The perils and pitfalls of non-UK resident directors

Employment Tax   Tax voice

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Lee Knight looks at the key PAYE considerations

Companies must appoint directors to take charge of the management of the company's business, to make strategic and operational decisions for the company, and ensure that the company's statutory obligations are met.

Often, a UK company will appoint a director who is not tax resident in the UK (hereafter referred to as a "non-resident director"). This might be for a variety of reasons, including because the UK company wants to access and utilise the experience or talent of an individual based overseas, or because it is part of a larger overseas group and a decision is made to appoint a senior employee or director from the overseas group to the board of the UK company.

If a non-resident director is working wholly outside the UK, has not been resident in the UK before, and does not intend to perform any duties in the UK, it is unlikely that there will be any significant UK PAYE obligations associated with the appointment of the non-resident director. But when the non-resident director starts to work in the UK, the UK company will quickly acquire such a PAYE obligation.

This is an area of PAYE compliance which many UK companies with non-resident directors working in the UK either miss or struggle to get right. This makes it an area of interest for HMRC, who routinely investigate it during compliance checks of employer records. HMRC will often be prepared in advance for discussions on the topic, with information obtained from various sources including (but not limited to) the company's accounts and Companies House.

Failure by a UK company to accurately apply the correct PAYE position could expose it to underpaid liabilities, including any tax and employee's and employer's National Insurance contributions (NIC) due on the non-resident director's earnings, HMRC interest charges, and HMRC penalties. These underpaid liabilities have the potential to be significant where the remuneration paid to the non-resident director is considerable and the inaccuracy continues for several years. This, together with the potential reputational risks associated with non-compliance, makes getting this right crucial.

The income tax position – an overview

Non-resident directors of UK companies are office holders, and the provisions of the employment income parts of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), that are expressed to apply to employments, also apply equally to offices.

Double tax treaties generally do not offer non-resident directors protection from UK tax when they work in the UK. As an example, the wording from Article 15 of the double tax treaty between the UK and the US states the following regarding director's fees:

"Directors' fees and other similar payments derived by a resident of a Contracting State for services rendered in the other Contracting State in his capacity as a member of the board of directors of a company that is a resident of the other

Contracting State may be taxed in that other State."

Because of the lack of protection from UK tax in double tax treaties, a Short-Term Business Visitors Arrangement under HMRC's EP Appendix 4 cannot be applied in respect of non-resident directors. Furthermore, non-resident directors are excluded from the PAYE Special Arrangement for Short Term Business Visitors introduced in October 2015 for individuals who cannot meet the strict terms of EP Appendix 4. Consequentially employers of non-resident directors are blocked from utilising the PAYE relaxations which might be available to other inbound employees and short-term business visitors from overseas.

The key point for income tax purposes therefore is that remuneration paid to a non-resident director working in the UK will generally be liable to income tax in the UK and, if it is, the UK company paying that remuneration will invariably be required to subject that remuneration to tax under PAYE. That can, however, be more complicated than it sounds.

Income tax practicalities and complexities

1. Establishing the earnings attributable to the directorship role

The first step is to establish the amount of the non-resident director's earnings which are attributable to the UK directorship. Where the UK directorship is remunerated, and those earnings have been agreed (for example, in a service agreement) this step can be relatively straightforward.

The UK tax position can, however, be more complex where a non-resident director has other employment duties for the overseas group the UK company is part of. It is quite common in this situation to be told that the UK directorship role is unremunerated. In these circumstances, and depending on the facts, it may be appropriate to allocate a proportion of the total employment income the individual receives from the wider overseas group as earnings of the UK directorship role.

Once the amount of the earnings of the non-resident director which are attributable to the UK directorship have been established, it will then be a case of considering where those directorship duties are performed. If the duties of the directorship are performed by the non-resident director in the UK only, then the UK company will need to subject all the non-resident director's earnings from the directorship to tax under PAYE in the normal way.

If, however, those, duties are performed in the UK and overseas, the UK company may want to obtain a direction under Section 690 ITEPA 2003, which allows it to operate tax under PAYE only on the percentage of the employee’s total earnings which it anticipates will relate to UK workdays.

2. Is the director also performing the duties of a wider separate employment in the UK?

It is also necessary to ask whether the non-resident director is performing substantive duties of a wider separate employment with the overseas group in the UK.

If the non-resident director is performing substantive duties of a separate wider employment in the UK, it is important to consider how this affects PAYE compliance for the UK company. Can, for example, a Short-Term Business Visitors Arrangement under HMRC’s EP Appendix 4 or a PAYE Special Arrangement for Short Term Business Visitors be applied in respect of this separate employment? If these relaxations cannot be applied, it may be appropriate to add a proportion of the salary from the overseas employment to the earnings for directorship duties being subjected to tax in the UK.

It may be contended that, despite the non-resident director performing substantive duties of a separate wider employment in the UK, that they are not working for the benefit of the UK company in respect of this wider role, and that the UK Company therefore has no PAYE obligations in this regard. If this is the case, care should be taken to ensure that this can be substantiated in the event of HMRC challenge.

National Insurance contributions

The UK NIC position for a non-resident director working in the UK can also be complex and must be considered separately to the UK tax position.

UK NIC applies where an individual is gainfully employed and is also either resident, present (but for any temporary absence), or ordinarily resident in the UK. Gainful employment includes an office or directorship.

Normally payments to a director, for acting as a director, are therefore treated as earnings for Class 1 NIC purposes although there are some limited exceptions where this is not the case (for example, where the director is a member of a professional partnership, or is a nominee director, and certain conditions are met).

For a non-resident director of a UK company it is therefore possible that Class 1 could be due on their earnings from the directorship if they perform the duties of the directorship in the UK. It is, however, first necessary to consider whether the EEA Social Security Regulations or a Reciprocal Agreement with the director's home country apply, meaning that the non-resident director should be subject to the Social Security regulations of their home country and not the UK.

If the EEA Regulations or a Reciprocal Agreement do not apply, the next step is to consider whether the non-resident director only attends board meetings in the UK, and whether an administrative HMRC concession can therefore be applied. Under the concession no UK NIC liability applies to such a director's earnings provided that:

- The director attends a maximum of ten board meetings in a tax year; and
- Each visit lasts no more than two nights at a time; or
- If the director only attends one board meeting in a tax year, the visit lasts no more than two weeks.

If the EEA Regulations, a Reciprocal Agreement, or the above HMRC concession do not apply to a non-resident director working in the UK, then a liability to Class 1 NIC will arise in respect of their earnings, and this should be calculated by reference to an annual earnings period. It may also mean that NIC is due on any expenses which are attributable to the non-resident director's UK duties, where UK tax relief is not available.

Non-resident directors' expenses

The UK tax and NIC treatment of non-resident directors' expenses is a frequently misunderstood area and it is equally important that the UK company applies the correct tax and NIC (where NIC applies) position to expenses payments in addition to payments of salary and bonuses.

The UK company may meet the cost of a non-resident director's expenses for travelling between their home country and the UK to perform their UK directorship duties. Often the cost of subsistence and overnight accommodation in the UK will be met by the UK company too.

It is important to consider whether the non-resident director’s workplaces in the UK are (for tax and NIC purposes) temporary or permanent workplaces. In general terms if travel, subsistence and accommodation expenses are attributable to the non-resident director’s attendance at a temporary workplace in the UK, then tax relief will likely be due on these expenses (assuming the non-resident director necessarily incurs the expenses as the holder of the directorship and provides evidence of the costs incurred).

But if these expenses are attributable to attendance at a permanent workplace, those expenses will likely be taxable and (where NIC applies) liable to NIC. In this situation the UK company will need to report the expenses to HMRC in the appropriate way. This, depending on the facts (and noting the tax relief potentially available for non-domiciled directors highlighted below) may involve adding reimbursed expenses to the non-resident director’s other earnings reported under PAYE, and/or potentially reporting certain costs on a form P11D for the director. If the UK company and the non-resident director agree that the director should not pay any tax and (where it applies) employee’s NIC on these expenses personally, then it may be appropriate to seek HMRC agreement to deal with such costs through a PAYE Settlement Agreement (PSA) instead, but this will subject to the conditions for inclusion in a PSA being met.

The following are examples of questions which will invariably need to be asked to establish whether a workplace is a temporary or permanent one, and if the expenses highlighted above are taxable and (where NIC applies) liable to NIC:

- If the non-resident director has a service agreement, what does this say about their places of work and where their duties are performed?
- What is the purpose of the non-resident director’s visits to the UK? Are they for a particular reason rather than part of a series of visits to the same workplace for the continuation of a particular task?
- What is the nature of the work undertaken by the non-resident director while they are in the UK?
- Where are the duties of the UK directorship normally performed, and how much of the non-resident director’s overall working time is spent at each workplace? Does the non-resident director have a single place of work which they spend all (or almost all) of their working time at?

- If the non-resident director has no permanent workplace, are their UK duties defined by reference to a geographical area?

It should be noted that where a non-resident director attends a workplace regularly for a period exceeding (or expected to exceed) 24 months and they spend 40% or more of their working time (in respect of that directorship) at that workplace, HMRC will deem the workplace to be a permanent workplace and travel, subsistence, and accommodation expenses attributable to their attendance there will be taxable and (where NIC applies) liable to NIC.

There is, however, a limited exception to the above rules about temporary and permanent workplaces. Where the workplace in the UK is treated as a permanent workplace tax relief may still be available for travel expenses between the director's home country and the UK for five years from their qualifying arrival date in the UK. This relief is given under Section 373 ITEPA 2003 but is only available if the non-resident director is also not domiciled in the UK for tax purposes and has not been resident in the UK for two years before the qualifying arrival date.

Summary

The complex nature of the rules surrounding non-resident directors, with different considerations for tax and NIC under PAYE, and particularly challenging and ambiguous rules around expenses, makes the issue of tax and NIC compliance for non-resident directors a particularly difficult task. There is plenty of scope here for UK companies to reach the wrong conclusions, or not keep suitable records which substantiate the position they have taken. Exercising reasonable care to comply is therefore key.