Chartered Institute of Taxation
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# The Chartered Tax Adviser Examination

May 2020

## Application and Professional Skills

### Human Capital Taxes

**SUGGESTED SOLUTION**

**Draft report to Bob Robins HR Director of Navy AFT Ltd relating to the UK tax aspects of the offer of employment to Jack Smith**

Introduction

This report has been prepared to provide you with advice relating to the potential employment of Jack Smith, specifically:

- the PAYE obligations for Navy AFT Ltd
- whether a direct employment with Navy AFT Ltd or a secondment would be preferable
- whether the bonus payable in January 2021, should/could be paid in Switzerland or UK
- any other considerations

Our advice is based on the information provided by Bob Robins in his meeting with Vanessa Brown and his email of 3 May 2020.

Executive Summary

As Jack will continue to work in both Switzerland and the UK, it would be preferable for him to be seconded to Navy AFT Ltd by Ein SA and then to employ him in the UK from July 2021. This results in a lower social security cost to AFT Ltd as Jack's salary and bonus would be liable to Swiss rates instead of UK, resulting in a saving of £33,998.

This arrangement would also allow for the potential that flights and accommodation in the UK could be provided tax-free saving a possible £14,100 in tax for Jack and £2,271 in social security for Navy AFT Ltd.

Recommendations

1. Employment v Secondment – we recommend that Jack remains employed by Ein SA and is seconded to Navy AFT Ltd until he relocates to the UK with his family.
2. UK accommodation – if Jack remains employed by Ein SA until July 2021, there are no adverse tax consequences of renting a home for Jack as opposed to paying for his hotel bills. We recommend that Navy AFT Ltd comply with Jack's request if the cost of providing an apartment is cheaper. (The position is different if Navy AFT Ltd employ Jack directly from September 2020.).
3. A1 Portable Document– we recommend that an A1 Portable Document is requested from the Swiss social security authorities to maintain Jack and Ein SA in the Swiss social security system until July 2021.
4. S. 690 direction – we recommend that a direction is sought from HMRC that PAYE need only be accounted for in respect of UK workdays
5. UK Payroll – Navy AFT Ltd should set up a shadow UK payroll to deal with the UK tax payable
6. Bonus – we recommend that the bonus is paid by Ein SA in January 2021 with the UK taxable portion processed through the UK shadow payroll.
7. Loan – we recommend a formal loan arrangement is set-up for the UK tax payable on Jack's workdays to avoid the risk of it being treated as additional pay and we suggest you also seek legal advice on this
8. Permanent Establishment – we recommend a further review of the permanent establishment position for Ein SA in the UK
9. Secondment agreement – we recommend that a secondment agreement is drawn-up for Jack's assignment to the UK
10. Inter-company agreement – we recommend an agreement should be drawn-up between Navy AFT Ltd and Ein SA
11. Personal Tax Assistance – you may wish to provide support to Jack for his UK and Swiss personal tax returns

Our analysis

*2019/20 UK Residence Position and liability to UK tax*

We note that Jack has spent 99 days in the UK in 2019/20. Jack has not met any of the automatic UK residence tests and is likely not to have sufficient ties to the UK to make him UK tax resident. Therefore, based on the information provided Jack is UK non-resident for the 2019/20 tax year.

As a non-resident, we consider whether Jack's UK workdays were liable to UK income tax. His days in the UK are not merely incidental to his work in Switzerland as they are a significant part of the role and therefore under UK domestic law, he will be liable to tax on the pay that relates to his UK workdays. However, Jack can rely on the UK/Swiss double tax treaty to exempt him from UK tax on his UK workdays as he is likely to be also resident in Switzerland under the treaty and:

(a) he is present in the UK for less than 183 in the tax year;
(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the UK; and
(c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the UK.

Although Jack often worked informally at your offices, we understand that there has been no agreement for him to provide services to Navy AFT Ltd and no payment to Ein SA. We have also assumed that Ein SA does not have a permanent establishment in the UK as it has no premises here and Jack does not negotiate or conclude contracts here on Ein SA's behalf. We also assume that Jack has not been working under Navy AFT Ltd's management and control.

In this case in addition to his ability to claim treaty exemption at an individual level, as Jack is not working 'for' Navy AFT Ltd you did not have an obligation to operate PAYE or report his presence on an STBV agreement.

*2020/21 UK Residence Position*

Below is our understanding of the UK workdays Jack for 2020/21:

| | **Option 1 Remain Employed by Ein SA** | **Option 2 Employed by Navy AFT Ltd from September 2020** |
|---|---|---|
| Days to 31 May 2020 | 17 | 17 |
| Estimated days per month 1 June to 31 August 2020 | 10 x 3 months = 30 | 10 x 3 months = 30 |
| Estimated days per month 1 September 2020 to 31 March 2021 | 10 x 7 months = 70 | 15 x 7 months = 105 |
| Estimated days 1 to 5 April 2021 | 10 x 5/30 = 2 | 15 x 5/30 = 3 |
| **Total Estimated days** | **119** | **155** |

Based on the estimated UK presence under option 1 we believe that Jack will continue to be UK non-resident if he remains employed by Ein SA as he will spend less than 120 days in the UK and will have two connecting factors (substantive UK employment and 90 days or more in either of the previous two years).

However, if Jack becomes employed by Navy AFT Ltd at September 2020, his day count would increase so we believe that it is likely that he would become UK resident for 2020/21.

However, as he will be resident in both the UK and Switzerland, for the purposes of interpreting the terms of the Double Tax Treaty he will be considered as a Swiss resident if he only has a home in Switzerland. Therefore, if he does rent a flat in the UK (and so has a home in two countries), we have to look at his centre of vital interests. Under Option 1, he has family in Switzerland and a Swiss employer, which are both strong Swiss factors and he is likely to be Swiss resident under the Treaty.

If he is employed by Navy Ltd from September 2020 (Option 2), this gives him a strong UK tie and there is a risk that we have to go on to look at habitual abode. Again, having a UK flat and the increased time spent in the UK under Option 2 could give him a habitual abode in the UK as much as he has one in Switzerland. The final test is nationality and this would definitely make him UK treaty resident (and subject to UK tax on his worldwide income and gains). It would therefore be advisable to not rent a flat pending moving his family to the UK if you decide to go with Option 2.

Comparison of Options

*Option 1 remaining employed by Ein SA and seconded to Navy AFT Ltd until 30 June 2021*

We would look to separate the 2020/21 tax year into two periods.

In the first period, up to the end of August 2020, the position is the same as 2019/20 and the treaty will provide exemption from UK tax.

In the second period, from 1 September 2020, Jack is seconded to the UK. His costs would be invoiced to Navy AFT Ltd under the secondment agreement so Navy AFT Ltd would become his economic employer and the treaty Article 15 2(b) would fail thereby precluding exemption.

In this case, Navy AFT Ltd would be required to set up a shadow payroll for Jack and account for PAYE from September 2020; a shadow payroll is a regular UK payroll for Jack to account for the UK tax without delivering pay to Jack in the UK. Technically, PAYE should be applied to all of Jack's earnings. However, as Jack is non-resident, a S690 direction should be sought from HMRC to restrict PAYE to the UK taxable element only.

As Jack would be responsible for his own tax, Jack will need to reimburse Navy AFT Ltd for the UK tax which needs to be paid to HMRC. One option could be through a net deduction from Jack through his Swiss payroll and the amount withheld included in the recharge between Ein SA and Navy AFT Ltd.

If a reduction in Swiss payroll taxes is not possible he will suffer a cashflow disadvantage until he is able to receive a repayment in Switzerland after claiming double tax relief for the income taxed in the UK. It is possible, however, that amount of refund which Jack receives in is lower than the UK taxes paid.

We understand that you would potentially pay Jack's UK tax through a loan; the loan would increase each month when Navy AFT Ltd meets the UK tax on Jack's behalf. A legal loan agreement is needed to avoid the payment of tax by Navy AFT Ltd being grossed-up and will include repayment of the loan to Navy AFT Ltd at an agreed time in the future. We suggest you seek legal advice on this. As the loan is likely to exceed £10,000, a UK beneficial loan interest charge would apply based on the difference between the amount of interest paid and the official rate of interest (currently 2.5%), which would need to be reported on a P11D.

We would recommend that you ensure he is aware of this and that model calculations are prepared to enable his to fully understand the financial impact. If you wished to assist Jack the balance of the loan could be written-off, however, the amount of the loan written-off would be liable to UK tax.

This PAYE requirement would be the same for the first three months of 2021/22 until July 2021 when Jack takes up the employment contract with Navy AFT Ltd and switches onto the regular UK payroll.

*Expenses*
Jack's main place of employment would remain in Switzerland as under the secondment agreement he would be temporarily working in the UK. Jack would be entitled to claim temporary workplace relief, meaning that his travel and hotel costs could be reimbursed tax-free, whilst he intends to remain here for less than 24 months. This would apply if Jack was merely seconded to the UK and a decision about offering Jack a permanent UK role is deferred until he relocates, as much could change between now and July 2021. The relief stops at the point arrangements for Jack's permanent employment with Navy AFT Ltd are agreed as this would indicate a fixed intention for the Navy AFT offices in the UK to become a permanent workplace. There is a risk HMRC may challenge this arrangement if they feel an intention to remain in the UK for longer than 24 months has occurred at an earlier date.

*Bonus*
Despite Jack's wishes, it is not possible to simply exclude this from UK tax. The part which relates to UK workdays from September 2020 to December 2020 will be taxable in the UK. Navy AFT Ltd will need to operate PAYE through the shadow payroll. Relief for the UK tax payable could be available through Swiss tax returns and again Navy AFT Ltd may wish to help Jack with any cashflow disadvantage by including this tax in his loan.

*National Insurance*
As both Jack's employer and his habitual residence are in Switzerland Swiss social security will be due throughout the secondment period and will be deducted by Ein SA as normal. An A1 Portable Document should be obtained from the Swiss authorities to confirm liability in Switzerland and exemption in the UK.

This is beneficial as before relocating to the UK, Jack and his family wish to enjoy local Swiss benefits. Additionally, the lower cost of employer social security means this would be cheaper for Navy AFT Ltd. As an employee seconded to the UK there is no requirement for Navy AFT Ltd to offer UK pension under auto-enrolment

Appendix 1 shows the comparison of UK NI/apprenticeship levy and Swiss social security which shows annual savings for Navy AFT Ltd of £31,108 by remaining in the Swiss social security regime. In the period between

September 2020 and June 2021 savings of £25,923 would be possible for Navy AFT Ltd. A further social security saving could be possible on Jack's bonus of £8,075.

Jack will be liable to Swiss tax as a resident until his family moves to the UK, however, relief under the treaty would be possible for the income charged to UK tax. This is a complex area and we suggest that we support Jack and work with his Swiss tax adviser.

*Option 2 Employed by Navy AFT Ltd from September 2020*

As described above, up to the end of August 2020, the treaty will provide exemption from UK tax.

In the second period, once the UK employment has commenced Navy AFT Ltd would operate a regular UK payroll to deliver and operate PAYE on his employment income. It may be possible to apply for a S690 ITEPA 2003 ruling to exclude UK tax on Jack's Swiss workdays, although consideration should be given to whether commercially the cost of applying for such a ruling does not outweigh the tax benefit.

As already mentioned above, Jack will be liable to Swiss tax as a resident until his family moves to the UK, however, relief under the treaty would be possible for the income charged to UK tax. This is a complex area and we suggest that we support Jack and work with his Swiss tax adviser.

*Expenses*
Jack's place of employment would change to the UK so the tax-free reimbursement of travel and subsistence would stop as Jack would no longer be temporarily based in the UK. Jack plans to return to Switzerland every weekend, however, if he has no business reason for the trips, the costs would be liable to UK tax and Class 1A NI. You may wish to limit the number of trips to Switzerland to reduce the cost and resulting tax liability. You may also wish to restrict the regular trips and instead fund trips around the time Jack and his family relocate to the UK to take advantage of the £8,000 exemption for reimbursement of relocation related travel and temporary accommodation.

Appendix 2 shows the comparison of costs by allowing the trips to continue in both scenarios; the calculation shows an estimated £30,000 would be spent on expenses in either scenario. If however, Jack was seconded to Navy AFT Ltd by Ein SA the costs would be £30,000 for Navy AFT Ltd and zero for Jack assuming the expenses remain tax and social security free in Switzerland and UK, whereas they would increase to £34,140 for Navy AFT Ltd and £14,100 for Jack if he was employed from September 2020.

*Bonus*
If the bonus was paid fully in the UK, PAYE would need to be operated by Navy AFT Ltd in full and this would result in the Swiss part also being liable to UK tax. As the bonus is guaranteed, perhaps an alternative would be for Ein SA to pay a proportion of the bonus to Jack through the Swiss payroll either in August 2020 before he joins the UK payroll or in January 2021; the UK part could then be paid in the UK subject to UK tax. This would have the advantage of the tax being paid in the correct location but the UK portion of the bonus would still be liable to UK NI; the employer's UK NI being higher than Swiss social security.

Another issue is that there is a risk that Jack becomes entitled to the bonus at the date his employment with Ein SA ends and so the tax point could arise then even though the bonus is not paid until January 2021. Whilst an alternative could be to make the bonus conditional on certain performance conditions being met or Jack remaining employed by Navy AFT Ltd until the bonus is paid, this adds an additional layer of complexity to the arrangement which is unlikely to be welcomed. Our recommendation to go with option 1 means these difficulties are avoided but it remains important that the documentation around the loan is carefully considered to ensure that the tax point and the payment date are aligned.

*National Insurance*
UK NI would be payable from September 2020 as Jack would have a UK employer. UK pension would have to start from this point too.

However, as Jack's habitual residence remains in Switzerland (until July 2021) and he will be partly working in Switzerland the proportion of his work there should be carefully monitored. If he works 25% or more of his time in Switzerland Swiss social security would be due instead of UK.

While this would meet Jacks' request, and would mean lower social security costs for Navy AFT Ltd, these should be balanced against the additional administrative burden as Navy AFT would be obliged to set-up a mechanism to pay social security in Switzerland which will incur additional professional fees.

<u>Conclusion</u>

Based on the comparison above, we would recommend that Option 1 provides a better outcome with Jack being seconded to the UK from Ein SA because this results in savings social security savings on salary and bonus and gives the potential for tax savings on travel expenses. It also ensures that Jack remains in the Swiss social security system without additional administration for Navy AFT Ltd and can have a rented apartment instead of hotels without adverse tax consequences.

An application should be made for an A1 Portable Document from the Swiss authorities to exempt Navy AFT Ltd and Jack from UK NIC (including employer's Class 1A NI on benefits in kind).

Careful and regular tracking of Jack's UK workdays would be important to ensure that accurate information is available as Jack will be also be required to file a UK tax return reporting the UK and overseas workdays in each period.

<u>Other Considerations</u>

*<u>Permanent Establishment Risk</u>*

An additional point relevant to Ein SA is the risk of creating a permanent establishment (PE) in the UK, giving rise to a UK corporation tax liability for Ein SA.

A PE will be created if Ein SA has a place of business in the UK or if its employees carry out certain activities in the UK such as negotiating or concluding contracts on Ein SA's behalf. On the information provided, we do not think that Ein SA has a permanent establishment in the UK to date but, during the secondment, especially after the purchase of Ein SA, Jack's time in the UK will increase and care should be taken to define Jack's role to ensure that his UK activities do not cause a problem. It is recommended that a review is carried out to understand more about the risks of a PE for Ein SA and the results are included in the forthcoming purchase discussions. It is possible that additional warranties and indemnities may be required in the purchase agreement between the two entities.

Conversely, at the point Jack becomes an employee of Navy AFT Ltd, we would also recommend reviewing Jack's duties in Switzerland to determine whether a PE in Switzerland is created for Navy AFT Ltd.

*<u>Secondment Agreement</u>*

Under a secondment arrangement we would also suggest a formal agreement is drawn-up so that all parties are clear on how much, how and where Jack will be paid plus details the tax and social security impact of his secondment. The letter should be an addendum to his Swiss employment contract and should state Jack's regular place of work as Zurich and seconded to the UK for a period up to July 2021 as this will help with the expenses remaining tax-free under a secondment arrangement.

Jack may need support to file his UK and Swiss personal tax returns whilst seconded to the UK so if Navy AFT Ltd or Ein SA would like to pay for this for him, the cost of the fees would be a taxable benefit in kind for Jack. If support is provided, we would be happy to help on the UK side or discuss directly with Jack a personal engagement. We would need to ensure that an engagement letter is in place to correctly reflected the services to be provided to Jack. The secondment letter should also detail whether tax advice will be provided to Jack in the UK or Switzerland.

*<u>Inter-Company Agreement</u>*

An inter-company agreement should also be established between Ein SA and Navy AFT Ltd to ensure the terms of the secondment are clear so that disputes about the amounts to be paid by Navy AFT Ltd are avoided. It also helps lower the risk of Jack creating a PE for Ein SA. Once Ein SA have become a fully owned subsidiary of Navy AFT Ltd it will be important to ensure the arrangements are reviewed for transfer pricing purposes. If you would like any support on drafting these agreements or with the review, please let us know.

Appendix 1 – Comparison of Social Security

| | UK NI £ | Swiss Social Security (@ 6.225%) £ | Difference £ | Total |
|---|---|---|---|---|
| ***Salary £400,000*** | | | | |
| Using 2019/20 rates: | | | | |
| **Employee** | | | | |
| £8,632 @ 0% | - | | | |
| £41,368 @ 12% | 4,964.16 | | | |
| £350,000 @ 2% | 7,000.00 | | | |
| | 11,964.16 | 24,900.00 | (12,935.84) | |
| **Employer** | | | | |
| £8,632 @ 0% | - | | | |
| £391,368 @ 13.8% | 54,008.78 | | | |
| £400,000 @ 0.5% | 2,000.00 | | | |
| | 56,008.78 | 24,900.00 | 31,108.78 | |
| **Annual employer savings** | | | | £31,108.78 |
| **Employer Savings in 10 months September 2020 to June 2021** | | | | £25,923.98 |
| ***Bonus £100,000*** | | | | |
| Using 2019/20 rates: | | | | |
| **Employee** | | | | |
| £100,000 @ 2% | 2,000.00 | 6,225.00 | (4,225.00) | |
| **Employer** | | | | |
| £100,000 @ 13.8% | 13,800.00 | | | |
| £100,000 @ 0.5% | 500.00 | | | |
| | 14,300.00 | 6,225.00 | 8,075.00 | |
| **Employer savings on bonus in full** | | | £ 8,075.00 | £ 8,075.00 |
| **Total Employer Savings** | | | | **£33,998.98** |

Appendix 2 – Comparison of Travel Expenses

| | UK Employee Navy AFT Ltd | Secondment |
|---|---|---|
| September 2020 to June 2021 | | |
| 10 months @ £3,000 | 30,000 | 30,000 |
| | | |
| Employer NI @ 13.8% | 4,140 | 0 |
| **Total Employer Costs** | **£ 34,140** | **£ 30,000** |
| | | |
| Tax @ 45% | 13,500 | 0 |
| NI @ 2% | 600 | 0 |
| **Total Employee Costs** | **£ 14,100** | **£ 0** |