

Institution **CIOT - CTA**
Course **APS Human Capital Taxes**

Event **NA**

Exam Mode **OPEN LAPTOP**

Answer-to-Question-_1_

Draft Report

**Report on the proposed employment arrangements of Tony Farrell
and the implications of winning a bid for a UK project.**

Report by Taxadv UK Ltd for Havarn CA Ltd on 1 May 2023

A) Introduction

This report sets out the UK income tax, national insurance (NIC) implications, and compliance obligations of the proposed employment arrangements of Tony Farrell and the potential 2025 project in the UK. This report considers the following key areas:

- The UK Income Tax, NIC implications and compliance obligations of employing Tony locally by Milvarn UK Ltd and seconded to Havarn CA Ltd;
- The UK Income Tax, NIC implications and compliance obligations of employing Tony directly with Havarn CA Ltd;
- The potential UK tax and compliance obligations regarding the 2025 UK project and;
- Other tax and law implications.

This report has been drafted in accordance with the UK law in force at 1 May 2023. The contents of this report is based on the following information:

- the email between Taxadv UK Ltd and Taxadv Canada Ltd dated 26 April 2023;
- the report prepared by Taxadv Canada Ltd dated 20 April 2023;
- emails between the HR Director and Head of engineering at Havarn CA Ltd dated 20 April 2023 and 21 April 2023 and;
- the meeting notes regarding the proposed UK project from 17

April 2023

This report is for Havarn CA Ltd only and no other individual or entity can rely on the contents of this report.

B) Executive Summary

1. Tony will be UK tax resident under the sufficient ties test, in accordance with the statutory residence test.
2. Double tax relief will be credited where tax has been paid in Canada or the USA.
3. There is a risk of creating a permanent establishment (PE) where work is performed in the UK for a UK business purpose, and therefore corporation tax may be due on profits generated from the UK business performed.
4. In addition to the above, a VAT liability may arise on the supply and servicing of machinery in the UK. VAT registration should be made in anticipation of the 2025 UK project.
5. It is recommended that Tony is to be employed directly by Havarn CA Ltd. PAYE would not have to be operated by Havarn CA Ltd where a PE has not been established in the UK. Tony would have to account for the UK income tax via his self assessment return. Tony would also not be in the UK social security system. However, where a PE is established, a PAYE scheme would have to be set up.
6. It is recommended that a tax equalised arrangement is in place so that Tony does not have the impact of his earnings being reduced as a result of taking this employment. An EP Appendix agreement should be made with HMRC to prevent potential payroll compliance issues.

7. Tony's potential remuneration package should be reviewed in order to be as tax efficient as possible. In addition to this, a beneficial loan should be provided to Tony to reduce the cash flow implications of having to wait for foreign tax credit to pay his tax liability.

8. Havarn CA Ltd should be aware that any additional employment of a UK national with regards to the 2025 UK project should be included on the PAYE scheme with Tony and the same provisions and compliance obligations will apply.

C) UK Income Tax position of Tony Farrell

The UK income tax position for Tony Farrell depends on his UK tax residency position. The UK tax position is determined using the statutory residency tests.

Under the statutory residency tests, Tony Farrell will be a UK tax resident in accordance with the sufficient ties test. This is because he will likely spend more than 45 days in the UK given his work commitments in the UK. As Tony has four ties to the UK, being the accommodation tie, family tie, work tie and UK presence tie, he will have exceeded the number of days permissible to be a UK tax resident.

Tony will therefore be liable to UK income tax on worldwide earnings and gains.

As mentioned in the report regarding Canadian tax implications dated 20 April 2023, despite the double tax agreement between the UK and Canada, as Tony has a permanent home in the UK, he will not be tax resident in Canada, and instead will be UK tax resident. Relief will be given to Tony by reason of double tax relief for the tax paid in Canada and the USA on his employment

income.

D) Permanent Establishment Risks

A permanent establishment (PE) is created when a place of business is carried out in the UK. This can be either by having an office within the UK in which UK business is carried out, or by carrying out business within the UK. Tony having his home registered as his contracted workplace could give rise to a place of business being opened within the UK.

Where a PE is created, Havarn CA Ltd will need to register as a UK company with companies house. In addition to this corporation tax will be due on the UK income generated by reason of the UK work carried out. The current UK corporation tax rate is 19%. Therefore a possible double tax on the same profits may be liable as corporation tax in Canada will also be due on the same profits. Where income is double taxed, credit will be given by the UK, however the difference in the tax rates could mean that an additional corporation tax liability is due. Corporation tax is due within 9 months and one day following the end of the accounting period. Where corporation tax returns are not filed by the relevant deadline, penalties and interest can be levied by HMRC.

To minimise an unwanted PE risk, it is recommended that Havarn CA Ltd restrict the amount of working time that Tony works in the UK on preparing servicing reports.

However, due to the potential UK project taking place in 2025, a UK place of business would need to be setup in order to engage with the customer, therefore a PE risk may not be such an issue for Havarn CA Ltd.

E) VAT Implications

In addition to the possible PE risks, Havarn CA Ltd will also have to possibly register for VAT. UK VAT is normally determined by reference to where the supply of the contract sits. For example, if a piece of machinery is sent by Havarn CA Ltd to the UK with no installation or servicing elements to the contract, no UK VAT will be due on the sale.

However, where the contract includes installation or servicing within the UK, UK VAT is due. This means that Havarn CA Ltd should register for VAT in the UK and charge VAT once the 2025 project takes place.

F) PAYE Implications of the employment of Tony Farrell

1a) Employed locally by Milvarn Ltd and seconded to Havarn CA Ltd

If Milvarn Ltd was to employ Tony instead of Havarn CA Ltd, Tony would need to be included on the Milvarn Ltd UK payroll with PAYE operated. PAYE would also have to be operated on earnings attributable to overseas workdays. Tony would have to submit a self assessment tax return in order to claim tax relief for the taxed income in Canada and US. Tony would be a new starter for Milvarn Ltd, and therefore the appropriate starter checklist should be completed.

Milvarn Ltd would be recommended to seek an appendix 5 agreement with HMRC. This would allow the foreign tax credit from Canada and the US to be taken into account when operating PAYE on Tony's earnings resulting in less cash flow issues for both Tony and Milvarn Ltd.

1b) NIC Implications

Tony would be employed by a UK employer, and therefore, UK NIC

would be due.

Class 1 NIC would be liable on all earnings both by Milvarn Ltd and Tony himself.

Class 1A NIC would be liable on all benefits in kind provided by Milvarn Ltd which would be an additional cost.

It is not recommended that his approach is taken as it does not align with Havarn CA Ltd's business objectives.

2a) Employed by Havarn CA Ltd

If no PE is established in the UK, and Havarn CA Ltd do not have any economic presence in the UK, then the company has no obligation to register for PAYE. PAYE would not need to be operated by Milvarn Ltd, unless Tony was to carry out any work for Milvarn Ltd, creating a link between the two companies.

However where a PE is established, a UK PAYE obligation for Havarn CA Ltd arises, and a PAYE scheme should be set up accordingly. PAYE needs to be withheld at Tony's marginal rate of tax and in accordance with his tax code which will be provided by HMRC. Payments made to Tony must be reported on the full payments submission (FPS) on or before the date of payment, and PAYE is due to be paid to HMRC within 14 days following the end of the tax month in which the payment has been made. Therefore this date is usually by the 19th of the month or 22nd if paid electronically.

Taxadv UK Ltd can support with setting up the PAYE scheme if needed.

It is noted from the email between the HR director and the head of engineering, dated 20 April 2023, that Tony does not want to

be worse off by reason of moving to Canada. Therefore it is recommended that Havarn CA Ltd look to tax equalise Tony.

Tax equalisation allows for the company to pay the UK tax due on Tony's earnings. A hypo tax is usually deducted from the employees earnings which relates to the tax rate in Canada. It should be noted however that an additional tax liability would arise as a result from tax equalisation and therefore the tax liability should be grossed up by Tony's marginal rate of tax, which can lead to a potentially expensive arrangement.

Should tax equalisation be a chosen method of EP Appendix 6 agreement should be sought with HMRC, which allows for the PAYE tax to be estimated and paid in equal installments during this year. This reduces the risk of potential payrolling compliance failures. It should be noted that Havarn CA Ltd would be responsible for ensuring that Tony files his UK tax return by the statutory deadline of 31 January following the end of the tax year. Again, Taxadv UK Ltd would be happy to support.

It is recommended that this approach is taken, as it means that Tony is no worse off as a result of the move to Canada and also it aligns with the business interests to employ Tony directly with Havarn CA Ltd. The risk of a PE is a non starter due to one being created if the UK project is undertaken.

2b) National Insurance Implications (NIC)

UK NIC is liable from day one of earnings in the UK. However as there is a reciprocal agreement between Canada and the UK, no UK NIC will be liable on his earnings for the first five years, as long as he remains employed by Havarn CA Ltd in Canada.

3) Conclusion

It is recommended that the approach to employ Tony by Havarn CA

Ltd is taken. This is because, due to it not been in the interests of either Tony or Havarn CA Ltd to limit his duties in the UK to prevent a PE. A PE would be established once the project in 2025 has commenced due to the supply of machinery with a UK customer. This means that the obligations as set out in 2A would arise at that point, delaying the inevitable compliance requirements. In addition to this, it is in the interests of Havarn CA Ltd to employ Tony themselves rather than Milvarn Ltd. This would achieve that goal.

G) Employment Law Matters

Being employed in the UK presents potential employment law matters. These include the requirement for Tony to be included in the UK pension scheme under auto enrollment requirements. There are possible penalties and fines where compliance is not maintained.

In addition to this Tony must receive all the statutory requirements such as statutory sick pay, holiday pay, and potential paternity pay.

Minimum holiday allowance in the UK is 20 days annual leave.

None of these issues will arise if Tony is employed by Havarn CA Ltd.

H) Income Tax requirements for Tony

Tony will be required to submit a self assessment tax return regardless of which employment option is chosen. He will be required to report all his earnings both from UK workdays and overseas workdays. Where Tony is not included within a UK PAYE scheme by Havarn CA Ltd, Tony would be recommended to set up a direct payments scheme with HMRC to account for his earnings from Havarn CA Ltd and limit the amount of tax payable on the 31

January. Tony will have to account from earnings starting from day one of this employment.

As mentioned, the deadline for submitting the tax return and paying any applicable taxes, is 31 January following the end of the tax year. Penalties and interest may apply where submission is not made in time and late payments of the tax.

It is recommended that Havarn CA Ltd support Tony with his self assessment return, as Tony may not feel comfortable doing this himself, however it is important to note that any payments made in relation to supporting Tony with this will be a taxable benefit in kind and must be reported on his form P11D.

I) Cash Flow issues

It is also recommended that where Tony is relying on foreign tax refund in order to pay his UK tax via self assessment, that a beneficial loan is provided to Tony in order to prevent potential cash flow issues. A beneficial loan can be provided up to £10,000 tax free, however where this is exceeded the full amount becomes taxable. In this event, the loan should be reported on his form P11D and Class 1A NIC would be due (subject to UK NIC provisions applying in accordance with part F of this report).

J) Structure of remuneration package

The structure of the remuneration package should be considered in order to prevent unnecessary tax liabilities in the UK or to provide a loss of benefits or earnings to Tony.

1 - Private medical insurance

Private medical insurance is a taxable benefit in kind for UK tax purposes. However, where the individual is to contract with the policy provider directly, rather than the employer contract

directly with the policy provider, it will be treated as earnings rather than a benefit in kind. This means that the £3,000 premium would also be subject to PAYE and taxed at his marginal rate, and Class 1 NIC would also be due on the benefit.

It is recommended that if possible, Havarn CA Ltd contract with a UK policy provider directly to mitigate the benefit being treated as earnings. This would prevent an additional cost to Tony regarding Class 1 NIC, as Class 1A NIC would be payable by the employer instead.

2 - Pension Contributions

Pension contributions made into a UK registered pension scheme are a tax free contribution. This means that neither Tony or Havarn CA Ltd would pay tax and NIC on the benefit. However, where it is paid as cash, this would not qualify for the favourable treatment. Therefore it is recommended that pension contributions are made into Tony's occupational pension scheme so that both Tony and Havarn CA Ltd receive optimal tax relief.

3 - Flights to and from Canada / USA

This would be exempt from any UK tax provisions. The flight inbound and outbound for work related trips does not give rise to a taxable benefit in kind.

4 - Week home visit

As mentioned above flights inbound or outbound of the UK do not give rise to a taxable benefit in kind. However, the approach to deduct two holiday days per visit could cause Tony to feel discriminated against. If no holidays are deducted from other employees, Tony could feel that he is been treated differently due to his circumstances of being a UK resident, and would have his annual leave significantly reduced as a result. Care should

be taken to propose the best solution here, as to not upset Tony but also not cause any disruption to the business operations.

5 - Accommodation

Employer provided accommodation provided where the workplace can be deemed 'temporary' does not give rise to taxable benefit in kind. To be deemed temporary, the workplace should not be attended for more than 24 months or if exceeded, more than 40% of working time. It is unlikely that this would trigger a tax liability as Tony will only spend three months at each client.

6 - Per Diem Rates

Per diem rates are taxable as earnings within the UK and therefore subject to UK income tax and Class 1 NIC through PAYE, unless the rates have been pre agreed with HMRC. It is recommended that agreement is reached with HMRC prior to providing the per diem allowance, or the pre approved subsistence rates of £20 per day is provided to Tony, which can be done so tax and NIC free.

Any benefits in kind to be reported on forms P11D should be done so by 6 July following the end of the tax year in which the benefits are reported, and where Class 1A NIC is liable, this should be paid to HMRC by 19 July following the end of the tax year or 22 July where paid electronically.

K) Conclusion regarding the potential 2025 UK project

As mentioned above, the business operations of Havarn CA Ltd in the UK for UK business would give rise a PE risk. In addition to this, as Havarn CA Ltd would be supplying and servicing the machinery within the UK, VAT registration would need to be done. There is a potential risk of penalties or fines if this is not done.

The employment of a UK based engineer would give rise to the same income tax, NIC provisions, and compliance obligations as Tony.

Transfer pricing should also be considered. Where costs are recharged between two companies under the same group, transfer pricing must be considered to ensure that the amounts have to correct mark up, in line with the law in that state. Penalties can be levied where the law has not been complied with.

It is recommended an inter-company agreement is drawn up between the two companies to set up the provisions of the costs that are recharged and the application of any transfer pricing complications. Advice should be sought from law professionals regarding the inter-company agreement.

L) Next Steps

Once Havarn CA Ltd has had time to review the contents of this report, it is recommended that a meeting is arranged between Taxadv UK Ltd and Havarn CA Ltd to discuss any questions which may have arisen upon the review of this report and to discuss the next steps in more detail.

Taxadv
May 2023