The 'people' aspect

Employment Tax

01 November 2018

Robert Salter provides guidance on the HR, finance and payroll aspects international businesses need to consider when recruiting or seconding employees abroad

Key Points

What is the issue?

International business expansion normally means recruiting people in overseas territories or sending UK employees to work abroad. For HR, finance and payroll departments this can present significant challenges, especially where businesses are operating internationally for the first time.

What does it mean to me?

Many employers ignore some of these steps. This can have serious implications for companies from a cost and compliance perspective, whilst potentially creating negative PR for the business and employees that are unnecessarily stressed and not focusing fully on their day job.

What can I take away?

Expanding internationally creates exciting opportunities for business. However, companies need to consider the 'people aspects' (and all the associated compliance issues that come with employees), closely and ensure that the finance, HR & payroll teams are closely aligned and continually communicating.

International business expansion normally means recruiting people in overseas territories or sending UK employees to work abroad. For HR, finance and payroll departments this can present significant challenges, especially where businesses are operating internationally for the first time.

One of the key practical challenges is paying employees who are located overseas, whilst ensuring that the company remains compliant when it comes to tax and Social Security withholding.

- Experience shows that the key steps for successfully employing people overseas are:
- Consider the employment policy arrangements that should apply;
- Ensure that costs are correctly budgeted;
- Review the income tax and tax withholding positions (and these can be different);
- Review the Social Security (National Insurance) position;
- Determine how and where pay should be delivered.

Many employers ignore some of these steps. This can have serious implications for companies from a cost and compliance perspective, whilst potentially creating negative PR for the business and employees that are unnecessarily stressed and not focusing fully on their day job. This whole area can be complex and requires specialist advice. The guidance below is a broad overview of the key issues.

HR policy issues

The issues that arise will differ depending upon whether the business is recruiting someone 'in-market' (i.e. in the overseas jurisdiction) or looking to send an existing UK-based employee into the new market. Employing an in-market individual is potentially 'easier' (if they have the right skill set and experiences). They may also bring an existing network of contacts etc. in that country. However, teams still need to consider a number of factors from a policy perspective when recruiting and employing the individual. This summary highlights some issues to consider:

- Pay & benefits (e.g. in some countries employees are automatically entitled to a month 13 payment);

- Holiday entitlement;
- Employment contracts (don’t just assume the existing UK contracts can be used abroad);
- Business expense reimbursement arrangements; and
- Training and development of the overseas employee(s).

It is also important to budget for the costs of local employees (as with expatriate employees). For example, Social Security costs for employers in some European countries can often represent ca. 40%–45% of the individual’s compensation package – have these costs been included in the relevant cost estimates?

When individuals go overseas on assignment, many of the same issues still arise albeit with additional tweaks and challenges. For example, the pay and benefits provided to an international transferee may need to be adjusted to include a cost of living allowance, school fee support or overseas accommodation. In addition, companies should consider what tax arrangements they implement for any international transferees (i.e. in respect of the employee’s personal tax position). Options in this regard include:

- Tax equalisation: i.e. the individual is (in simple terms) guaranteed not to be any better off or any worse off from an income tax perspective because of their overseas assignment;
- Tax protection on assignment benefits: i.e. the company agrees to pay the tax on specific assignment-related benefits (e.g. housing, school fees); or
- A laissez-faire approach: i.e. the company insists that all tax liabilities (home and host) are the responsibility of the individual transferee. The assignee could therefore ‘win’ if they go to a low tax country (e.g. UAE), but would potentially lose from a tax perspective if they went to a high tax country (e.g. Sweden or Denmark).

All these policies can come with benefits and challenges. However, whichever policy approach is adopted, it is important to ensure that this is well-documented and everyone understands the implications that arise from the approach.

Tax withholding

The income tax and Social Security position for a UK resident employee who works solely in the UK is straightforward – both PAYE and National Insurance Contributions (NIC) are due on any employment-related earnings.

However, where the business is expanding overseas, the likelihood is that it will need to pay someone who is working outside the UK. If a person recruited overseas is employed by a UK company directly, UK tax obligations should be considered in the first instance.

If an employee recruited overseas is not resident in the UK, generally no PAYE is due unless the non-resident employee performs duties in the UK which are more than incidental to their overseas work. The definition of what constitutes an incidental UK workday is based on case law, but would generally be those days which are subordinate or ancillary to overseas work, such as training in the UK or general meetings.

If there is no PAYE obligation, it is possible to pay non-resident employees on a gross basis via a UK payroll. HMRC accepts that there is no need to apply to pay such employees without PAYE withholding if they are:

- working wholly outside the UK (apart from some potential incidental duties)
- are not and have never been resident in the UK and
- do not intend to come and work in the UK.

At this point, it all seems quite straightforward – recruit the non-UK individual, ensure that they have a valid / reasonable employment contract based on the overseas rules and pay them on a gross basis via the UK payroll.

However, if an employee is performing duties in another country it is likely that they will be subject to tax in that country. If the UK company does not have a corporate presence, such as a limited company or branch, in an overseas territory there will often be no withholding tax obligation in the overseas territory. However, it would be correct to always ensure that the specific rules within each territory are reviewed in this regard. Other points to note in this general area are:

Could the employee's activities create a 'taxable presence' of the business at some stage in the future, as the role expands overseas? It is often sensible to review the overseas withholding (and corporate tax permanent establishment) positions on a regular basis.
Is there any risks/costs associated with not-registering for tax withholding in the overseas location – for example, could registering for payroll taxes overseas on a 'voluntary basis' actually help legitimise the company's presence in the overseas jurisdiction? Could it also help simplify tax reporting for the individual employee (e.g. it may mean that they don't need to file an annual income tax return each year)?

Where no withholding is required overseas, employees can be paid via the UK payroll on a gross basis and can settle any taxes due in the overseas country by filing a tax return in that country. However, care does need to be taken that the employee's activities do not unwittingly create a deemed corporate presence for the UK company – for example, it can be sensible to have formalised guidelines re the employee's precise role and to ensure that these arrangements are reviewed on a regular, ongoing basis.

If a UK company has specifically set up a corporate entity overseas or has a deemed corporate presence (as defined under the local tax legislation or the relevant double tax treaty with the UK) overseas, it is likely that tax withholding will be required for the employee. In addition, companies should be aware that even where they don't have a deemed permanent establishment overseas for foreign corporate tax purposes (e.g. because of the terms of a Double Tax Agreement), it is quite possible that the could still create a permanent establishment for 'withholding tax purposes' (i.e. broadly akin to the UK 'taxable presence' definition from the case of *Clark v Oceanic Contractors*). Double Tax Agreements do not provide any innate, automatic relief from withholding tax obligations – either for companies or individuals.

In these circumstances, the most appropriate solution is normally to set up a payroll in the overseas territory and pay the employee via the non-UK payroll. This means that you can ensure that the relevant tax withholding obligations overseas are fulfilled. If the employee's UK duties are more than incidental to the overseas duties there may be a PAYE obligation as well as a tax withholding obligation overseas. This can lead to 'double withholding' of tax and this situation would need to be managed carefully as it can lead to cash flow issues for employees.

Employees seconded overseas

Whether a seconded UK employee will be subject to PAYE will depend on:

- whether they remain resident in the UK when they go to work overseas and
- whether they will remain employed by the UK company while working overseas.

UK residence status for seconded employees is determined using HMRC's UK statutory residence test, though this can be 'superseded' in some cases by an individual's treaty residence status (i.e. in accordance with a Double Tax Agreement).

If an employee remains UK resident whilst working overseas, PAYE is due on their income, even if they are paid from outside the UK. The only way to avoid a PAYE obligation would be for the employee to be employed by the overseas entity, be paid from outside the UK and not perform any UK duties on behalf of the UK entity. The employee would still have a personal UK tax liability which they would need to settle by filing a UK tax return.

Where an employee is subject to withholding overseas but remains on the UK payroll it is possible to apply to HMRC for the overseas tax to be offset against PAYE each month so that the employee does not suffer double withholding. This can be done via a 'net-of-credit' arrangement (EP Appendix 5 Agreement) or potentially via an adjustment to the individual's PAYE tax code, to provide relief on an estimated basis for the overseas taxes that will be payable. Where an employee will remain on the UK payroll and becomes non-resident in the UK following their departure, a request can be made to HMRC for a NT code so any payments made from the UK payroll can be made on a gross basis with no PAYE.

For employees on short term international secondments most companies continue the employment via the UK company and UK payroll, because:

- there may be no entity overseas to employ the secondee;
- a UK employment may be required so UK pension contributions can be continued;
- the employee may have financial commitments in the UK and want payment in GBP.

Where overseas tax withholding is also due, the company will also need to set up a 'shadow payroll' to facilitate the payment of withholding to the tax authorities overseas, although no income is normally, physically paid from the overseas payroll.

In addition, if companies have seconded an employee overseas, it is worth remembering that the challenges don't always end as soon as an assignment finishes and the employee returns to the UK (or perhaps moves onto a local contract overseas). For example, issues can continue to arise with regard to 'trailing income' items – e.g. long-term bonus awards or share-related compensation that has been earned across various countries and remains partly taxable in more than one jurisdiction.

Social Security

One of the common errors made in international payroll is that social security is simply applied in the same country as the income tax withholding. However, social security and tax rules are usually subject to separate legislation and principles.

For expatriate employees, the social security position will depend on:

- the specific country to which the individual has been seconded (e.g. is it an EU/EEA country or another country with whom the UK has a formal Social Security Agreement);
- whether the employee will be employed in the UK or the overseas territory; and
- the planned duration of the secondment.

The social security position can be completely different to the UK tax position. For example, a company with a UK employee who is sent to Australia to work for three years would, unless their employment contract is transferred to a foreign company, still be required (usually) to operate employer and employee NIC for the first 52 weeks of the assignment, even where the employee breaks residence for PAYE purposes. Similarly, a UK employee in France for 3 years could remain fully liable to UK NICs throughout the overseas secondment, even though they may be subject to income taxes only in France (or potentially in both France and the UK depending upon their working pattern).

Moreover, the position with social security is potentially complicated by other factors including:

- Brexit: this may (potentially) result in British employees not being covered by the EU/EEA wide Social Security Regulation that presently covers British employees going overseas;
- The treatment of benefits-in-kind for UK nationals going overseas and breaking UK residence (such items may not be liable to a class 1A NIC charge for the employer); and
- The problem of tracking overseas payments (e.g. for housing or school fees), in the UK payroll and understanding what the exact contractual arrangements are behind such payments. For example, if the company is meeting the pecuniary liability of the individual with such payments, the amounts would remain liable to employee / employer NICs (subject to issues such as the 52 week period). However, if the contract for the housing is between the company and the overseas landlord, no UK NICs would potentially be due. The difficulties associated with capturing NICs correctly and on a timely basis for UK companies with overseas employees has resulted in the Revenue introducing a ‘relaxation’ of the rules – this is known as Modified NIC (EP Appendix 7b) and would involve companies making estimated NIC payments during the tax year, with relevant ‘true-ups’ to capture the NICs due on overseas compensation items.

Employees who need to make overseas contributions may want to consider making voluntary contributions to the UK system in order to preserve their contributions record for state pension purposes. Whether this is appropriate / necessary would depend upon a number of factors including their overall working history and the expected length of the overseas assignment.

Summary

Expanding internationally creates exciting opportunities for business. However, companies need to consider the ‘people aspects’ (and all the associated compliance issues that come with employees), closely and ensure that the finance, HR & Payroll teams are closely aligned and continually communicating. It is also important to ensure that professional advice is obtained on a timely and pro-active basis. Otherwise, companies could easily end up being ‘penny wise and pound foolish’.