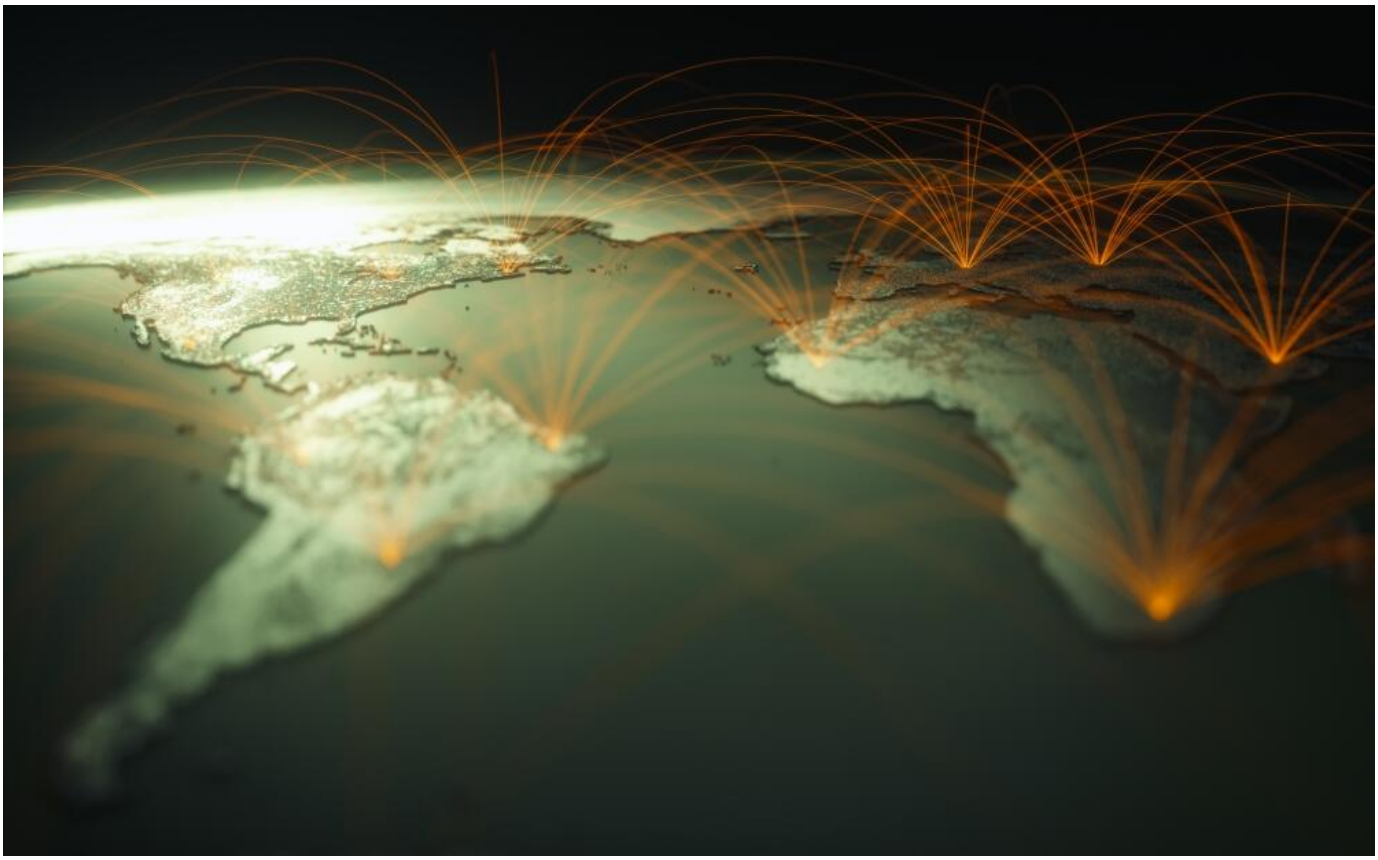
A tale of two countries (or more)

Employment Tax | International Tax | Large Corporate



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Steve Wade and Sarah Hewson examine the UK Pay As You Earn considerati ons for cross border remote workers

Key Points

What is the issue?

The Covid-19 pandemic has hugely impacted the way people work, accelerating a shift to flexible ways of working across the global workforce.

What does it mean for me?

There are a number of tax risks for employers, which need to be considered alongside how much flexibility employers wish to offer employees. Employers need to ensure they meet their global employment tax obligations.

What can I take away?

Employers should take steps to understand which employees were working where and for how long, and consider what UK PAYE obligations may have arisen.

As one of ‘the worst of times’ in recent history, the Covid-19 pandemic has hugely impacted the way people work, accelerating a shift to flexible ways of working across the global workforce. Some UK employees are undertaking their duties remotely outside the UK and some employees usually based overseas are performing duties in the UK.

Whilst Covid-19 is far from ‘the best of times’, it presents an opportunity for businesses to consider the potential advantages of permitting more flexible cross border working and redesigning their policies and processes accordingly. This does mean that there are a number of tax risks for employers, which need to be considered alongside how much flexibility employers wish to offer employees.

Whichever approach is taken, employers will need to ensure they meet their global employment tax obligations.

Pay As You Earn

This article focuses on UK employer PAYE obligations and is intended to give an overview of the key points to consider, although employers should consider the impact of the precise facts and circumstances of each case. Other issues such as National Insurance, employment law, immigration, wider tax considerations and overseas obligations, as well as any obligations arising for the individual, will also need to be considered but are outside the scope of this article.

Step 1: Identify the location of employees

The first step employers should take is to:

- identify and record which employees spent time working outside the UK, where they were working, for how long and whether they were working for any other group entities;
- ensure that they know which employees are still working outside the UK; and
- identify any employees of a connected overseas entity which may have undertaken duties for the benefit of the UK business.

Step 2: Consider whether a PAYE obligation arises

Broadly, for there to be a PAYE obligation there needs to be taxable employment income. If an employee is neither tax resident, nor performs any substantive duties, in the UK, there is no taxable employment income and therefore no PAYE obligation arises. On the other hand, where there is taxable employment income, the question becomes whether or not the employer has an obligation to operate PAYE.

Whilst not expressly addressed in the legislation, there is an implied territorial limitation on the operation of UK PAYE, such that only an employer with a sufficient tax presence in the UK is required to operate PAYE (see Clark v Oceanic Contractors Inc [1983] 2 AC 130). A tax presence includes a branch, permanent establishment or office where HMRC can contact the employer.

If there is no presence for the purposes of PAYE, the next question is whether the 'host employer rules' apply, as set out in the Income Tax (Earnings and Pensions) Act 2003 s 689. These rules apply when the employee 'works for' the benefit of another entity in the UK who is not the legal employer. 'Works for' is broadly interpreted but the UK entity has to have a degree of control over, and receive the benefit of, the employee's services. If these conditions are met then the UK entity, even if not physically paying the individual, will have a PAYE obligation unless the legal employer operates PAYE.

For employees ordinarily working in the UK who have undertaken duties overseas, employers will need to consider what information they have available to assess the likely tax residency of the individual. However, in the absence of any additional information, the prudent approach is to assume that the individual remains UK resident. If no changes were made (i.e. PAYE applied to all earnings), no adjustment should be made to the treatment via the UK payroll.

Step 3: Consider the availability of treaty relief

For overseas employees coming to the UK, where it is determined that there is a requirement to operate PAYE, the next question is whether relief is available under the Dependent Personal Services Article of a double taxation treaty.

Employees not resident in the UK may be eligible to claim relief under a tax treaty. To avoid PAYE being paid and then subsequently refunded when it is clear the income is exempt from UK tax under the terms of the relevant treaty, an employer can apply to HMRC for a Short Term Business Visitor agreement (Appendix 4). In the absence of such an agreement, unless another arrangement is in place (see below), PAYE will need to be operated on all remuneration paid to the individual. Any employers without an Appendix 4 agreement who have employees in this situation should apply for one as soon as possible.

Where an Appendix 4 agreement is in place, an employer can replace a PAYE withholding obligation with an annual reporting obligation for employees who are likely to be able to make a claim for relief under a tax treaty. Such relief will generally be available where:

1. the employee is resident in the other country;
2. the employee is present in the UK for fewer than 183 days in any period of 12 months starting or ending in the UK tax year;
3. the employee has a non UK resident employer; and
4. the cost of remuneration is not borne by a permanent establishment or a fixed base the employer has in the UK.

Some treaties have the extra condition that the remuneration must be taxable in the other country.

For the purposes of conditions 3 and 4, HMRC interprets the ‘employer’ to mean the economic employer (i.e. the entity bearing the risks and rewards of the employee’s services) and not just the legal employer. Where an employee is economically employed by the UK entity, the employee cannot be exempted from UK PAYE under an Appendix 4 agreement. Commonly, this is met where costs are recharged to the UK entity or the employee works for an overseas branch of the UK entity.

In such a case, the UK entity should consider the availability of the ‘60 day rule’ for employees who spent fewer than 60 days in the UK (and such days do not form part of a longer period – see Tax Bulletin 68 at bit.ly/2HUhCgG), under which HMRC will accept that the UK entity is not the economic employer, such that no UK tax

reporting is required.

Where treaty relief is not available, consideration should be given to using/agreeing a PAYE special arrangement with HMRC (Appendix 8) and accounting for PAYE annually for employees who had no more than 60 UK workdays in the tax year by 31 May following the end of the tax year.

Step 4: Where a PAYE obligation arises, consider the availability of PAYE reliefs

The precise obligations and available reliefs will depend upon whether the employee remains tax resident in the tax year. UK resident individuals are taxable on worldwide income, whilst non-resident individuals are only taxable on earnings related to substantive duties performed in the UK. However, where a PAYE obligation arises, UK tax must be accounted for on the entirety of an employee's earnings via the UK payroll unless a relaxation is agreed with HMRC before payment to the employee. Examples of such agreements include:

- **Appendix 5:** If a UK resident employee is due credit for the foreign taxes then, to prevent any cash flow disadvantages, agreement can be sought from HMRC (an Appendix 5 net of foreign tax credit relief agreement) that, where there is a foreign tax withholding obligation in addition to a tax withholding obligation via the UK payroll, relief can be taken via the UK payroll for any foreign taxes withheld. Employers will need to put a process in place to ensure the necessary steps are taken at the end of the UK tax year (see PAYE82001). Not all payroll software can process an Appendix 5 agreement, in which case relief can be given in a PAYE code.
- **Section 690 Determination:** Agreement can be sought from HMRC for either non-resident employees or resident employees entitled to overseas workday relief that only the percentage of the employee's earnings that relate to UK workdays relative to their total workdays should be subject to UK PAYE.
- PAYE Code: HMRC may agree to:
  (i) change the employee's PAYE code to reflect any foreign tax credit; or
  (ii) issue tax code NT (No Tax) where employers are confident no UK tax is ultimately payable, such that no PAYE is withheld via the UK payroll on payments made to the individual.

Whichever of the above approaches is taken, the position will ultimately need to be reconciled via the individual's UK tax return.
Whilst these UK payroll relaxations cannot always be applied retrospectively, where employers seek to retrospectively comply with any overseas withholding obligations, they should consider both how any overseas liabilities can be recovered from the employees (to prevent any additional UK and/or overseas liabilities arising) and whether any of these relaxations can or should be applied for, to limit any cash flow impact for employees.

Remote assignments

Where an employee has not been able to travel to the new location, a number of businesses have permitted the employee to start the assignment remotely. The key PAYE considerations remain those as outlined above.

Complications can arise where the employee received certain allowances and/or payments that relate to the assignment and specifically the move to or from the UK. A detailed analysis of the payment and the residence status of the employee will be required, given that:

- for non-UK assignments, not all payments will be taxable if the employee does effectively relocate and break UK residence; and
- for UK assignments undertaken remotely, such payments may still be taxable in the UK (albeit PAYE may not be due).

Statutory residence test and Covid-19 specific HMRC guidance

Establishing residence can often be complex and cannot always be determined until nearly a year after the tax year. However, under the UK's statutory residence test (SRT), a UK employee is likely to remain UK tax resident unless they intend to spend the entirety of the 2020/21 tax year working full time outside the UK.

The SRT has existing provisions under 'exceptional circumstances' where a maximum of 60 days spent in the UK in a tax year, which are beyond the employee's control, may be disregarded for some of the tests under the SRT. HMRC has recently issued updated guidance regarding 'exceptional circumstances' in light of Covid-19 (RDRM11005). Whilst this disregard may be helpful to prevent individuals who have spent a relatively short time in the UK from becoming tax resident under the SRT, it is worth noting this disregard does not:

- apply to all tests under the SRT (the 30 workday limit, significant break test when looking at the working time abroad, the home in the UK test or family, accommodation or work ties);
- affect the position under the terms of a tax treaty; or
- affect days of work in the UK.

Whilst the current year position may affect the residency position in the previous (and future) tax year, it remains to be seen whether HMRC will expect employers to review or amend the treatment in 2019/20.

Next steps

To avoid a ‘winter of despair’, employers should take steps to understand which employees were working where and for how long, and consider what UK PAYE obligations may have arisen. Employers should also consider the UK NICs position and whether any overseas tax and/or social security obligations have arisen. However, there is a ‘spring of hope’ in the opportunities for employers over and above understanding their compliance position. Employers may wish to review their approach to cross border working to benefit from the advantages arising from a more flexible approach, recognising the need to put appropriate processes in place to factor in any additional costs and manage any associated risks.