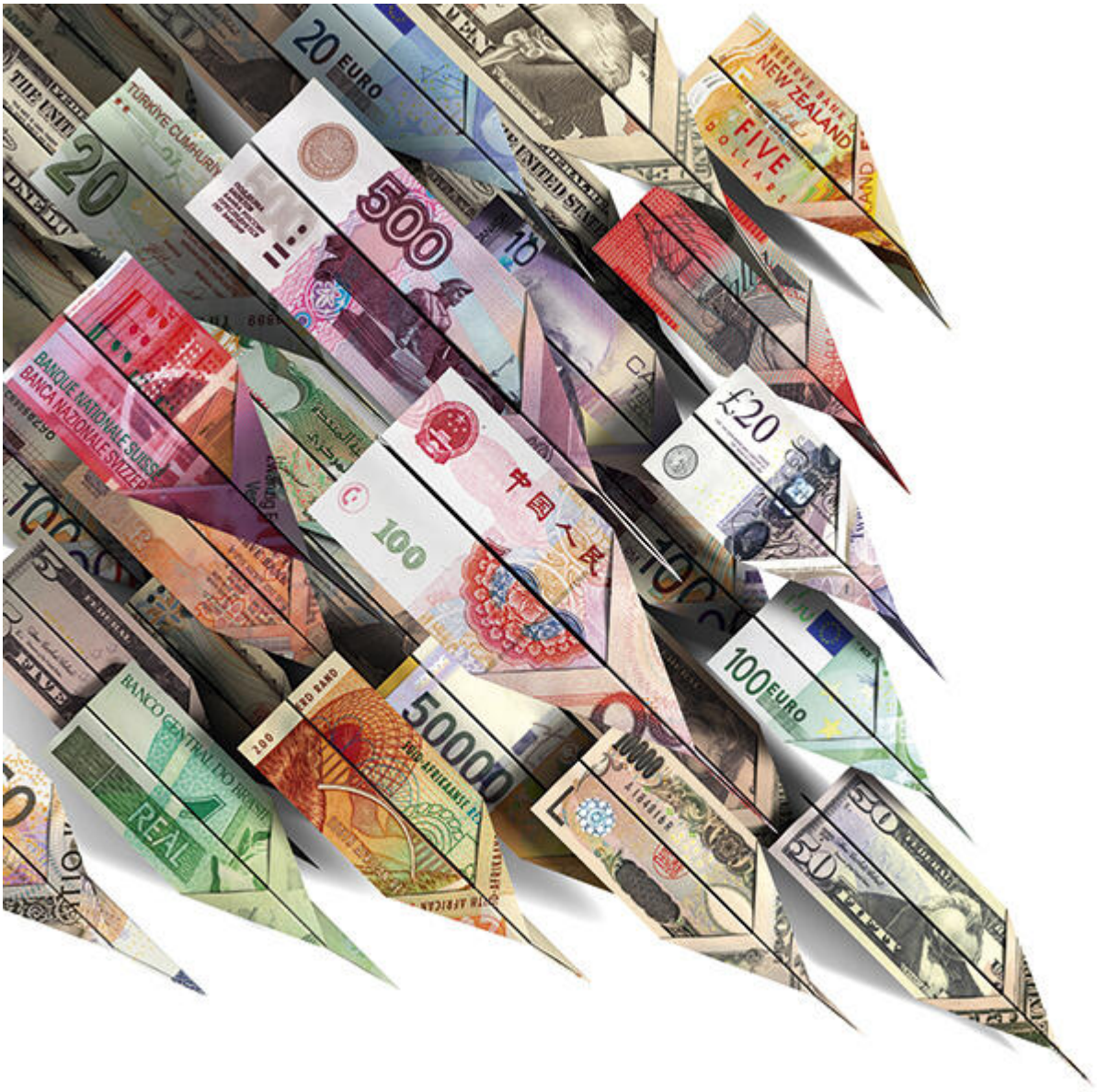
Poor payroll governance – a global headache



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John Lewis and Amelia Corfield highlight the importance of governance and risk management when dealing with clients that operate employment taxes in different jurisdictions

Key Points

Determining who is responsible for gathering payroll data can be difficult for organisations Employment tax compliance has moved up the boardroom agenda There is an increasing expectation that UK employment tax advisers have an awareness of international payroll obligations

Imagine you are the UK employment taxes manager for a multinational organisation. HMRC have queried the 2011/12 P11D returns for some UK inbound assignees, and you establish that living accommodation benefits have been significantly under-reported for a number of employees. The error is traced back to your shared service centre in Poland (which is responsible for collating assignees' benefits data). The shared service centre failed to supply details of a large number of rental payments to the UK team responsible for P11D preparation. These rental amounts were paid prior to the assignees' arrival in the UK, and therefore were incorrectly assumed to be irrelevant.

The cause of the problem is clear, and seems straightforward to remedy. You agree a settlement of income tax and NIC with HMRC, and provide confident assurances that it will not happen again. You explain to the Polish team what data is needed to calculate the living accommodation benefit correctly
going forward.

Many readers might reasonably assume that the issue is closed. However, what if you learn that the Polish shared service centre was also responsible for delivering assignee benefits data to 23 other jurisdictions? And it is likely that the same data omissions are occurring in most of these locations? Would you feel as confident then?

If you work in employment taxes, it probably won't come as news to you that determining who has responsibility for what can be difficult for almost any organisation. Multiple teams often have an input (eg HR, tax, finance, reward, payroll) and inevitably this sometimes results in certain compliance tasks falling through the cracks.

What is new, however, as illustrated by this example and examined below, is that the tax risks that are presented by ineffective governance are being magnified as businesses have increasingly globalised operations.

What does this mean for employers?

At this stage, some readers may be considering the relative size of their organisation (perhaps it is UK based with only a minor global footprint) and will start to turn the page, thinking, ‘This can’t be something that impacts my business.’ However, governance issues do not only impact large multinationals.

Regardless of the size of the business, the employment taxes cost is often one of the most relatively substantial items in the profit and loss. For example, a recent HMRC report for the banking sector revealed that in 2011/12, £17.6 billion of PAYE and NIC remittances were paid. Corporation tax and bank levy accounted for just £1.3 billion and £1.6 billion respectively.

Additionally, in today’s landscape employers are facing an array of new challenges, which can collectively generate systemic compliance concerns:

- Above all, globalisation is forcing us to rethink the way we assess our employment tax compliance risks. Tax compliance is being outsourced to offshore teams at unprecedented levels. UK tax calculations are performed in Chicago; US assignment data is collated in Mumbai; Australian share awards data is processed in Frankfurt. It is not uncommon for something as apparently simple as a P11D return to require input from not only UK tax and HR, but also offshore shared service centres and external relocation service providers. Globalisation undoubtedly delivers strong commercial benefits; however, when employment tax obligations are not adequately supported within these frameworks, it can also deliver compliance risks.
- For many employers who favour increasingly complex employee remuneration structures, this invariably equates to an increasingly complex tax compliance burden. This is even more problematic for businesses with internationally mobile employees, which require an understanding of their responsibilities in multiple jurisdictions.
- Employers are faced with mounting responsibilities to assist the fiscal authorities; not only with the collection of taxes, but even with the enforcement of governmental strategies. A good example is how, under real time information, UK employers are now required to report the number of normal hours worked by employees, which will be used by the Department for Work and Pensions for the purpose of assessing eligibility for the Universal Credit.

Pensions auto-enrolment is a further example of employers accommodating an added compliance burden within an already bursting inventory of responsibilities.

- Fiscal authorities are also becoming more proactive in assessing employer compliance globally. With every penalty notice issued, the knock-on effect is that tax compliance is moving up the corporate agenda. China is an example of how tax authority behaviours can influence employer priorities. Over 2011 and 2012, the Chinese authorities began intensifying their reviews of the collection of individual income tax (IIT), with a particular focus on high income individuals and expatriates. Many employers have responded by proactively reviewing their benefits structures and tax reporting procedures, with an emphasis on their senior executives.
- Tax (and tax avoidance in particular) is now subject to exceptional levels of public scrutiny. There are different views on these issues; however, what cannot be disputed is that reputational risk is now an undeniably important factor for employers when managing their tax affairs. For example, if HR decides to implement a bonus deferral, would the organisation consider consulting their public relations team? An absence of this sort of joined-up thinking can yield a significant reputational cost. The new UK Government procurement rules are a recent example of how businesses are being encouraged to reconsider their tax arrangements. On a global scale, the problems can be further magnified. For instance, a UK-headquartered business might take a conservative approach to its tax affairs, but is this message communicated effectively to its offices in other jurisdictions?
- There are increasing exchanges of information between different fiscal authorities. In the UK, for instance, overseas authorities are now able to share information with HMRC through an increasing range of instruments (eg bilateral and multilateral agreements). The consequence of such agreements is that many authorities are better equipped to enforce compliance globally.
- The UK’s senior accounting officer (SAO) regime has proven effective in helping HMRC move tax compliance up the boardroom agenda. Consequently, there is an added burden placed upon in-house tax professionals to ensure that their systems and processes are adequate for ensuring compliance.

When are employers exposed to the risk of a lack of governance?

We know that governance issues are becoming more prevalent and the context behind why this is an increasing priority for both employers and fiscal authorities. The next questions are:

- how are these risks manifesting themselves in practice; and
- what can employers be doing to protect themselves from these risks?

Over-reliance on third parties

Many employers involve third parties (eg outsourced payroll vendors, professional advisors, share plan administrators) in achieving employment tax compliance. While this can be an effective way for employers to resource the right levels of expertise, an over-reliance on third parties and a lack of internal tax knowledge can present risks (as seen in ***Example 1***).

Centrally managed processes with a global impact

Many employers manage certain global tax areas centrally via a single team. A common example is where an international assignments team is exclusively tasked with the collection of compensation data on behalf of all international assignees for a business. Shared service centres are another example where HR and payroll processes are centralised, with a view to achieving economies of scale.

There are obvious commercial and practical advantages for devolving responsibility for an unwieldy function such as international assignments into a single, centralised team. However, when poorly managed, these arrangements can create their own tax compliance risks, and also on a magnified scale where multiple tax jurisdictions are involved. As seen in ***Example 2***, a team based in one central location is unlikely to have sufficient tax expertise to make judgments that could impact, say, 40 different countries, all with unique tax requirements.

People with oversight of multiple jurisdictions

For multinational employers, there is an increasingly common expectation that their UK tax specialist employees should not only have an understanding of UK tax issues, but also at least an awareness of their obligations in other jurisdictions. But how can one individual keep on track of compliance/risk across say, a whole region, or even

globally? Unsurprisingly, many of us will struggle to achieve this without the appropriate framework of support.

Rapidly expanding businesses

Rapidly expanding businesses are inherently at risk of employment taxes compliance failures. The focus is on growing the business; tax compliance is often not the priority. Particularly for a multinational employer, when setting up a business in a new overseas location, it is a real challenge to get up to speed with local tax requirements. In some cases, an employer may not even be aware that the business is subject to any local tax obligations, if it has only a very light presence in that jurisdiction.

What can be done?

Employers can introduce a few simple controls to help minimise their employment tax compliance risks in their local jurisdictions and globally:

- It is essential that tax processes are underpinned by a robust framework of accountability. Every stakeholder in a process should be clear as to what their role is, and how they fit into the wider process. It should also be clear what their role is in cases where responsibilities overlap. Process documents can be a straightforward way to implement these frameworks; however, they will only be effective if they are actually followed in practice.
- Employers should create lines of communication which are clear in confirming when issues need to be escalated, and to whom. If a return is filed late in Poland, should the head of EMEA be notified? If the escalation process is dependent on the levelof materiality, how is that materiality assessed?
- A common yet critical mistake for many employers is that if a compliance issue arises in one jurisdiction, there is no consideration as to whether a similar issue is occurring in other locations. This is often a wasted opportunity. Many employers invest large amounts of time and resources in tracking their short-term business travellers into the UK, for example, but if they don’t track their travellers into Singapore they are still potentially exposed.
- As illustrated by the examples provided, it is clear that large multinational employers are well placed to benefit from a globally coordinated approach to employment tax compliance. An effective way to achieve this is by assigning individuals with global and/or regional responsibility for employment tax

compliance.
- Key compliance areas should be regularly and proactively self-reviewed. Risks can then be caught early and prevented. Employers who don’t do this will be at a higher risk of missing these issues, and so typically face higher penalties if later discovered by the authorities.

Looking to the future, the increasingly complex compliance landscape means that a process driven approach will be the only way for many employers to effectively manage risk. As compliance rules continually change, and expectations from authorities become more demanding, employers need to move away from manually driven processes and introduce automatic, streamlined systems and controls.

Employment tax professionals will also be expected to have a much clearer understanding of what their obligations and risks are, not just in the UK, but in their other key hubs. To achieve this, employers should be wary of containing their operations within specialised ‘bubbles’ of responsibility, and encourage increased connectivity and a sense of collective responsibility within their internal teams.

Recent trends are showing that technology will play a key role in achieving this more streamlined, automated and connected approach to tax compliance. Internationally mobile employees are an example of how technology has had a positive impact on employment tax compliance (eg tracking the activities of assignees, monitoring business travellers). We are also seeing employers using technology in order to track their global employment tax reporting obligations in other areas, including payroll, equity and benefits reporting. Employers are now using mobile phones and tablet devices as a means of communicating with their employees, and many employers also use internal social networking tools to achieve efficient lines of communication. These developments demonstrate how employers are succeeding in adapting to the shifting tax landscape by making use of continuing advancements in technology.

EXAMPLES

