Application and Interaction

(Ensure this number matches your candidate number on your desk label and on your candidate attendance letter)

Chartered Institute of Taxation

Excellence in Taxation

0	4	0	5	2	0	1	7	Date of Examination

☐ Tick box if you have answered in accordance with Scots Law

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Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your paper not being marked. You must:

(a) Complete the details on this page and on the answer pages using BLACK or BLUE ballpoint pen only.

(b) Write on one side of the page.

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Please do all of the above before the end of the examination.

	Tick question attempted	For use by examiner only
1	✓	
2		
3		
4		
5		

FORMAT & STYLE OF ANSWER	MAXIMUM MARKS	MARKS AWARDED
The answer is set out in the format demanded. Thus, if it is a letter, it will be properly set out as a letter with addresses, date, "Dear X" and conclude "Yours sincerely" etc. If it is a report, it will give some indication as to what it is about and who it is for.	1	
The report or letter should contain an introduction setting out the terms of reference, information being relied on etc. It should also contain a summary of the key findings and recommendations.	2	
The body of the letter or report should be laid out in a clear way with appropriate headings so that the reader can navigate around it easily and spot the key areas without reading the entire document to try to find a discussion of, for example, income tax on some employment related shares.	1	
The answer "flows" so that a logical chain of thought presented to the reader rather than a series of random comments (which may nevertheless be technically correct).	1	
The style of writing should be appropriate to what is being produced. For example, a report to a client or lay person (which will always be the main element of a question) should not contain large numbers of legislative references whereas a technical note to the tax partner should. Technical advice should be conveyed in style appropriate to the reader.	2	
RELEVANCE OF ANSWER		
The answer does not contain large amounts of irrelevant material which would only serve to confuse a client.	2	
Technical knowledge (which will be rewarded through the technical marks and should not affect the awarding of these marks) has been directly applied to the specific circumstances of the reader and has this resulted in an answer tailored to their circumstances.	3	
The question(s) posed has/have been answered.	2	
PROVISION OF ADVICE		
The report gives advice. This means that where possible it should come off the fence and suggest the best option rather than simply giving a list of unweighted possibilities which fail to give the client an answer to their real problem: what should I do?	4	
Advice should include relevant and appropriate planning for the future.	2	
Advice should be commercial. This means that candidates should consider the bigger picture rather than narrowly focussing on saving tax.	2	
TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS	22	

Paper Ref	Question No.
A&I	1

Appendix 1

Tox computation comparing when UK resident with being non - UK resident.

~~Current position~~

Income.	17/18 ~~16/17~~		18/19 ~~17/18~~	
Rental income (UK)	NS+E	O	NS	O
- 1-8 Station Road	40k		40k	
- Poppy House (FHL)	28k		28k	
- Daisy House (Commercial sold)	—		—	
Overseas income	~~35k~~		~~[illegible]~~	
FHL	35k		—	
Costa Sea	29k		—	
Cocoa Sand	32k		—	
UK pension (not 16/17 as still working)	—		18k	
Foreign pension (W1) ~~[illegible]~~				
UK dividends		25k		25k
UK interest	10k	—	10k	—
	174	25k	96k	25k
Less PA (W2)	—	—	—	—
	174	25k	96k	25k

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Tax due	17/18	18/19
32000 @ 20 % =	6400	6,400
118k / 64k @ 40 % =	47,200	25,600
24k @ 45 % =	10,800	—
5k @ 0 % =	—	—
20 k @ ~~20~~ 38.1 % =	7,620	7,620
TOTAL TAX DUE	72,020	39,620

Not claiming PA for 18/19

tax due	34,620
less 20 % on savings	(2000)
7.5 on div	(1,875) ~~(2000)~~
	35,745

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W1) Any pension received in 17/18 will be allowed a 10% tax credit.

I have assumed all pensions will not be received until 18/19.

W2) No personal allowance as earnings over £122k

W3) Assumed share investments sold / transferred to trust.

W4) No salary income has been included. Assume that PAYE will cover this tax.

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Appendix 2

Cossa Sun

Proceeds	720k
less: Cost (MV @ ...)	(550k)
enhancement	(50k)
	120k
less AE	(11,100)
	108,900

Tax @ 10% : £10,890

Daisy House

Proceeds	780k
less: Cost (MV @ DOD)	(550k)
Enhancement	(50k)
	180k
less AE	(11,100)
	168,900
Tax @ 28%	47,292

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N.B .

Expenses are related to capital expenditure & are therefore deducted from proceeds.

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TAX REPORT

For review by Julie Wright:

TO: JOHN BROOKES

FROM: JAMES REID

DATE: 4th MAY 2017

For the purposes of this report I have used the information provided in your letter of 1st inst. & the valuations of your current assets and assets at the 31st March 2010 which were passed to you from your late father.

You will undoubtedly be aware that the law continues to change & the advice given in this report is relevant to the current provisions.

I have provided an executive summary below outlining the main points & advices contained in this report.

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A&I	1

The report is set out as follows:

1. Residency rules & Position
2. Funding the purchase of property abroad
3. Establishing a trust
4. Trust for Emily
5. IHT position
6. Other matters

1.1

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A&I	1

EXECUTIVE SUMMARY

i) You will be resident in 17/18

ii) You will be non-resident in 18/19

iii) Consider selling Casa Sun or Daisy ~~your house to~~ Hill to fund the overseas property purchase

iv) A trust deed will be required to establish a trust

v) Establish a disabled trust for Emily.

vi) Your UK assets ~~is~~ + overseas assets are subject to IHT when domiciled in the UK

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① RESIDENT STATUS

You have indicated that you are retiring at the end of June & will live abroad come November.

This will mean that you will likely become a non-resident from the date that you begin living in Goldenstien (G).

Any individual who is resident in the UK will be automatically taxed on their world wide income and gains. The only exception is a UK resident who is non-domiciled but this will not be the case in your situation.

An individual who is non-resident will only be taxed in the UK on their UK source income. Any gains made by a non-UK resident will not be taxed in the UK irrespective of where the asset is situated.

There are exceptions to the this rule re. gains of non-residents in particular non-resident capital gains tax

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on UK residential property. ~~and~~ Additionally rules re. temporary non-residence but I will explain these further on.

To determine your resident status we must look at the statutory residence test. This helps to determine whether you are UK resident or not.

~~The first test is the automatic overseas test~~

There are three tests we must consider:

1) Automatic overseas test
2) Automatic UK test
3) Split year rules

1) Automatic Overseas test

You will be non resident if you:

a) spend less than 46 days in the UK in a tax year & were resident in any 3 previous years
b) you work full time overseas.
c) non-resident in any of the previous 3 tax years & spend less than 16 days in the UK.

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Note : A day is spent in the Uk if you are present in the Uk at midnight.

You will not meet any of these criteria going forward as you will ~~not~~ be present in the Uk for eight weeks of the year being 56 days. In addition you are retiring & ∴ will not be working at all never mind full time.

2) Automatic Uk test

The three conditions are : (only 1 need to be met)

a) you spend over 182 days in the Uk in the year

b) You work full time in the UK

c) You have a home in the Uk and you only have ~~an~~ an overseas home in which you spend less than 30 days in that home.

The automatic Uk test condition a) will mean that you are a Uk resident for the full 17/18 tax year. This will be because you ~~were~~ will spend 204 days of the year here (assuming you leave on the 1st November 2017) You will have a Uk home but the overseas home rules out this test.

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However looking forward this test will not apply to you as you will not spend the necessary amount of days in the UK, nor will you only spend 30 days in your home in G.

We must therefore look at the ~~split year~~ ~~treatment~~ sufficient ties test to determine your residence status for 18/19. You will be classified as a leaver. As a leaver & spending 56 days in the ~~The ties~~ UK you will require at least 3 ties to the UK to be deemed a UK resident for tax purposes.

The ties are:

a) Family Tie

Your spouse or minor child will not be resident in the UK during 18/19 & therefore you will not have a family tie.

b) An accommodation tie

This tie will be met as you will have a place to live in the UK, being Brooks House.

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This house will be available for a continuous period of 91 days & you will spend at least 1 night a year there.

c) A work tie.

A work tie will be established if you work for more than 40 days in the UK. A day of working is when you do more than 3 hours work.

As far as I am aware I do not believe this will be the case. As such you will not meet this tie

d) 90 day tie

If you had been present in the UK for at least 90 days in either of the two previous tax years this tie will be met.

We are looking at the 18/19 tax year. You will have spent over 90 days in 16/17 ∴ you meet this tie.

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e) Country tie

You will meet this tie if you spend more time in the UK than any other country. This ~~will~~ will not be the case ∴ this tie is not met.

As such you will only have two UK ties in 18/19 & ∴ be non-UK resident. You will therefore only pay tax on your UK ~~&~~ rental income.

The income from the overseas ~~FHL~~ furnished holiday lets & rental properties will not be subject to UK income tax

In respect of the ~~tg~~ 17/18 tax year we must look to see if split year treatment can apply. This will have the effect of splitting the tax year in two. The first part, being up until you left the UK & the latter the time spent in G.

You do not meet the split year treatment as it

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currently stands as you have your home in the UK. However should this change please let us know as this may affect your tax position.

I have attached your income tax calculation for 17/18 and 18/19. at appendix 1. You will note that your tax will be reduced by £32,400.

However, as ~~both~~ non-resident you can claim to use your personal allowance (PA) or to obtain credit for tax paid on savings interest at 20% and dividend income at 7.5%.

What ever way works out as the lower tax liability will be the best way forward.

In this instance it will be beneficial to claim no PA. This will mean that you will have tax to pay of £35,745 in 18/19.

(9)

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② Selling Property.

In order to fund the property you are required to fund the purchase by selling an asset. This will be a disposal for capital gains tax (CGT) purposes.

Any disposal will be calculated as the net proceeds less the cost and any disbursements / enhancement expenditure. An ~~annual~~ annual ~~allowance~~ exemption (AE) of £11,100 will be allowed to reduce any gain on the sale.

Tax will be at a rate of 20% (as you are a high earner) or 28% should you dispose of residential property.

I have taken each asset in turn and considered the benefits / disadvantage of selling some.

Ⓐ Entire Share Portfolio

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The gain on the shares will be £710k less cost, at date of death when you inherited them being, £400k giving you a gain of £310k. Tax at 20%, after AG, would be £59,780.

This would leave you with only £650,220 to purchase the property in G. You note that you require £700k ∴ I would advise you not to sell these shares.

(B) Cossa Inn

The gain on this property will stand at £120k being (£720k - 50k (enhancements) £550 cost at 31/3/10)
As this is a Furnished Holiday Let (FHL) you will qualify for entrepreneurs relief (ER) on the sale.

ER will be available when you sell a FHL if you have owned it for the past 12 months, own the property (over 5%) & the FHL is trading.

You have indicated that it meets the criteria for a

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for a FHL ∴ as such GR will apply to the disposal.

GR will mean that any gain is taxed at 10% opposed to 20%. Full AE is allowed. A life time limit of £10million is allowed.

The total tax is therefore £10,890. See Appendix 2. The total proceeds available would therefore be £704,110.

ⓒ Daisy House

This disposal gain would be taxed at 28% as it is a residential property. I have calculated the tax to be £47,292 (see appendix 2).

This would give total proceeds of £732,708.

My advice would be to sell Casa Sun as it qualifies for GR ∴ lower tax to be paid on the gain. ~~As~~

(12)

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Any claim will need to be made ~~for~~ by
first anniversary of
the ^ 31 January following the year of disposal. i.e.
dispose in 17/18 = claim by 31/1/20.

③ Trust Establishment

In order to establish a trust a deed must be drafted. This will need to be completed by a legally qualified individual as it would fall outside our scope of services.

The deed must be signed by you as settlor. The trust will have trustees being your ex-wife and solicitor. As they are both UK ~~dom~~ ~~resident~~ resident then the trust will also be UK resident. As such it will be subject to UK tax on worldwide income & gains.

A trust that holds land / property will be required by law to have two trustees.

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<u>Assets</u>

The trust will be formed when the assets are transferred from you to the trustees. The trustees legally own the property. ~~The~~ They have a fiduciary duty to act with due care & with integrity.

There are generally two main types of trust that you can establish.

1) <u>Discretionary Trust</u>

gives the trustees full powers of appointment. They can exercise their discretion as to when & what beneficiaries get income / capital.

2) <u>Interest in possession trust</u>

Any income will be distributed to the beneficiaries in the tax year. The trustees have full discretion on what to do with the capital.

You can be a beneficiary of the trust but this has tax implications & I would not advise it.

It is my understanding that Emily will be the sole

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beneficiary of the trust. As she is disabled, a term specified in statute, special rules can apply to the trust established for her. These are set out below.

4 Establishing a Trust for family.

When establishing a trust this will generally be a chargeable lifetime transfer (CLT). Tax would be charged at 20% / 25% (depending on whether the trustees / donor pays the tax.

However any gift made to a trust for a disabled beneficiary will be classified as a potentially exempt transfer (PET). NO immediate charge to IHT will arise.

Should you, unfortunately, ~~pass~~ pass away within 7 years of gift then tax on the PET will be at 40%. You can use your annual exemptions (AE) of £3,000 each year to lower the PET. ~~An~~ AE's can be used from the previous

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year is not utilized.

Should you survive at least three years then taper relief will be available to reduce the tax which the trust would have to pay. Taper relief reduces the ~~tax~~ tax ~~value~~ by 20% each year.

* (Please insert)

Any gift to the trust will be a disposal for CGT. Relief will not be available for gift relief in line with an inheritance tax (IHT) gift as a PET is not deemed to be chargeable to IHT.

Should you gift a business asset then gift relief may apply. Gift relief would be available to a UK resident donee. A business asset for gift ~~relief~~ relief purposes is:

A) An unquoted trading Co,

B) 5% share in quoted trading ~~Bag~~ Co.

C) Land + Buildings used in a trade.

For the purposes of gift relief FHL will qualify as business assets. The FHL must be trading + I

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(BPR)
* Business property relief ~~will~~ may also be available should you give one of your FHL.

BPR reduces the value of ~~the~~ the transfer for IHT purposes by 100% if the business is wholly or mainly trading + has been held for 2 years.

A FHL can qualify ~~qualifying~~ for BPR at 100%. This is only if the activities of the FHL are not mainly land related.
(+ Insert)

Not mainly land related will mean that other activities are offered to the tenants. Things such as ~~or~~ transport + cooking will add to the chances of convincing HMRC that it is not only the letting of the property that you are concerned in.

There is recent case law, namely the Pawson case, whereby it made it extremely difficult for FHL to qualify for BPR. 16.1

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As such I do not believe that Cosson Sun would qualify for BPR if it were gifted to the trust for ~~EMILY~~ Emily.

To be mainly trading the business must be at least 50% not dealing in land or investments. It needs to be looked at in the round as to whether or not it is.

16.2

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have assumed it is as you have noted that it qualifies as a FHL.

If gift relief is claimed then the base cost of the FHL ~~(Cassan ... Hawke) ...~~ being Cassan Jun in this instance as I note you wish to keep all the remaining properties, will be given to the trust.

Any future disposal of the trust will be treated as if Emily has disposal of the asset herself. She will be allowed her full AE of £11,100. She will pay tax at according to her basic rate of either 10 / 20%. or 18 / 28% for residential property.

The reason for this is that it is a trust for a disabled person & so such period rules apply.

Any normal trust would be taxed at the higher rate of 20 / 28% and only have an AE of £5,550.

(17)

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It would be my advice to transfer ~~the~~ either Eason Sun or the shares to the trust. The advantages of both are detailed below.

Ⓐ Eason Sun

No immediate charge to IHT or CGT if S.165 is claimed.

It will provide an income stream for family each year being £35,000. Any income will not be taxed at the ~~£~~ Trust IIP rates of 7.5% for dividends or 20% for savings / non-savings.

It will be deemed to have payed is it she earned it ~~£~~ ∴ ~~to~~ a full personal allowance will be available for her to use.

The remaining ~~£24k~~ £24,000 will be taxed at 20% being her basic rate band.

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(B) Gift Shares

By gifting the shares to the trust you will be liable to pay CGT as no reliefs would be available.

However you could gift the shares to the trust incrementally ~~thereby~~ there using your AG & crystallising ~~the~~ the shares with the lowest gains.

I understand that this may not be with your intentions & as such you may wish to gift Cassian Inn.

The trust will ~~be~~ qu be a qualifying IIP & as such not a relevant property trust. This will mean that no exit or ~~principle~~ principal charge will be levied on the trust.

A principal charge is a charge every 10 years on the value of the trust. ~~&~~ An exit charge is one in which arises when property leaves the trust & is appointed to

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a beneficiary.

The QIIP trust will form part of Emily's estate when she passes away. IHT will be paid at 40% on the value of the estate less her Nil rate band (NRB of £325,000 currently)

If the trustees were ever to sell the property in the trust they should consider purchasing AIM shares. These will pay out some form of income & will qualify for full BPR subject to being held for 2 years.

This will, in effect, reduce the IHT due on the trust on death ~~on~~ by 100%.

Consideration will have to be given ~~to~~ as to whether (for a foreign purchase) you sell Casa Sun or transfer it to the trust.

Any gift or disposal will will not obtain relief but would generate an income for the trust of £10,000 p.a. £180,000 gain would be taxable.

(20)

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Two elections must be made in respect of the disabled trust.

One to ~~xxx~~ notify that it is such a trust & second to apply the special ~~rules~~ rules.

This must be done every year.

2.0.1

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(5) IHT POSITION

Your ~~ta~~ IHT liability does not rest on where you are resident but on where you are domiciled.

You will have a ~~tha~~ domicile of origin ~~ab~~ in the UK. This will not have been displaced ~~whereby~~ living overseas. previously. Once you returned to the UK you will have reformed to your domicile of origin.

A domicile of origin can only be displaced by a domicile of choice. To choose a domicile would mean that you would have to sever all ties with the UK & set up permanently ~~in~~ ~~the~~ elsewhere.

As you will continue to have a UK home & will return for a period of 8 weeks one would have to assume that you have kept your UK domicile of origin.

(21)

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~~A domicile or de~~

Deemed domicile must also be considered. You will be considered to be deemed domicile in the UK if you leave the UK for the 3 years preceding your departure. Therefore should you leave in Nov. '17 you will be deemed domicile until until Nov. '20.

This rule is in a result of you being resident in the UK for the past 10 years.

An individual domiciled in the UK is subject to IHT on their world wide estate. If ~~When~~ you become domiciled in G then only ~~your~~ your UK assets will be subject to UK IHT. A full NRB will be available.

If you do sell your house & cease to return to the UK only the following, if still owned will be subject to UK IHT:

+ 1-8 Station Rd
+ Poppy House
+ Daisy House
+ Listed securities (UK) (2)

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+ UK bank accounts (in sterling only)

+ Any other UK investments / assets.

Again BPR may be available, but unlikely, on Poppy House.

⑥ OTHER MATTERS

~~A~~ As you will becoming a non-resident then you will be a non-resident landlord. As such you should inform HMRC.

HMRC ~~require~~ will insist that basic rate tax (20%) is withheld ~~by~~ from the rent income by the estate agent to paid to them quarterly.

An application can be made to ~~dis ap~~ disapply these rules if you can demonstrate that you have paid tax on time previously.

A new engagement letter will need to be signed ~~as~~ for the trust if you ~~wish~~ wish us to act for it.

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Also proof of ID of the trustees and Emily will also be required. This is for us to complete our money laundering checks.

When you become non-resident you will need to sign a new engagement letter as our scope of services will change.

We will need you to keep detailed records of all days spent in the UK through tickets for trains / planes.

✱✱ Creation of trust requires:

Certainty of objects - who beneficiaries are

" " subject matter - what will go into trust

" " intention - what you intend the trust to do

✱✱ insert under section (3) (sorry)

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PLAN

PAST · Present · future

+ Res. shoty.

- UK = WW
- O/S = UK

W
^
↑
GR

- UK res. now ∴ taxable ~~on~~ all
  = leave Nov. ∴ 17/18 = res.

- when NR?
  - SRT
  - Auto O/S 18/19 ?
  - UK
  - ~~Split~~ Ties CNB. Home
  - Split yr.

+ NR ~~taxable~~ get PA
  - ~~FYs~~ two comps + 1 for Income with PA
  + 1 " Income without PA sub 20 / 7.5%
  credit

+ Remit bsss doesn't apply

+

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(2) Sell property — FNR CGT

+ rep. NR

~~Don~~ + Disposal — CGT

- AG, Proceeds - cost, MV @ probate
- loss with gains

~~Reliefs~~ ~~[illegible]~~

Reliefs — ① shares, ② Dairy House, ③ Cousin Jun. (190k, 120k)

+ Rollover — CHL ③

+ ER — FHL ③ but IHT on BPR

+ GM

Explain — ER — 5%, 12 mths, ~~[illegible]~~ sole trader

- Trading = 20 test (80)
- 10m / 10%, claim 2 yrs

~~Shares~~ = CGT yes (20%) — Cousin Jun - 120k

310k - 30 : No consid. — No reliefs.

No relief — - 20%, less 35k pa

Dairy Farm c ER ... 18k roughly - less 10k

My love BPR - probs, not quickly

- Rollover any excess - BPR probs. ~~[illegible]~~ FHL excess

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Trust v Gift

Gift

PET, AE, No IMT, Tsrs, 3 yrs = taper, 40%

Donee pays tax.

Trust

~~Gift Trust~~ Trust

Establishing

How = Deed, legal prob., signed, when the assets = legal
- 2 parts, reed 2 ... lord.

- Trustees = UK ∴ will pay, prob trustees.

- Tax implications

- Con Do DT / IIP - QIIP DIG
  - Exc. prop. ∴ no GC & PC

- legal consequence

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IHT position.

~~How + when~~

+ Depends on Domicile. — UK — All
  — non-UK — UK assets.

— Origin / choice / dependence.

— Born for 3 yrs after you leave = Deemed dom.

Q.

— ~~IHT position~~

— Calc.

Other adv

Ethics — New scope of service

— Engagement letter

NR — Level land withhold tax

Application.

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Trust

IHT = QIIP, exc prop.

PET - explain.

CGT = No settlor int ∴

No S.260 bcoz no IHT

S.165 - bus assets

- Explain

- Unquoted / quoted trading 5% 80/20, Co.

- LHB

- FHL

IT - taxed as settlor

- ∴ both PA + AE

- .

+ Set up bk more to S165 only for NR. Ex

Rigber Ins with

+ ~~sook~~ What Assets? ~~...~~

Income stream Cash : NO CGT, BPR? when die = ok

Poppy House - shares to trust, charge to ADM ∴ BPR

Dispose next ∴ inc AG = 5550

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