

The Chartered Institute of Taxation

Application and Professional Skills

Taxation of Individuals

November 2023

Suggested solution

[Firm name]
[Address]

Mr Richter
32 Grove Road
London

November 2023

Dear Stefan

I write regarding the proposed disposals of your share of German property and your shares in Kremet GmbH. With the proceeds, you intend to make contributions into either your UK pension or your German pension (or both). You wish to understand how to approach these transactions and contributions tax efficiently.

The advice contained in this letter has been prepared using current tax rates and rules and information provided at our meeting on 31 October 2023. It should not be relied upon by any third party. I recommend that you seek advice independently in relation to any German tax considerations.

1. Executive Summary

As a UK resident, non-domiciled taxpayer, you can access the remittance basis of taxation, where your foreign income and gains are excluded from UK tax to the extent that they are not remitted to the UK. I recommend that you amend your 2022/23 tax return to include such a claim, generating a refund of £1,306.

You should also make a foreign capital loss election for 2022/23, to get relief for the loss arising on the disposal of your shares in Kremet GmbH (£19,167).

The sale of your share of Kloostergasse 45 to your brother is calculated using the market value at disposal and acquisition. You are eligible for main residence relief for the periods you lived in the property and the final nine months of ownership. In addition, if you make a nomination for this property to be your main residence for the period during which you lived in Frankfurt, a further four years' relief will be available. I recommend you make such a nomination. The chargeable gain on disposal would be £37,888.

For 2023/24, I do not recommend claiming the remittance basis. Although you will owe Capital Gains Tax (CGT) of £1,798 on the foreign disposals, you can then remit the proceeds to pay into your UK pension scheme. The tax relief will offset the CGT. No UK tax relief is assumed to be available on contributions into your German pension scheme under the double tax agreement.

To maximise the UK tax relief, you can use the proceeds to make contributions in both 2023/24 and future years to reduce your income to £100,000 each year (or lower), thus reinstating your UK personal allowance and getting tax relief of up to 60% on the contribution.

Proceeds from the disposals should be paid into a separate bank account from the account containing foreign income received since becoming resident in the UK.

Finally, I recommend you seek further advice on Inheritance Tax (IHT) if the net value of your UK-situs assets exceeds the nil-rate band (£325,000) or you become deemed domiciled in the UK for IHT purposes (after 15 years of residence).

2. Residence, domicile and basis of taxation

Residence status

If you have spent at least 183 days in the UK for each of 2020/21 to 2023/24, you will be UK tax resident for each of these years. For 2020/21, you should have been eligible for split-year treatment on the basis of starting full-time work in the UK.

Domicile status

I understand you are not domiciled in the UK, because:

- your permanent home remains outside the UK,
- you do not have a long-term intention to remain in the UK, and
- you have not severed ties with your original country of origin.

However, once you have been tax resident in the UK for 15 out of the previous 20 tax years, you will be deemed UK domiciled for Income Tax, CGT and IHT purposes.

Basis of taxation

UK resident taxpayers are, by default, taxable on their worldwide income and gains (the 'arising basis').

However, UK resident, non-domiciled taxpayers have access to the remittance basis of taxation, under which non-UK income and gains can be excluded from UK taxation provided that the income and proceeds from gains are paid and retained overseas.

If your unremitted foreign income and gains are no more than £2,000 in a UK tax year, the remittance basis applies automatically. This would not apply for 2020/21 to 2023/24, though it may apply for future years.

Where unremitted foreign income and gains are more than £2,000 in a UK tax year, the remittance basis must be claimed for it to apply. In this case, the taxpayer forfeits their UK Income Tax personal allowance and UK CGT annual exempt amount for the year of claim. The time limit to make the claim is normally four years after the end of the tax year.

If you have been resident for 7 of the previous 9 tax years, a Remittance Basis Charge (RBC) of at least £30,000 applies where the remittance basis is claimed. The RBC is not applicable for 2020/21 to 2023/24.

You have prepared your UK tax returns on the arising basis, but you have not remitted any of your foreign income and gains to the UK since becoming resident here. You are still in time to make a claim for the remittance basis for 2020/21 (deadline 5 April 2025) and subsequent years.

Your overall tax liability under both bases for 2020/21 to 2022/23 is as follows (see Appendix 1):

<u>Tax year</u>	<u>Arising basis</u>	<u>Remittance basis</u>
2022/23	£35,966	£34,660
2021/22	£29,566	£30,058
2020/21	£11,494	£15,708

You can therefore achieve a UK tax saving of £1,306 by amending your tax 2022/23 UK tax return to claim the remittance basis, and I recommend doing this.

However, you should be aware that your foreign income for 2022/23 would then be taxable in the UK if it is remitted to the UK in future. Also, see below regarding a foreign capital loss election to be made in that year.

3. Kloostergasse 45

This CGT base cost is the market value when inherited.

If the disposal results in a gain and you are taxed on the arising basis for the year of disposal, then the gain will be subject to UK CGT in that year. If the remittance basis applies for the year of disposal, the gain will be taxed when the proceeds are remitted to the UK.

As you are selling your share of the property to your brother, a 'connected person', we must ignore the actual proceeds received and calculate the gain using the market value on disposal. You may argue that the market value of your share of the property is less than 50% of the total market value of the property, to reflect the facts that a 50% interest is less saleable than a 100% interest and that your brother is occupying the property when it is sold. However, we have assumed no such discount.

The property was your main residence when you inherited it, so you will be entitled to main residence relief on disposal of the property, as follows:

1 November 2007 to 1 March 2010

This is a period of actual occupation as a main residence.

1 March 2010 to 1 September 2020

During this period, you were working in Frankfurt and staying in rented accommodation. Provided you were prevented from residing in (and re-occupying) the Leipzig property in consequence of either:

- the situation of your place of work, or
- any condition imposed by your employer requiring you to reside elsewhere, being a condition reasonably imposed to secure the effective performance by you of your employment duties;

then you may treat the Leipzig property as being occupied as a residence for up to four years of this period of absence. Our understanding is that, given the impracticality of commuting between Leipzig and Frankfurt, the conditions will be satisfied.

Accordingly, relief will be available if you nominate for the Leipzig property to be treated as your only or main residence for this period. There is normally a two-year time limit to make the nomination from the point at which you have an interest in two or more residences. However, as your interest in the rental property would have been of negligible market value, the two-year time limit is disapplied. You are therefore still in time to make the nomination and I recommend you do so.

Unfortunately, your UK duties during your role in Frankfurt prevent the entire period being treated as a period of occupation as a residence.

1 September 2020 to 1 February 2021

During this period, you were working in London and staying in rented accommodation. No further relief is available under the four-year rule described above, nor the separate rule which requires no UK duties during the period of absence.

The only remaining possibility for a deemed period of occupation as a residence would be if you re-occupied the Leipzig property before sale. As this does not apply either, no relief is available for this period.

1 February 2021 to 1 March 2023

During this period, you were working in London and living in your residence at 32 Grove Road, which you own.

32 Grove Road is your only or main residence for this period. The Leipzig property is neither occupied as a residence nor deemed to be occupied as a residence under the period of absence rules described above.

Accordingly, relief will not be available for this period against the gain on the Leipzig property.

1 March 2023 to 1 December 2023 (assumed date of sale)

This would be the final nine months of ownership, which is always eligible for relief for a property which has at any point been your only or main residence during the period of ownership.

To summarise:

<u>Period</u>	<u>Months</u>	<u>Eligible for relief</u>
1 November 2007 to 1 March 2010	28	Yes
1 March 2010 to 1 March 2014	48	Yes
1 March 2014 to 1 September 2020	78	No
1 September 2020 to 1 February 2021	5	No
1 February 2021 to 1 March 2023	25	No
1 March 2023 to 1 December 2023	9	Yes

A total of 85 out of 193 months is eligible for relief. The chargeable gain for UK CGT purposes will be £37,888 (see Appendix 2).

Gains on residential property are charged to UK CGT at 28% for higher-rate taxpayers.

4. Kremet GmbH shares

If you sell your entire shareholding now then the proceeds will be £37,500 (1,000 * £37.50). To determine the gain, we must calculate the base cost:

<u>Date</u>	<u>Number of shares bought/(sold)</u>	<u>Cost/proceeds per share</u>	<u>Pooled base cost after transaction</u>
1 July 2008	1,000	£50	£50,000
1 March 2010	2,000	£60	£170,000
1 August 2015	(2,000)	£55	£56,667 (£170,000 * 1,000/3,000)

The loss on the disposal of your remaining 1,000 shares will be £19,167 (£37,500 less £56,667), less any incidental costs of disposal and acquisition (assumed nil).

5. 2023/24 UK tax position (arising basis)

Under the arising basis, provided any necessary foreign capital loss election has been made, the foreign loss will be offset against the gain and UK CGT would be due as follows:

	£
Gain on Klostergasse 45, Leipzig	37,888
Loss on Kremet GmbH shares	(19,167)
Net chargeable gains	18,721
Annual exempt amount	<u>(12,300)</u>
Taxable gains	<u>6,421</u>
UK CGT at 28%	<u>£1,798</u>

You have advised us that no German taxes are payable on the disposal of Klostergasse 45, so no foreign tax credit (FTC) is applicable against the gain.

Although the UK CGT liability on the disposal of Klostergasse 45 can be avoided if the remittance basis is claimed and the proceeds are not remitted to the UK, the UK CGT liability may be worth bearing, given that:

- you would be able to remit the proceeds freely to the UK, which could then be used to make contributions to your UK pension scheme and reduce your UK Income Tax liability; and
- claiming the remittance basis would involve forfeiting your UK Income Tax personal allowance for 2023/24 (and UK CGT annual exempt amount for that year, but this would not be required if the proceeds are retained offshore).

6. UK Income Tax relief on pension contributions

Relief for contributions into your German pension scheme would only be available under the UK-Germany Double Taxation Convention if expressly provided for in that agreement. From the information available, it does not appear that there is such a provision. We therefore assume that contributions made into your Germany pension scheme would not attract any UK Income Tax relief and thus they are not considered for UK annual allowance purposes.

By contrast, UK Income Tax relief on contributions to your UK pension scheme will be at your marginal rate of tax (subject to limits) and therefore is quite generous. In particular, gross pension contributions that will reduce your total taxable income in the range £100,000 to £125,140 reinstate your personal allowance by £1 for each £2 in that range, equivalent to 60% tax relief.

There are two limits to the contributions which can attract UK tax relief. The first is the annual allowance, which is £40,000 a year. However, you can carry forward the unused part of the annual allowance from the previous three tax years. I estimate your total available annual allowance for 2023/24, including carry forward, is £121,314 (Appendix 3).

Secondly, you are cannot get tax relief on more than 100% of your earnings for a tax year. As your earnings for 2023/24 are estimated to be £110,000, this is likely to be the limiting factor.

The total funds you expect to receive from the disposals are £150,000 from Lukas for the Leipzig property and £37,500 from the sale of the Kremet GmbH shares, i.e. a total of £187,500.

To achieve the maximum UK Income Tax relief on the funds, you may consider making contributions each year (over a number of years) to reduce your UK taxable income to £100,000. This would maximise the 60% tax relief mentioned above. For example, in 2023/24 you estimate that your total taxable income is £120,000, so in the current tax year you would make a gross contribution of £20,000, providing a tax saving of £12,000.

To obtain UK Income Tax Relief sooner, you might consider reducing your total taxable income to £50,270 (i.e. a gross contribution in 2023/24 of £69,730) on which the tax relief would be £31,892 (£69,730 at 40% plus £20,000 * 20%).

If you plan to remit proceeds to the UK in order to make these pension contributions, then I recommend that:

- the remittance basis is **not** claimed in 2023/24; and
- the proceeds from both transactions are paid into a separate bank account from the funds containing your foreign income, to avoid remittance of foreign income from 2022/23.

7. 2023/24 UK tax position (remittance basis)

I estimate your UK Income Tax liability for 2023/24, if the remittance basis is claimed and no element of the gain is remitted to the UK, to be £36,460 (Appendix 4A).

If the remittance basis is claimed, then the remittance of the proceeds from the sale of the property will be deemed to be the gain element first. This would be taxed at 28%, with no annual exempt amount available. While this could then be used to make a pension contribution in the UK, it would only attract tax relief at a maximum rate of 40%, given the personal allowance will have been forfeited.

If the remittance basis is claimed and a £20,000 gross pension contribution is made from the remitted proceeds, I estimate that the total Income Tax and CGT liability for 2023/24 would be £34,060 (Appendix 4B). This compares with £29,980 if the remittance basis is not claimed for that year (Appendix 4C).

Accordingly, I recommend that the remittance basis is not claimed in 2023/24.

8. Foreign capital loss election

For the first tax year the remittance basis is claimed, you must decide whether to make an irrevocable foreign capital loss election. The deadline is four years after the end of this tax year.

If the election is not made, foreign losses in that year and each subsequent year (even where the arising basis applies) are not allowable.

If the election is made, foreign capital losses must be offset against gains in the following order:

1. foreign gains remitted in the same year of the loss,
2. foreign gains not remitted in the same year of the loss,
3. UK gains arising in the year.

The election therefore allows use of foreign capital losses but potentially risks having them offset against foreign gains which are not taxed in the UK if they are not remitted and the remittance basis applies for that year.

The election will mean that the foreign loss arising on the shares can be offset against the gain arising on the property. Furthermore, as you have no other foreign assets then at present you do not risk blocking any future foreign loss against any future foreign unremitted gain.

I recommend you make the election for 2022/23.

If the remittance basis is not claimed in 2022/23, the decision to make the election would be deferred until the first tax year the remittance basis is claimed.

9. IHT

Non-domiciled individuals are in scope of IHT on UK situs assets. Your UK situs assets include your UK property and any cash savings (even if they are held in an ISA), but not your UK pension.

If you are deemed to be domiciled in the UK (i.e. you have been resident in the UK for 15 out of the previous 20 tax years), or you acquire a UK domicile of choice, you would be in scope of IHT on your worldwide assets. If you leave the UK after becoming deemed domiciled, then you will need to be non-resident for five years to lose that status.

Generally, IHT is payable at 40% on the value of your taxable estate above the nil-rate band (NRB), currently £325,000. An additional Residence Nil Rate Band of up to £175,000 is potentially available where you leave your home to lineal descendants and your taxable estate is worth less than £2 million. Leaving your main residence to your nephew would therefore not be eligible for the RNRB.

If you own 32 Grove Road upon your death and the market value of the property (at that point, net of any mortgage owed), plus any other UK situs assets, exceeds the NRB at that time, then IHT may be due if your estate is left to your nephew in Germany. However, you mention you have an interest-only mortgage so absent any policy which would settle outstanding mortgages on death, I would not anticipate any IHT liability at this stage.

I recommend you seek further advice on IHT, if required.

Please do not hesitate to contact me should you require any further explanation.

Yours sincerely
[Tax adviser]

Appendix 1: UK tax calculations for 2020/21 to 2022/23, with remittance basis

2022/23

	£
Employment income	<u>105,500</u>
Taxable income	<u>105,500</u>
Tax thereon:	
£37,700 at 20%	7,540
£67,800 at 40%	<u>27,120</u>
Total tax liability	<u>34,660</u>

2021/22

	£
Employment income	<u>93,995</u>
Taxable income	<u>93,995</u>
Tax thereon:	
£37,700 at 20%	7,540
£56,295 at 40%	<u>22,518</u>
Total tax liability	<u>30,058</u>

2020/21

	£
Employment income	<u>58,020</u>
Taxable income	<u>58,020</u>
Tax thereon:	
£37,500 at 20%	7,500
£20,520 at 40%	<u>8,208</u>
Total tax liability	<u>15,708</u>

Appendix 2: Calculation of gain for UK CGT purposes on disposal of Klostergasse 45

	£
Deemed proceeds (50% of market value when sold)	203,125
Less: 50% of market value when inherited	<u>(135,417)</u>
Gross gain	67,708
Main residence relief (85/193 months)	<u>(29,820)</u>
Net chargeable gain	<u>37,888</u>

Incidental costs assumed to be nil.

Appendix 3: Calculation of estimated available annual allowance for 2023/24

<u>Tax year</u>	<u>Net salary</u>	<u>E'ee</u> <u>contributions</u> <u>(5%)</u>	<u>E'er</u> <u>contributions</u> <u>(5%)</u>	<u>Total</u> <u>contributions</u>	<u>Annual</u> <u>allowance</u> <u>for year</u>	<u>Unused</u> <u>annual</u> <u>allowance</u>
	<u>£</u>	<u>£</u>	<u>£</u>	<u>£</u>	<u>£</u>	<u>£</u>
2023/24	110,000	5,789	5,789	11,578	40,000	28,422
2022/23	105,500	5,553	5,553	11,106	40,000	28,894
2021/22	93,995	4,947	4,947	9,894	40,000	30,106
2020/21	58,020	3,054	3,054	6,108	40,000	33,892

Total available annual allowance for 2023/24, including carry forward: £121,314

Appendix 4A: UK tax liability for 2023/24, with remittance basis claim

	<u>£</u>
Employment income	<u>110,000</u>
Taxable income	<u>110,000</u>
Tax thereon:	
£37,700 at 20%	7,540
£72,300 at 40%	<u>28,920</u>
Total tax liability	<u>36,460</u>

Appendix 4B: UK tax liability for 2023/24, with remittance basis claim and £20,000 gross pension contribution

	<u>£</u>
Employment income (£110,000 less £20,000)	<u>90,000</u>
Taxable income	<u>90,000</u>
Tax thereon:	
£37,700 at 20%	7,540
£52,300 at 40%	<u>20,920</u>
Total tax liability	<u>28,460</u>
Remitted gain	£20,000
CGT at 28%	<u>£5,600</u>
Total Income Tax and CGT liability	<u>£34,060</u>

Appendix 4C: UK tax liability for 2023/24, arising basis and £20,000 gross pension contribution

	£
Employment income (£110,000 less £20,000)	90,000
Foreign rental income	7,000
Foreign savings interest	500
Foreign dividends	<u>2,500</u>
Total income	100,000
Personal allowance	<u>(12,570)</u>
Taxable income	<u>87,430</u>
Tax thereon:	
£37,700 at 20%	7,540
£46,730 at 40%	18,692
£500 at 0%	-
£2,000 at 0%	-
£500 at 32.5%	<u>162</u>
Tax before reductions	26,394
Estimated FTC*	<u>(1,212)</u>
Tax after reductions	<u>25,182</u>
CGT (see section 5)	£1,798
Total Income Tax and CGT liability	<u>£26,980</u>

*15% of the rental profits (assuming the same taxable base as in Germany) plus the UK dividend tax liability of £162.