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Sharpen your tax skills
Case study – suggested solutions

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Case study- Alphabet shares

- Gerry and Frances started a small manufacturing business in the 1980s. Despite the ups and downs in the economy, it has quietly thrived.

- They have adult children, a son and a daughter, who are employed in the company and 5 employees.

- They want to make their children shareholders, but to be able to pay dividends to them differentially (Gerry and Frances are quite comfortable and the children have minor children of their own).

- Will this work?

Gerry and Frances – suggested solution

- Alphabet shares can work in the right circumstances
- Gerry and Frances can keep their shares (A shares) and create B shares (or even C shares) for their adult children
- Keep it simple – avoid preference shares – ordinary shares only
- BIK - by reason of their employment?
- CGT issues for Gerry and Frances – but ER.

Gerry and Frances – suggested solution

- Must consider total distributable profits and max dividend payable per share

- Like dividend waivers cannot pay a bigger dividend on some shares than others:

  - eg Gerry and Francis 500 ‘A’ shares each
  - 2 children – say 250 ‘B’ shares each
  - distributable profits £24,000
  - max dividend payable £16 per share

Case study - Jay

- Jay is an IT consultant with his own limited company
- He lives in Manchester
- He has a contract in London for 6 months
- He looks into the figures and deduces that it is cheaper to stay in a flat than in a hotel.
- Will he get the tax deduction for the flat expenses?

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Suggested solution

- Tim Healy v HMRC (March 2012)
  - Lived in Cheshire with family
  - working in London on theatre run
  - rented flat rather than hotel
    - cheaper than hotel
- Costs deductible for tax as wholly and exclusively for purposes of profession
  - London was held not to be his permanent base
  - Subsistence exp and taxi fares disallowed

Not W&E for profession

Lack of evidence

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Suggested solution

- Case appealed by HMRC
- UT remits case back to the FTT for a re-hearing!
- Single (business) purpose or duality of purpose?
- What conclusions can we draw?

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Case study - Paul and Mel

- Paul and Mel live in town 1. They have two shops – one in town 2 (run by Mel) and one in town 3 (run by Paul) – both of them are in a single company which is owned by them.

- They have a company Land Rover (seats in the front only) which is used to buy stock for the shops and pull trailers to various trade shows which they attend to show their wares

- Each morning they leave the house and drive to town 1 where Paul drops Mel off. He then drives to town 2 for the day. In the evening they reverse the process.

- Tax implications?

Paul and Mel – suggested solution

- Land-Rover is a van, so no company car implications
- Incidental use or a taxable benefit?
- HMRC guidance says this is OK – ordinary commuting to home and back is not private use
- Other practical issues:
  - P11D?
  - Dispensation?

Case study - Trevor

- Trevor has his own company with 10 employees
- As it's coming up to Christmas, he wants to give them all a "Christmas box"
- He wants to take then all out for an Xmas party and they can bring their partners/spouses
- He also wants to give them a turkey, an M&S voucher for £50 and a case of wine
- He has asked you if that's OK for tax.

Trevor – suggested solution

- Staff entertaining
  - annual function or similar cost <£150 no impact
  - cost >£150 taxable benefit on excess
    - usually paid through PSA
  - if > 1 function can chose which is taxable
  - cost = total cost inc VAT
    - divided by number of people who say they will attend

- Does not apply to ‘one-off’ events

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Vouchers

Cash
Vouchers
(rare)

Tax face value
PAYE

Both Class 1 NIC

Non-cash
vouchers

Pay for goods
or services
Transport
Credit and store cards

Benefit
= cost to employer
of providing
voucher
P11D

Vouchers

- Capable of being exchanged for Readily Convertible Asset
  - or voucher saleable or exchangeable for cash
    - PAYE
  - others – P11D
  - Both cash and non-cash Class 1 NIC

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Trevor – trivial benefits

- HMRC allow trivial benefits to be ignored
  - trivial benefits not P11D or included in PSA
  - consider admin cost of collating info
    - not amount of money involved in total
  - trivial considered in relation to employee's income
  - ignore if related to staff welfare
- Bottle of wine – trivial but case of wine – not
- Turkey – trivial – but food hamper – not
- Free tea and coffee OK
- Cash cannot be trivial

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Case study - Bert

- Bert currently operates as a sole trader but has been persuaded to incorporate the business.

- The business owns a freehold property used as the main office/warehouse which is expected to increase in value over the next few years

- Should the property be transferred to the company or retained by Bert?
  - if he retains it should rent be charged?

Bert - Pros and cons of personal ownership

- Transferring property to company can create SDLT cost for company – depending on value
- Rent may be efficient way of extracting profits as no NIC and CT deductible
- May need rent to service loan interest and running costs of property
  - may consider reduced rent allowing some ER
- Rent can continue to be received after Bert retires and sells/gifts shares
- More flexibility on when sold allowing income stream to be maintained after shares sold

Bert - Pros and cons of personal ownership - 2

- If rent charged no ER available on disposal
  - but ER only available if property sold at same time as shares - which may not be desirable
- What is likely gain on disposal of shares?
  - if >£10m no ER on property even if associated disposal
- What is cost of charging rent when sold?
  - additional 18% on gain on property (28% - 10%)
  - but only payable when property sold
- What is position with regard to Bert's wife
  - can we transfer property to her to generate income
  - no 'Arctic Systems' type attack

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Case study - Ghazanfar

- Ghazanfar has a buy to let property which he bought some years ago for £50,000
- It has appreciated significantly in value over this period
- It is now worth £250,000 – there is no mortgage
- He would like to give it to his son who cannot afford to get a foot on the property ladder on his own
- What tax implications should Ghazanfar be aware of?

Ghazanfar - suggested solution

- If it's a direct gift:

  - CGT on the disposal to a connected person
    - treated as mv disposal
  - No SDLT providing donee does not take over mortgage

- IHT – this is a PET, so not immediately chargeable
  - gift may escape tax completely – will depend on whether Ghazanfar lived for 7 years and his available nil rate band if he dies < 7 years

Direct gift of the property – the CGT problem

Asset cost £100,000
mv £250,000

cost to son
£250,000

No gifts relief
gain £150,000

Using a discretionary trust (aka RPT)

RPT

Asset cost £50,000
mv £250,000

gain £200,000
Holdover relief applies
no CGT

Trustees
Asset cost £250,000
less: HO gain £200,000
= £50,000

Trustees gift to son
Holdover relief applies
no CGT

Cost to son
£250,000 less gain HO
£200,000
= £50,000

This utilises S260, TCGA 1992

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Case study - Sue

- Sue is 18 and is going to university after her gap year

- The costs of renting in Derby (where she will be studying) are around £400 per month.

- Mum and Dad have some spare cash.

- Are there any ways that they can help?

Suggested solution

- Possible strategies:

- Give Sue some money for a deposit

- She services the mortgage with rent from fellow students

- Parents buy the house and she lives in it rent free (or pays some rent) and her housemates help pay the mortgage.

- Which is better?

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Bank of Mum and Dad

- Son Sam wants to buy a flat
- He can afford a flat for £100,000
- But a good flat costs £150,000
- He has a girlfriend that he’s likely to marry, but Mum and Dad are sceptical about whether the relationship will last
- What’s the best way for Mum and Dad to help with the purchase?

Bank of Mum and Dad

- Suggested solution:
- This is less about tax and more about protection of Mum and Dad's money
- It may be better for Mum and Dad to take a stake in the house rather than give the money to their son and his girlfriend
- This way, if the relationship doesn't last, then at least they have protected their money.

Good investment?

- George wants to buy an investment property in his town.
- He has seen a one-bedroom flat for £100,000. The flat is let to a good long-term tenant (through a series of ASTs) and the rent (after service charges, insurance and ground rent) is £6,000 per annum.
- George has £100,000 of cash left by his mother. He asked whether putting the money into his pension would be a better investment. He is a 40% tax-payer and is married with two children.
- Advise on the tax implications – could he do both?

Suggested solution

- Investment in the property:
  - Good yield (6%) – better than money in the bank (0.5%)
  - Can sell to get his capital back
  - There might be capital appreciation in the property – possible CGT issues
    - charged at 18/28%
    - No ER

Suggested solution

- Investment in his personal pension:
  - Assume b/f relief on the annual allowance
  - 40% tax relief
  - Assume 5% annuity
- No tax-free money

- £125,000 for annuitisation (100,000 x 100/80)
- Cost after tax relief(40%) is £75,000
- Gross income is £6,250 per annum
- Return on investment is 6,250/75,000 = 8.33%

Conclusion

- No definitive solution

- Better ROI for the pension (it would be less if George had taken the tax-free money)

- Could possibly do both:

- If George borrows say half the money, he could get his tax bill down to zero (deduction of the interest against letting profits), thus allowing him to put £50,000 into his pension!

Case study - Andrew

- Andrew owns a farm in Dorset. He paid £140,000 for it 25 years ago and it's now worth around £800,000. He has a small mortgage (£80,000) secured against the property.
- He has a son and would like him to have the farm in due course
- Andrew farms it himself and it makes a small profit each year
- Is it best to gift the farm in life or on death?
- What tax (and other non-tax issues does he need to consider?

Suggested solution

- There is no right or wrong answer

- Non-tax issues such as what Andrew would do if he gifted it and whether his son is ready for the task are relevant
  - what will Andrew do after the gift?

- Tax issues:
  - Principally CGT if 100% APR/BPR applies
  - If the farm is standing at a substantial gain, then a lifetime gift would incur CGT
  - Gifts relief provisions?
  - SDLT –on assumed debt

Suggested solution (cont)

- The chargeable gain would probably be under the ER provisions

- If Andrew is married, then transferring half of the farm to his wife would be worth doing

- Could she have ER?
  - as partner should be available
  - if farmed through company needs employment and 5% holding

APR on death

- Ownership requirement – 2 years if farmed by deceased
  - 7 years if let to tenant

- HMRC have recently challenged (successfully) situations where parents farmed property
  - then brought children into partnership
  - did parent's share qualify for APR on death
    - were they 'active' in the business
    - or just receiving profit share as effectively sleeping partners

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Case study - Robert

- Robert is 65.
- He is considering a Legal & General life insurance policy that pays out £3,743 for a £15 per month premium and has asked you about it.
- What advice would you give about the tax aspects of this proposal?

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Robert – suggested solution

- This is a standard life insurance policy
- It is payable on death
- It will be paid into Robert's estate unless he writes it into trust
- This is a standard trick
- It is no longer part of Robert's estate

Case study - John

- John is divorced
- He has children from his first marriage
- He is marrying again
- His wife is younger and has also children from a previous marriage
- He wants a roof over her head if he dies first but the main part of the estate should go to his children

John – possible solutions

- He leaves the whole estate to his wife
  - no IHT
  - she has ‘200%’ nil band on her death

  - but – she can then leave the property and other assets to her children
    - by-passing John’s children

John - 2

- He leaves nil band legacy to children with remainder to spouse
  - assuming she will leave them on her death to his children
    - but again she has assets to pass to her children when she dies if she wants

  - also – unless the estate is large enough the nil band legacy may leave too little in her legacy to include the house and enough income producing assets for her to live off

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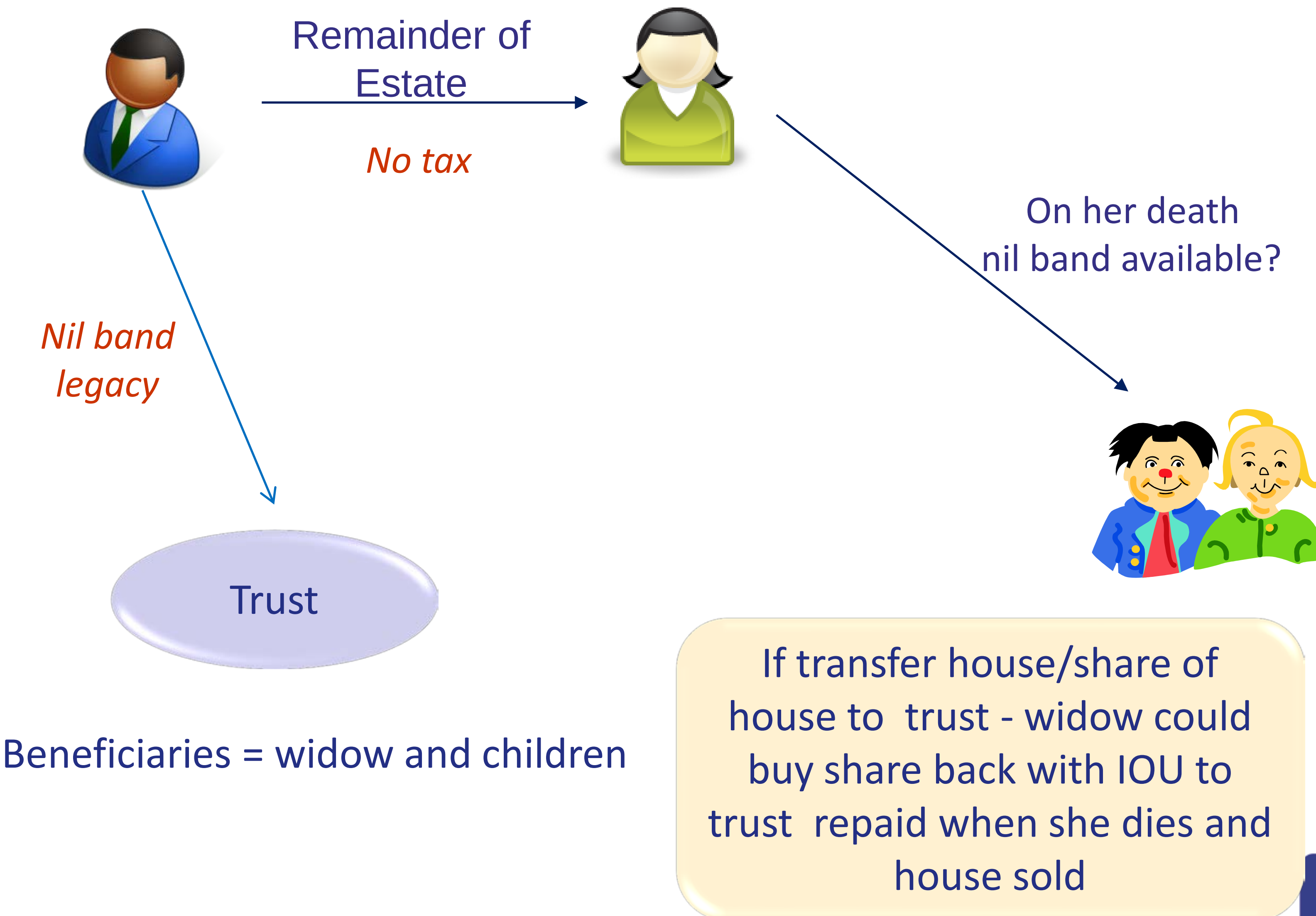
John - 3


Remainder of Estate
No tax
On her death
nil band available?
Nil band legacy
Trust
Beneficiaries = widow and children
If transfer house/share of house to trust - widow could buy share back with IOU to trust repaid when she dies and house sold

John – 4 – is this the 'best' option