient to say what gift they would like up to that value or give them vouchers for a shop, which they can nominate.

We have checked the service records and have established we will offer the following awards:

<u>Name</u>	<u>Department</u>	<u>Years of service</u>	<u>Salary</u>	<u>Award Value</u>
			£	£
Bob White	Marketing	7	30,150	600
Liam Green	Post sales	8	32,580	600
Miriam Blue	Reception	11	23,000	800
Charles Orange	Marketing	19	45,260	1,000
Sally Red	Finance	19	45,800	1,000
Eve Black	Reception	23	26,740	1,000

Continued

3. Continuation

- 3) For the eight staff with under five years' service we will give each of them a voucher to the value of £30.
- 4) We also want to make a special award to Bob White. He made a suggestion about how we could change our supply chain, which we implemented. It has saved us £500,000 in the first year. We thought perhaps a weekend away for him and his wife.

Can we do the above without causing personal tax problems? It would not have the desired effect if all the staff had to pay tax on some kind of deemed taxable benefit.

Regards

Helena

You are required to draft an email to the client explaining and quantifying the tax and National Insurance consequences of the proposed celebrations. (20)

4. You work for a firm of accountants and have received the following email from Julian Brown, the Financial Accountant at Holo plc, which is one of your clients.

To: Marcus Hayman
From: Julian Brown
Date: 28 April 2018
Subject: Employee Shares

Dear Marcus

I have a bit of a problem, which I hope you can help me with. Our internal reporting system has recently flagged up that there is a "tax on share scheme" action to deal with. However, as you know, I have only been at Holo plc for a little over a year and there have certainly not been any share schemes put in place during my time. I have been digging in the records that my predecessor left me and I have established that it relates to when we changed from a private limited company to a listed plc four years ago.

We gave each of the 11 employees at that time 300 shares for no consideration because we wanted them to have a stake in the company and be interested in making Holo plc a success. Nothing happened in terms of tax at the time. There was a condition attached to the shares that they would be forfeited if the employee left the company for any reason within four years and this condition is about to expire. All of these employees have remained with the company.

My predecessor's notes also have the following details listed, which I presume is useful information:

Value per share at date of public listing	£2.00
HM Revenue & Customs agreed restricted value due to forfeiture	£1.80

Today's share value is £6.40.

The notes also have a comment, which is underlined twice, so I think it must be important, "Employees may not have enough to pay tax/NIC bill!". Do you know what this might mean? The 11 employees each earn in the region of £27,000 salary per year and have PAYE codes of 1150L.

I am sure that, as always, you will be able to explain what this is all about and keep us on the straight and narrow with the taxman.

Kind regards

Julian

You are required to write a reply to Julian's email. (15)

5. You are a tax adviser in the Human Capital department of a large accountancy firm. You have recently attended a meeting with Jenny Perrin, who works in the corporate tax department of your firm, regarding one of her clients. She has provided you with the following information.

Titanium Ltd, a UK company that sells various sporting equipment throughout Europe, has recently expanded into the Australian market. During the initial trial period, the UK company contracted with an independent agent to introduce their product to the Australian market and promote this on their behalf.

Following this trial period, the company now wish to expand their growth in Australia further and accordingly the directors have set up an Australian company, Ferrus Ltd, to run this venture through.

The Sales Director of the UK company, Fred Manwaring, has recently expressed an interest in moving to Australia to work to promote the brand further and secure the company's presence in the Australian market.

Fred has submitted a two year business plan for the other directors of Titanium Ltd to consider regarding the growth of the Australian business. The directors are happy to give this venture a go and it is likely that Fred will leave the UK on 5 March 2019 for 2½ years to give him time to acquaint himself with the markets and then to implement the business plan.

Fred has taken Australian advice and is aware that the Australian company would be able to sponsor Fred's request for an Australian visa, which would be a subclass 457 visa. This visa is a temporary residence visa and would require Fred to have private health insurance in place throughout his Australian stay. He is aware that there is no social security agreement in place between Australia and the UK.

Ferrus Ltd would be required to contribute towards superannuation on behalf of Fred. This would be a minimum of 9.5% of his ordinary time earnings (meaning salary, bonuses, commission and other allowances) and is payable quarterly. Fred may be able to access this fund at the point he leaves Australia.

Fred has also taken advice regarding the Statutory Residence Test and is aware that from departure on 5 March 2019 he will qualify for split year treatment under Case 1 and in the following tax year will be automatically resident overseas due to meeting the conditions of full-time work overseas.

As Fred will break UK tax residence and has requested the opportunity to work overseas personally, Titanium Ltd have decided that he will be responsible for his own overseas taxes. It has not yet been decided whether Fred will go to Australia as an assignee remaining employed by Titanium Ltd, or whether he will be employed locally by Ferrus Ltd. Whichever applies, his employer will contract with the providers directly to provide Fred with the following benefits:

- 1) Initial travel to Australia for him and his family
- 2) Shipment of personal effects
- 3) Costs of the visa application
- 4) Accommodation whilst living in Australia
- 5) Private medical insurance

Continued

5. Continuation

The company will also pay for private school fees for Fred's children whilst he is living in Australia, which are estimated to be £8,500 per year.

The company would like advice on whether Fred should go to Australia on assignment or be hired locally by Ferrus Ltd.

Finally, as Fred would need to return to the UK to attend relevant training courses, the company would like to understand the distinction between substantive and incidental duties.

You are required to write a technical note for Jenny to assist her when she next meets with the Chief Executive of Titanium Ltd:

- 1) **Advising on whether Fred should go to Australia on assignment or be hired locally by Ferrus Ltd.** (17)
- 2) **Discussing the difference between substantive and incidental UK workdays.** (3)

Total (20)

6. You are a tax senior in a firm of Chartered Accountants which prepares UK tax returns for Jeffcock Inc group, which has separate subsidiaries for its operations in the US, UK, Italy and Saudi Arabia. You are inspecting the 2017/18 UK tax returns for a number of individuals who are on assignment to and from the UK within the group.

1) Geoff is a UK national who began a two-year tax-equalised assignment to Italy on 1 July 2017. He is entitled to split-year treatment under Case 1 for 2017/18, with the overseas part of the year beginning on 1 July 2017. He did not have any UK workdays between 1 July 2017 and 5 April 2018.

The 2017/18 UK tax return shows a refund of £1,024 which will be mandated to the employer. The 2017/18 tax equalisation calculation, which was prepared for the full year ended 5 April 2018, shows a settlement due to the employer of £655. The settlement will be collected via the payroll within two months of being issued.

In March 2018, Geoff received a bonus of £20,000 relating to the 2017 calendar year. Hypothetical taxes of £8,000 were deducted from the bonus, but Geoff was only a basic rate taxpayer in 2017/18.

2) Kathy has been on a tax-equalised assignment from the US to the UK since February 2015. Approximately 20% of Kathy's work duties are outside the UK during her UK assignment and she meets the requirements of s.26A ITEPA 2003 in 2017/18.

The 2016 US tax equalisation calculation shows the following:

Hypothetical tax responsibility	\$	\$
		(72,959)
<u>Amounts paid by assignee</u>		
Hypothetical tax withholding	56,767	
Federal tax withholding	145,385	
Less US Federal refund	<u>(87,375)</u>	
Total tax payments:		114,777
Net cash flow before advances		41,818
Less advances		<u>(24,573)</u>
Net cash settlement due to assignee		<u>\$17,245</u>

The net cash settlement was finalised and paid on 30 August 2017.

Having reviewed Kathy's 2015/16 and 2016/17 UK tax returns you note that the Federal tax withholding was taken as a deduction against UK taxable income. Furthermore, you note that the advances, which were paid by Jeffcock Inc, have not previously been reported for UK tax purposes.

3) George is a US national who was on a tax-equalised assignment to the UK between 1 February 2011 and 31 January 2014. He was UK tax resident between these dates and entitled to split-year treatment for his years of arrival and departure. After his UK assignment, George went directly to Saudi Arabia for a further equalised assignment, where he remained until 30 June 2015. After this point, George returned to the US.

George continued to have some UK workdays after his departure from the UK and while he was on assignment in Saudi Arabia. These were treated as exempt under Article 15(2) of the UK-Saudi Arabia Double Tax Treaty.

In 2012/13 he was granted an unapproved stock option which you have determined is taxable under Part 7 Chapter 5 ITEPA 2003. George exercised the option as soon as it vested. The vesting period of the option is 1 January 2013 to 1 January 2017 and the total option gain is \$50,000.

Continued

6. Continuation

You have reviewed the 2014 US tax equalisation calculation, which was prepared late and not settled until 1 May 2017, and identified that there was a hypothetical tax adjustment in favour of the employer of \$15,638.

- 4) Vincenzo is an Italian national on assignment to the UK from 1 July 2016 to 30 June 2017. He continues to be paid and taxed via the Italian payroll. The Italian subsidiary does not have a formal secondment agreement in place with Vincenzo, nor does it have any intention to recover any Italian withholding taxes paid on Vincenzo's assignment income.

It has not yet been determined whether the UK subsidiary will be bearing Vincenzo's UK tax liability on his behalf.

You are required to explain the UK tax impact of the information provided for each individual. (15)

NOTE: Relevant extracts from the UK–US and UK–Saudi Arabia Double Tax Treaties are provided.

UK - US DOUBLE TAX TREATY EXTRACT

Article 14

Income From Employment

1. *Subject to the provisions of Articles 15 (Directors' Fees), 17 (Pensions, Social Security, Annuities, Alimony, and Child Support) and 19 (Government Service) of this Convention, salaries, wages, and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.*

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

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the taxable year or year of assessment concerned;

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

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

3. *Notwithstanding the preceding provisions of this Article, remuneration described in paragraph 1 of this Article that is derived by a resident of a Contracting State in respect of an employment as a member of the regular complement of a ship or aircraft operated in international traffic shall be taxable only in that State.*

Continued

6. Continuation

UK - SAUDI ARABIA DOUBLE TAX TREATY EXTRACT

Article 15

Dependent Personal Services

(1) Subject to the provisions of Articles 16, 18, 19 and 20 of this Convention, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

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

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

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

(c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

(3) Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment exercised aboard a ship or aircraft operated in international traffic shall be taxable only in that State.

End of Question