Is it time to replace Overseas Workday Relief?

Tax voice

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Steve Wade discusses Overseas Workdays Relief, the issues and problems the relief presents, and suggests a better relief

What is overseas workday relief?

Overseas workday relief (OWR) is the common parlance used to describe the situation whereby:

- a UK resident but non-UK domiciled employee who claims the remittance basis
- is taxed on earnings for UK duties wherever that remuneration is paid or received
- but is only taxed on the remuneration for non-UK duties if that remuneration is remitted to the UK when certain conditions are met.

Those conditions are found in section 26A ITEPA 2003 which states that:

"(1) *An employee meets the requirement of this section for a tax year if the employee was—*

(a) non-UK resident for the previous 3 tax years, or
(b) UK resident for the previous tax year but non-UK resident for the 3 tax years before that, or
(c) UK resident for the previous 2 tax years but non-UK resident for the 3 tax years before that, or
(d) non-UK resident for the previous tax year, UK resident for the tax year before that and non-UK resident for the 3 tax years before that.

(2) *The residence status of the employee before the 3 years of non-UK residence is not relevant for these purposes.*"

OWR therefore, commonly applies when an employee is assigned to the UK for the tax year of arrival and the next two tax years if the employee becomes domestically resident in the tax year of arrival. If the employee arrived in the UK late in the tax year and consequently did not become UK resident, then the relief would be due for the next three years. The period of relief can therefore be up to 3 full tax years.

The amount of the relief is the amount of the earnings that are not remitted and not, therefore, subject to UK taxation. Although it is called a relief it isn't specifically claimed. The relief simply follows from the claim for remittance basis in respect of all foreign income or gains.

Issues with Overseas Workday Relief

There are a number of policy issues with the relief including:

- Whether it makes sense to have a relief that encourages employees to keep earnings offshore and not use those earnings for the benefit of the UK economy, particularly when we are trying to recover from the coronavirus pandemic
- Given that to benefit from the relief you need to have overseas workdays, should we be encouraging overseas travel when we are trying to reach net zero carbon emissions
- If the relief is to encourage businesses to employ individuals from overseas in the UK why no relief is available to those individuals who only work in the UK, for example, employees who work for the health service.

However, the fundamental issue with the rules in practice are that they complicated to understand and difficult for HMRC to administer efficiently.

Difficulties with administration

Complicated rules

The concept of OWR may appear deceptively straight forward but any readers who deal with HMRC enquires involving OWR know that the rules are complicated, and that pitfalls abound for the unwary. Even without a pandemic enquires can take years to resolve.

This article doesn't have space for an in-depth analysis of all the complications, but it is sufficient to highlight that due to the complexities of the remittance basis, it was

decided that OWR needed a set of simplified rules incorporated in the legislation. Despite these Special Mixed Fund (SMF) rules, there is no agreement between HMRC and agents about how you apply OWR in cases when the employee is partly paid in the UK and partly overseas. Many expats are paid this way in order to facilitate the payment, for example, of continuing overseas social security liabilities. The interaction of OWR and split payrolls has been the subject of an outstanding question to HMRC's Expat forum for two years. This delay highlights the difficulties in applying the legislation in practice.

Determining whether sums remitted to the UK are taxable is difficult enough but there are also the constructive remittance rules to consider. When this is explained to career expats, they are surprised by how complicated the UK regime is compared to other countries.

Even if an employee is paid into one overseas bank account, in certain circumstances the employee is required to predict the future in order to take advantage of the relief. This is because the simplified SMF rules require you to nominate a bank account and then meet certain conditions. One condition is that the account cannot receive any "prohibited" sums and you may not know whether the account will qualify, or whether the sums are prohibited until after the end of the tax year.

Not fit for the modern world

HMRC have a digital vision for the UK tax administration. It will be difficult to include the complexity of OWR and the remittance basis within a wholly digital administration.

The section 809RC(6) ITA 2007 definition of prohibited sums stops an employee and the employee's spouse/partner from paying their own earnings into a joint account. This is not how many couples would wish to arrange their finances.

Problems are, however, not restricted to couples. Singles and couples may both hit problems with the prohibited fund rules, for example if a bonus is paid for a calendar year which overlaps the 3rd and 4th UK tax year following the year of arrival - part of the bonus is a prohibited sum. Unfortunately, many employers pay bonuses based on a calendar year.

Nominating bank accounts

A relevant bank account must be nominated on the SA tax return for the first UK resident tax year. The qualifying conditions have to be met in year and that sometimes requires a crystal ball. The SMF nomination of an account rules require a “qualifying date” and that sums paid into the account are earnings for a relevant tax year. Section 809RB(5) defines a relevant tax year as a tax year in which the employee has general earnings that are taxable

under section 15(1) and section 26(1) ITEPA 2003. This requires that the employee has UK and overseas workdays in a tax year in order to have a qualifying date in that tax year. The qualifying date is the first date on which general earnings of more than £10 are paid into the account for such a relevant tax year - Section 809RB(3)(4).

If the individual nominates the account and does not have both UK and non-UK workdays in that tax year the nomination will not only be invalid but when the next tax year commences the account cannot be nominated for that year either if it still contains earnings from the prior tax year of more than £10. This is because section 809RB(10)(b) states that an account is not a qualifying account if immediately before the qualifying date the account has a credit balance of more than £10. This £10 rule also often precludes the use of an employee’s existing bank account

Knowing when to nominate an account and ensuring that no prohibited sums are paid into the account can also be difficult because of the Statutory Residence Test and in particular the split year rules. The account has to be set up in year, but both the qualifying date of the account and the split year may not be known until after the end of tax year. If an employee gets the qualifying date incorrect then prohibited sums may be held in the account and the SMF rules will not apply. The even more difficult ‘normal mixed fund rules’ will have to be considered which can give different results.

Arriving expats can also have difficulty in opening accounts in time for the first salary payment particularly if they are occupying temporary accommodation.

S690 Determinations

In order to obtain OWR when PAYE is operated, a section 690 (S690) determination has to be obtained from the employer unless the employee can be included on an Appendix 6 payroll for tax equalised employees. Unfortunately, it seems that HMRC’s systems cannot deal with S690 determinations efficiently at present. HMRC

have been taking up to a year issue the determinations whilst most expatriate will be being paid monthly or more frequently.

HMRC recognises that their systems are not sufficient and are looking at improving how they deal with such applications. Hopefully after HMRC implement their new processes we will see improvements. This leaves open the question of whether the requirements in this area should be changed in any event but a discussion of that issue would need to be the subject of another article.

In future it is hoped that HMRC will allow for “real time” S690 determinations. This would allow an employer to adjust the percentage of the determination to reflect the workday proportions of the year to date. The current system is based on estimates.

Administrative summary

The complex nature of the rules that surround the claim for OWR take a lot of effort by agents, employers, and employees which is an extra cost to the business. The rules can also be very costly to the employee if not followed properly.

The complexity of the rules is not just a problem for taxpayers and their agents. It is also a problem for HMRC. HMRC enquiries and any analysis of remittances, particularly when the SMF rules do not apply take a long time to complete. This is not the most efficient way to ensure compliance.

In addition, encouraging employees to keep funds outside the UK also does not appear to be in the best interests of the economy.

Suggestions for a better relief

Merely abolishing the relief is not the answer. Many countries have reliefs to encourage employees to come and work there. The UK system is unusual in that it is so complicated and, somewhat oddly, specifically discourages the spending of funds in the UK. A better system is needed that is easier to administer and allows employees to spend their earnings in the UK.

One option would be to allow a flat rate percentage of earnings to be exempt from UK tax for a certain period such as when the current section 26A ITEPA 2003 conditions are met. A flat rate exemption would be easier to understand and for HMRC to administer. It would also give the Government more certainty about the amount of the relief and increased flexibility to alter the amount in response to

economic pressures.

Another option would be to exempt the remuneration for overseas workdays, that is removing the requirement for the income to be kept offshore. This would however still encourage overseas work which would not align with the Government’s green agenda. It would also still have the complication that a workday for the purposes of the SRT is not the same as a workday for the purposes of OWR.