A global issue

Employment Tax | International Tax | Personal tax



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Increased globalisation in recent decades has changed the way in which multinational enterprises conduct their business across the world. *Vanesha Kistoo* and *Mark Abbs* consider the options.

Key Points

What is the issue?

HMRC recognise that for internationally mobile employees, employers are faced with challenges. Therefore, HMRC offer a concession to help address complex payroll issues in multiple countries.

What does it mean to me?

As payroll reporting in the UK is on a real time basis, employers who need to operate a UK and a non UK payroll for their expat population often struggle to comply because payroll deadlines do not align or they simply do not have enough resource to manage a dual payroll reporting properly. With the zero tolerance approach being adopted by HMRC, we have outlined a welcome payroll concession that may be relevant.

What can I take away?

Usually, the payroll options are a standard payroll or a shadow payroll. However, there is an alternative and it is a modified payroll but it comes with responsibilities which should be complied with.

Increased globalisation in recent decades has changed the way in which multinational enterprises conduct their business across the world. More freedom from restrictions, ease of travel and communication, together with the growth of new markets has contributed to a wider spread of activity. As part of this trend to increased globalisation, movement of employees across borders has evolved, from a pattern of extensive assignments to one of increasingly short term engagements by internationally mobile employees. Payroll reporting in the UK is not only relevant to UK employers but also non UK employers under the ‘host’ employer rules. This

article looks at a modified payroll arrangement, the responsibilities and challenges.

Modified payroll arrangement

This is a more relaxed payroll reporting approach which can be adopted where an employer has employees who need to remain on their home country payroll but have host payroll reporting obligations.

The reporting under RTI is done on an estimate basis but the arrangement comes with responsibilities which should be complied with to avoid penalties.

Who can be reported on a modified payroll arrangement?

This payroll arrangement only applies to employees who are tax equalised on all their general earnings under part 2 Chapters 4 and 5 of ITEPA 2003 for UK income tax.

Employees who are not tax equalised on specific employment income, i.e. they are responsible for the UK tax/social security on employment related share awards, can be included under a modified payroll arrangement provided the other conditions are satisfied.

Putting in place a modified payroll arrangement

The first step is to determine which application(s) need to be made. For employees who come to work in the UK there is one application for tax withholding and another for social security withholding; appendix 6 and appendix 7a. Employees can only be covered by an appendix 7a agreement if they are under an appendix 6 arrangement. Where employees leave the UK to work abroad and continue to have a UK social security withholding obligation, then the relevant application is appendix 7b.

Image

WHAT IS TAX EQUALISATION?

A tax equalisation arrangement involves an agreement under which the employee is entitled to specified net cash earnings and/or non-cash benefits. The employer undertakes to meet UK Income Tax arising from the earnings and/or benefits and to provide a professional adviser or in-house specialist to deal with the individual's UK tax affairs. It generally involves switching actual tax withholding to a 'hypothetical tax' withholding. Hypothetical tax withholding, as the term suggests, is an estimate of what an employer would expect an employee to pay as tax. The amount collected from the employee as hypothetical tax on a monthly basis is used to fund the taxes due in the home and host locations. If the actual total tax due is higher than what the employee would have usually paid in their home country, the employer funds the difference.

Some challenges of operating a tax equalisation arrangement

To operate a tax equalisation arrangement is not without any challenges. It requires an understanding of an employee's withholding requirement in the home and host country. In addition, the method used to calculate the hypothetical tax withholding also means that an employer may have to perform a reconciliation calculation of the employee's tax position in the home country.

Hypothetical tax withholding versus actual home country tax withholding: When an employee has a UK payroll withholding obligation, it may be possible to reduce or stop the payroll tax withholding in the home country. Generally, the withholding obligation depends on the time an employee is expected to continue to spend working in the home country. In the US, for example, if a US citizen can suspend federal wage withholding where there is mandatory foreign withholding like in the UK, actual federal tax withholding can stop. However, if the employee is expected to continue to spend a substantial amount of time working in the US, strictly, their federal tax withholding should be reduced rather than cancelled.

Home country tax reconciliation calculation (commonly known as TEQ): The purpose of the reconciliation is to determine whether the employee is in a tax and/or social security neutral position as intended. It will also help the employer assess whether corrective adjustments need to be made to the hypothetical tax withholding.

If there is no tax reconciliation, an employer may struggle to demonstrate to HMRC that there is a genuine intention to ensure that the employee is no better or no worse off. This can prove costly to an employer as HMRC can deny a deduction for hypothetical taxes in the gross up tax calculation.

There is no deadline to perform a tax reconciliation calculation but it generally works well when the tax reconciliation calculation is done soon after the home country's tax return is filed.

Appendix 6

Such an agreement is relevant for overseas employees coming to work in the UK, and broadly, the rules for these modified payroll schemes are:

- All general earnings are tax equalised;
- At the start of each tax year the employer estimates the total taxable pay (including benefits) for the year and calculates the estimated annual tax liability which is spread out in the tax year;
- A review should be carried out between December and April in the year to adjust for material changes, bonuses, share gains, etc.;
- The deadline to submit modified form P11ds is 31 January following the end of a UK tax year;
- A self assessment tax return should be filed by the employee and further liability due is settled by the employer;
- Quarterly payment of PAYE to is due to HMRC where the total number of employees does not exceed 5. If the total number of employees exceeds 5, payment of PAYE changes from quarterly to monthly from the beginning of the next tax year and vice versa where the number falls to below 6;

- PAYE due can be adjusted for foreign tax where an agreement has been reached with HMRC;
- PAYE can also be adjusted for employee contributions into an overseas pension scheme where the employee qualifies for tax relief in the UK.

See ***example 1: Appendix 6***.

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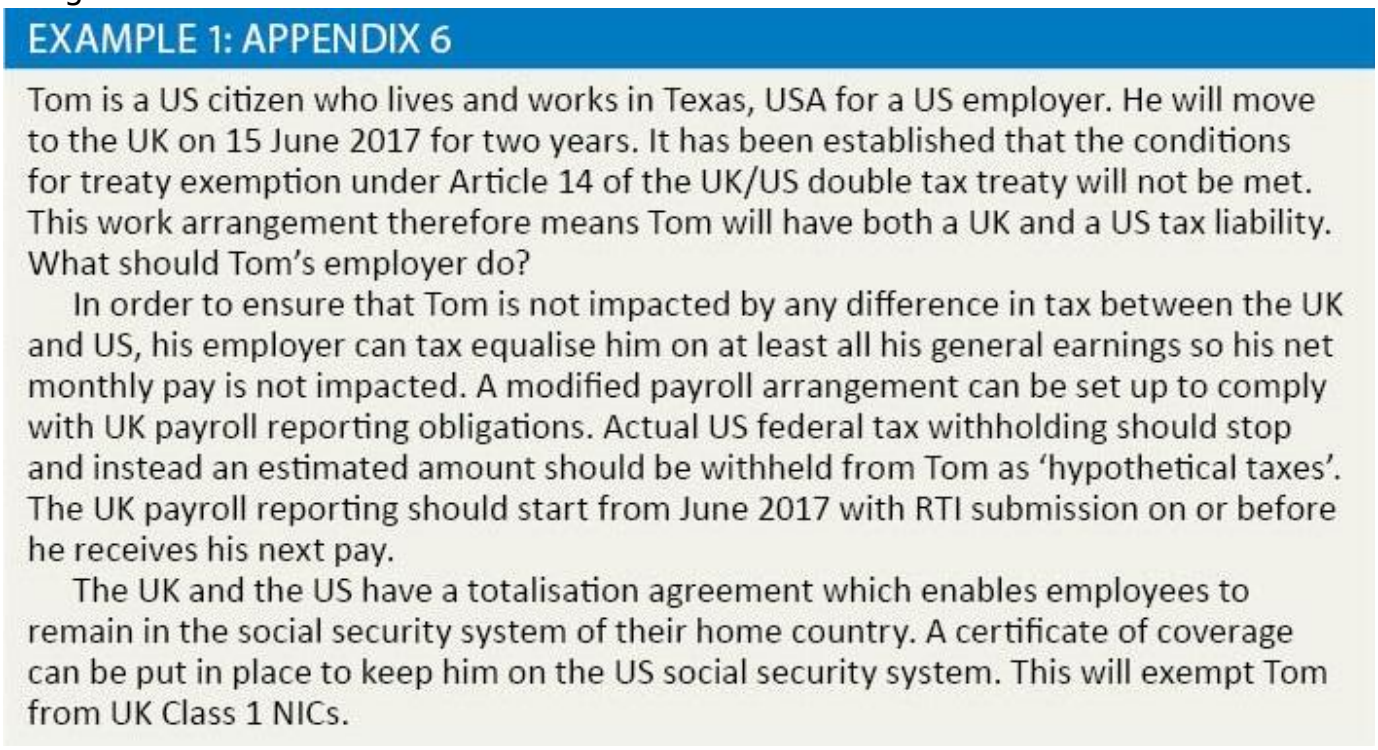

EXAMPLE 1: APPENDIX 6

Tom is a US citizen who lives and works in Texas, USA for a US employer. He will move to the UK on 15 June 2017 for two years. It has been established that the conditions for treaty exemption under Article 14 of the UK/US double tax treaty will not be met. This work arrangement therefore means Tom will have both a UK and a US tax liability. What should Tom's employer do?

In order to ensure that Tom is not impacted by any difference in tax between the UK and US, his employer can tax equalise him on at least all his general earnings so his net monthly pay is not impacted. A modified payroll arrangement can be set up to comply with UK payroll reporting obligations. Actual US federal tax withholding should stop and instead an estimated amount should be withheld from Tom as 'hypothetical taxes'. The UK payroll reporting should start from June 2017 with RTI submission on or before he receives his next pay.

The UK and the US have a totalisation agreement which enables employees to remain in the social security system of their home country. A certificate of coverage can be put in place to keep him on the US social security system. This will exempt Tom from UK Class 1 NICs.

Appendix 7a

In summary, the rules under a modified social security arrangement for overseas employees working in the UK are:

- The scheme only applies to employees under an appendix 6 agreement;
- Similar to the appendix 6 agreement, at the start of each year the employer estimates the earnings, including non cash benefits subject to Class 1 NIC for the year, calculates the estimated annual NIC liability and pays 1/12th of that tax each month;
- A review is carried out in December to April in the year to adjust for material changes;

- If there is additional Class 1 or Class 1A NIC, the amount must be paid by 31 March following the end of the tax year;
- Annual NIC settlement prepared to reconcile NICs.

See ***example 2: Appendix 7a***.

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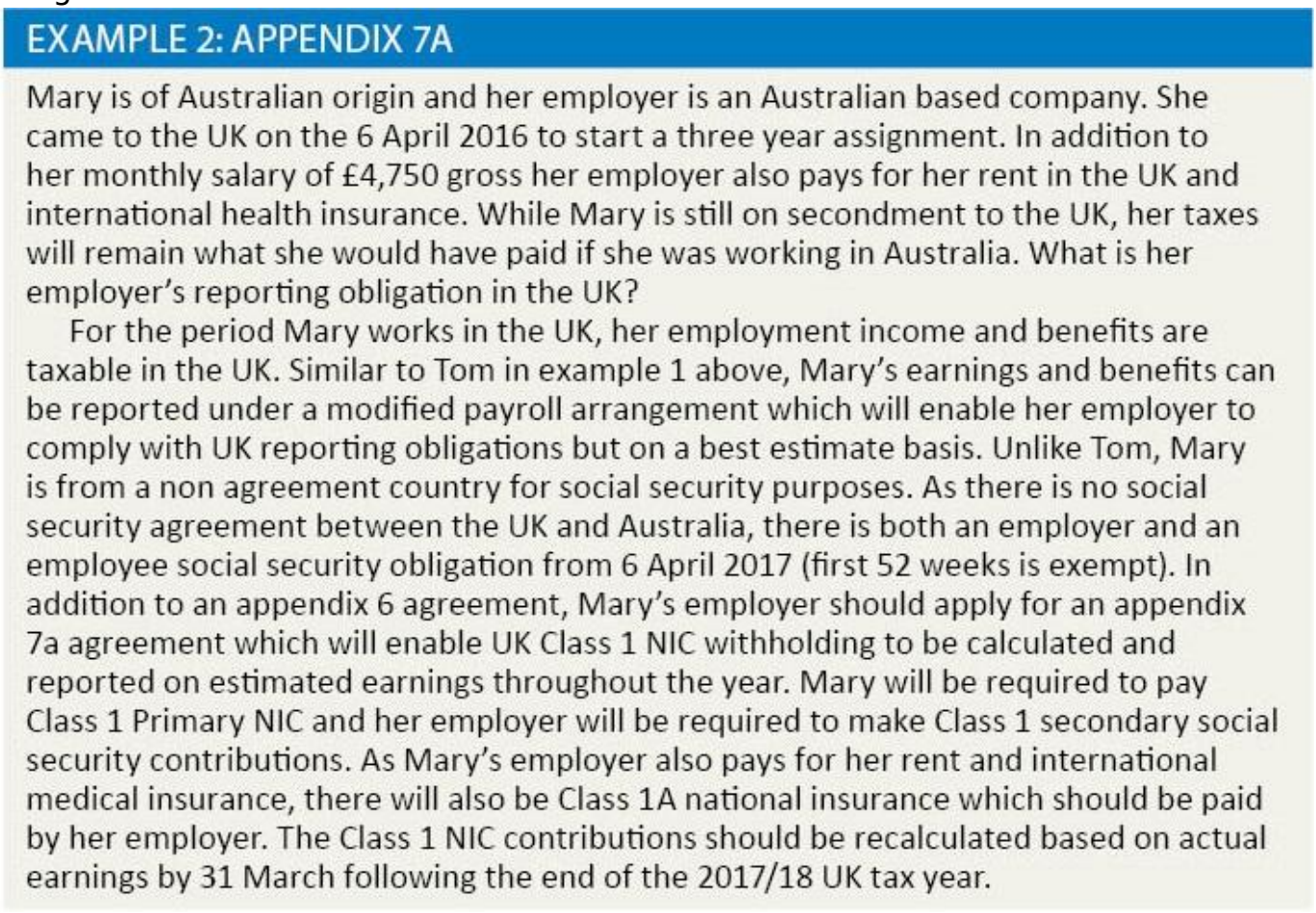

EXAMPLE 2: APPENDIX 7A

Mary is of Australian origin and her employer is an Australian based company. She came to the UK on the 6 April 2016 to start a three year assignment. In addition to her monthly salary of £4,750 gross her employer also pays for her rent in the UK and international health insurance. While Mary is still on secondment to the UK, her taxes will remain what she would have paid if she was working in Australia. What is her employer's reporting obligation in the UK?

For the period Mary works in the UK, her employment income and benefits are taxable in the UK. Similar to Tom in example 1 above, Mary's earnings and benefits can be reported under a modified payroll arrangement which will enable her employer to comply with UK reporting obligations but on a best estimate basis. Unlike Tom, Mary is from a non agreement country for social security purposes. As there is no social security agreement between the UK and Australia, there is both an employer and an employee social security obligation from 6 April 2017 (first 52 weeks is exempt). In addition to an appendix 6 agreement, Mary's employer should apply for an appendix 7a agreement which will enable UK Class 1 NIC withholding to be calculated and reported on estimated earnings throughout the year. Mary will be required to pay Class 1 Primary NIC and her employer will be required to make Class 1 secondary social security contributions. As Mary's employer also pays for her rent and international medical insurance, there will also be Class 1A national insurance which should be paid by her employer. The Class 1 NIC contributions should be recalculated based on actual earnings by 31 March following the end of the 2017/18 UK tax year.

Appendix 7b

The rules for a modified social security arrangement for employees assigned from the UK to work overseas are:

- The scheme applies to employees assigned to work outside the UK for more than one complete UK tax year;
- The employee breaks UK residence;
- The employee does not have UK taxable earnings but they remain liable to UK NIC;

- At the start of each year the employer estimates the earnings, including non cash benefits subject to Class 1NIC for the year, calculates the estimated annual NIC liability and pays 1/12th of that tax each month;
- A review is carried out in December to April in the year to adjust for material changes;
- The deadline to submit form P11ds is 31 January following the end of a UK tax year;
- If there is additional Class 1 or Class 1A NIC, the amount must be paid by 31 March following the end of the tax year;
- Employees must be paid at a rate above the Upper Earnings Limit (UEL) throughout the year except in arrival and departure months, which may be a part month.

See ***example 3: Appendix 7b***.

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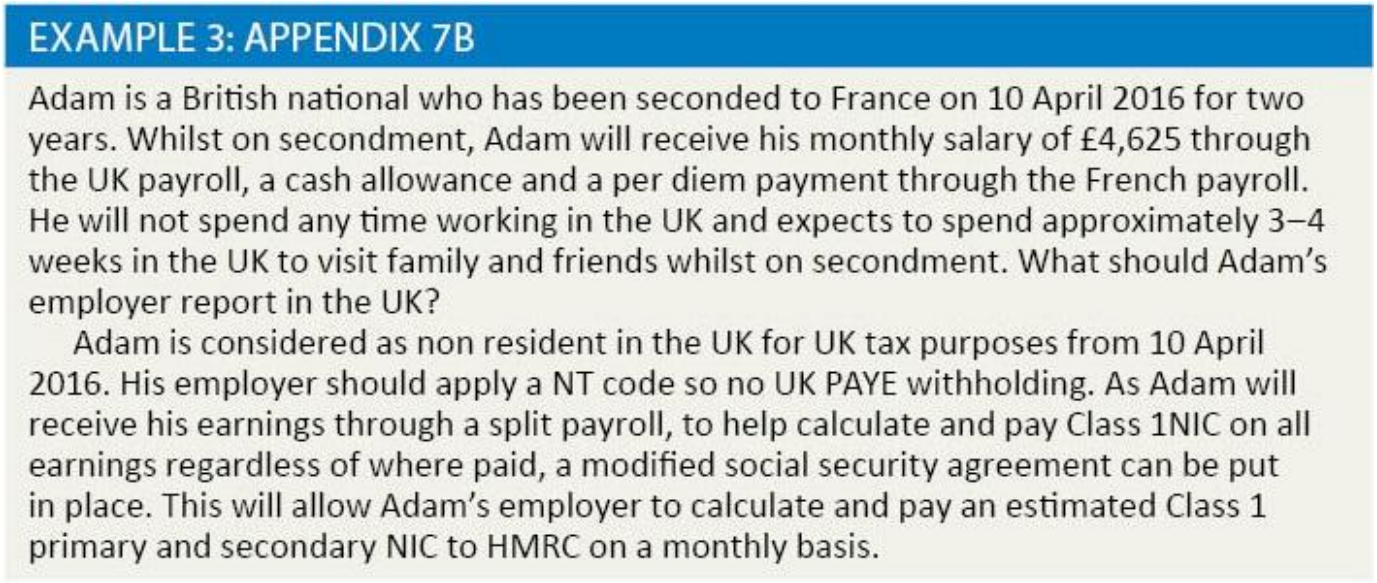

Conclusion

The current trend in employee mobility indicates a growth in short term (training related) assignments and short term business travellers. Although there are regulations and guidance in place such as the OECD model and social security agreements to harmonise cross border tax and social security reporting, they do not offer a solution all the time. A modified payroll arrangement can help, especially for employees who spend time working in countries which are more challenging than

others such as Brazil, Russia, India, China and the USA. A modified payroll arrangement can help with cash flow and the employer can report best estimates so there are no penalties provided the terms and conditions of the arrangement are complied with. Interest and penalties still apply to tax and NICs paid late