Global immobility

Employment Tax International Tax

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Damien Bailey and Davyd Fisher consider the impact of Covid-19 and the international tax consequences of working remotely

Key Points

What is the issue?

The Covid-19 outbreak has had an impact on the mobility of the internationally mobile workforce. What are the implications of allowing employees to return to their home countries to work during the pandemic?

What does it mean for me?

There are tax and social security risks that employers need to balance with the flexibility they are able to offer their employees.

What can I take away?

This is something employers should be thinking about – either because they need to mitigate their tax risk during the pandemic, or they are open to the potential benefits of a non-centralised workforce in a post Covid-19 world.

The Covid-19 outbreak has no doubt had an impact on the mobility of the internationally mobile workforce.

However, it has also had a profound impact on the way we work and the rise and acceptance of homeworking.

Global mobility specialists are receiving questions on a daily basis on the implications of allowing employees to return to their home countries to work during the pandemic; and in many cases, employees have taken it upon themselves to do so. Many employers are already aware of the risks that exist but want to support their employees as best they can. Some may consider this to be a temporary response to the outbreak, believing that 'normality' will resume in due course; others, however, will see this as the big push towards the 'new normal' – a change that was inevitable even without a global pandemic to set wind in its sail.

GlobalWorkplaceAnalytics.com revealed in a study in 2018 that 56% of employees in the US have jobs that could be accomplished remotely (see bit.ly/2CiiM2V). Many employers, such as Facebook, are aware of this shift, setting in motion plans for a 'Work from Anywhere' strategy in the new few years. Covid-19 has forced many employers and employees globally to be unwitting participants in this experiment.

Whatever happens in a post Covid-19 world, there are tax and social security risks in the here and now that employers need to balance with the flexibility they are able to offer their employees. These risks may change going forward as governments adapt to the ever increasing global mobility of the workforce.

Corporate presence and permanent establishments

Many businesses are aware that if they operate within another country, that country may seek to tax the profits deemed to arise there. This could typically arise either by having a corporate tax residence in that country or a permanent establishment.

Corporate residence

Under UK domestic law, a company is deemed to be tax resident if it is incorporated in the UK or if its place of central management and control is in the UK.

Due to the disruptions caused by Covid-19, there is a risk that the place of central management and control of a non-UK incorporated company could inadvertently shift to the UK; for example, if the UK directors are unable to travel outside of the UK for board and other strategic decision meetings. However, HMRC recently published guidance (INTM261010) stating that it does not consider a company to have become tax resident in the UK because a few board meetings have been held in the UK over a short period of time. Businesses should exercise a degree of caution in this area and detailed record keeping is crucial.

However, not every country takes this approach and the domestic law of each jurisdiction should be considered. This is particularly relevant where mobile workers have returned to their homes overseas and are making decisions on behalf of a UK company outside the UK. Relevant tax treaties should be reviewed to determine the ultimate place of corporate residence or whether an entity might be dual resident.

Permanent establishment

A taxable presence can also arise for an employer if it has a permanent establishment in another country. If a tax treaty exists between the two contracting states, then what defines a permanent establishment is typically enshrined within the tax treaty.

Under the OECD Model tax treaty (which forms the basis for many treaties – but note changes under the BEPS Multilateral Convention), a permanent establishment can arise where:

- an entity has a fixed place of business in another contracting state; or
- a person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts, that are routinely concluded without material modification.

The first leg of the permanent establishment test is particularly relevant, as employers could be said to be conducting operations of their business at a ‘fixed place of business’ in an overseas country if an employee is working from their home there.

Under the OECD model, and as explained by the OECD in a recent statement (see bit.ly/3fkAqR7), there needs to be a ‘degree of permanence’ to the arrangement for it to be ‘fixed’. The fixed place in question, such as a home office, must also be at the disposal of the enterprise and its business must be carried on partly or wholly from that fixed place. It is the OECD’s view that a remote location should be deemed to be temporary to the extent that it does ‘not become the new norm over time’ and therefore may lack the degree of permanence necessary to create a permanent establishment.

With respect to the second leg of the permanent establishment test regarding agencies, HMRC guidance and the OECD statement referred to above emphasise that the agent’s role relating to the conclusion of contracts must be habitual. Therefore, as reflected in the OECD statement, a permanent establishment should not arise where activities are undertaken in a home for a temporary or transitory period due to government directives impacting on their normal workplace.

Interpretation of the wording of the treaty and OECD guidance can vary for each contracting state. As governments have reacted in different ways to the permanent establishment rules following the global pandemic, it is difficult to give a general view. HMRC considers that the current UK approach is sufficiently flexible to deal with permanent establishment risks arising as a result of Covid-19, and that the approach taken by other tax authorities should be considered separately. It should also be remembered that authorities are increasingly linking up their systems between corporate and employer taxes.

Employer withholding taxes

Unless employees are intending to spend at least until the end of the UK tax year of departure and the significant majority of the following tax year working full time overseas before returning to the UK, they are more than likely to remain UK tax resident under the statutory residence test.

At a personal tax level, if a double tax treaty exists then this may prevent income tax arising for the employee if the conditions of Article 15 of the OECD model tax treaty apply. This states briefly that:

- the employee is either non-resident under the host country's laws or under the treaty residency tie breaker rules;
- the employee is not present in the host country for an aggregated period of 183 days or more;
- remuneration is paid by the UK employer; and
- the costs of the remuneration are not borne by a permanent establishment which the employer has in the host country.

However, each country interprets the double tax treaty in its own way, and this exemption does not necessarily apply to an employer's obligation to withhold income tax in that country. A number of countries have put relaxations in place for foreign employers as a response to Covid-19 and travel restrictions.

However, these typically only cover situations where travel restrictions make travel overseas impossible or impractical; therefore, they may not apply, leading to further administration and costs for the employer.

Where withholding taxes are required in the host country, the employer will need to consider how this can be practically applied. If the income is exempt under treaty, then how will the employer or employee recover the tax that has been withheld? It is likely that the employee will need to file a tax return in order to claim a treaty exemption and reclaim any withholding tax.

If the exemption does not apply but a foreign tax credit will instead be given in the UK, how will this be operated in order to avoid cashflow issues for the employee?

An Appendix 5 agreement could be entered into with HMRC so that monthly foreign withholding tax is offset against PAYE. End of year statements are required along with confirmation that the foreign tax has actually been paid. If the withholding does not reflect the actual liability, then the employer or employee will need to inform HMRC, which will then amend the UK liability for the specific tax year.

Alternatively, the employer could enter into a loan arrangement with the employee so that the employer settles the foreign withholding upfront on the agreement that any refund generated by the subsequent foreign tax credit is paid back to the employer. Careful consideration should be given to any contractual documents to mitigate the risk of HMRC deeming the loan to be income. UK tax implications will likely arise if either: the loan amount exceeds £10,000 during the tax year; and/or the employee is unable to repay the full amount of the loan. Consideration should also be given to the overseas tax implications of this loan.

Social security

Further to withholding taxes, an obligation to register, report and pay social security contributions may also arise in the host country. This could be alongside a requirement to continue operating National Insurance in the UK on the same remuneration.

Article 12 of EC Reg 883/2004 (posting of employees to other member states for less than 24 months) will typically apply so that social security continues to arise solely in the UK if:

- the posting is within the European Economic Area (the EU, Iceland, Liechtenstein and Norway) or Switzerland; and
- employees intend to return to the UK before the Brexit transition date of 31 December 2020.

However, for this to apply the employer would need to carry out business activities in the member state; and it would need to have specifically sent the employee to that member state specifically to carry out such activities. As such, it is unlikely to apply in the case of employees freely choosing to work overseas.

Some employers may be framing these ‘temporary arrangements’ as overseas secondments. This allows for easy application to HMRC for an A1 Portable Document, as an application under Article 12 allows the employer to make the application on the employee’s behalf without their input. Strictly speaking, this is unlikely to satisfy the conditions outlined above. However, some employers regard it as a low risk approach where workers are overseas for a short period of time.

In a recent survey by ECA International titled ‘Global Mobility and Covid-19’, it was found that 60% of companies have allowed assignments to begin remotely if the assignee has not been able to travel to the host location. As a result of Covid-19 and the ability to work remotely, many are now remaining in their home country to work for their new UK employer, having never stepped foot in the UK. This makes it very difficult to argue that under EC 883/2004 social security contributions should arise solely in the UK; it is expected that for Article 12 to apply, the individual should be attached to the social security system of that member state for at least one month immediately prior to their posting.

Article 13 (Pursuit of activities in two or more member states) would then need to be examined in detail. This can be relatively complex. However, this would likely give an answer whereby social security will continue to arise solely in the UK, assuming that: the UK remains their country of habitual residence; and during the previous and following 12 months they perform at least 25% of their working time in the UK. In exceptional cases, Article 16 may allow two or more states to come to an agreement to disapply Articles 11 to 15. The European Commission has confirmed that where movement between member states arises as a response to combating the Covid-19 outbreak, then member states should seek to invoke Article 16 so that the individuals do not suffer as a result of their vital work (see bit.ly/3jafzSG).

In any case, it would be prudent for employers to obtain an A1 Portable Document in order to certify that social security will continue to arise only in the UK and to avoid the costs and administrative burden of operating social security in another country. If the UK will not provide such documentation, then further advice should be sought to determine obligations in the host country.

Similarly, if the employees have returned to a country outside of the EEA that has a reciprocal agreement for social security contributions (see bit.ly/3gDWeZ9), then once again it would be prudent to consider the facts of the agreement and apply to HMRC for a Certificate of Coverage if necessary.

If the host country is neither within the EEA nor is a country with a reciprocal agreement with the UK for social security contributions, then social security is likely to continue to be operated in the UK with no explicit protection for social security (or often Provident Fund in Asia) also arising in the host country.

Other implications

- Are there minimum wage obligations to consider in the host country?

- Are there any obligations to pay into a pension scheme operated within the host country?
- Are there any company, employment or such legal implications that may need to be considered in the host country?
- Is the individual legally allowed to work in the overseas territory on behalf of their employer?

Overall, this is something employers should be thinking about – either because they need to mitigate their tax risk during the pandemic, or they are open to the potential benefits of a non-centralised workforce in a post Covid-19 world.

In a recent survey by AIRINC (see bit.ly/3ix8uLH), 182 leading multinational employers were asked if they had a policy in place for employees who live and work remotely in another country. Despite their large international presence and experience, only 6% had some form of policy in place to address this, with 40% considering implementing a policy in the future. Being deeper into the Covid-19 outbreak may have shifted their focus now that eyes have been opened to the benefits and risks.

What should employers do?

- Consider where their workforce are currently operating and whether policies should be put in place to limit what and for how long work can be done overseas in order to manage risk.
- Speak to their tax advisors to discuss the tax risks of employees working remotely overseas.
- Seek further advice and support in the UK and host country where necessary.

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