

The Chartered Institute of Taxation

Application and Professional Skills

Human Capital Taxes

May 2023

Suggested solution

Draft report for Havarn CA Ltd (to be provided to TaxAdv Canada Ltd for onward transmission to Havarn CA Ltd).

Introduction

This report has been prepared to provide advice relating to Havarn CA Ltd, who are recruiting a UK based employee to work in Canada and the USA. In particular, the report comments on the merits of:

Option 1: employment by Havarn CA Ltd

Option 2: employment by Milvarn UK Ltd

The report also comments on the impact in each scenario if undertaking the proposed UK-based project.

This report will include:

- the PAYE & National Insurance obligations for each party;
- the company reporting obligations;
- the Value Added Tax considerations; and
- the employment law and compensation package considerations.

This report also makes suggestions on how to vary Option 1 to better achieve Havarn CA Ltd's aims.

Our advice is based on the information provided by TaxAdv Canada Ltd and Havarn CA Ltd and is valid by reference to the tax legislation in place on today's date. If any of the information has subsequently changed or our understanding of the position is incorrect, please let us know as this may affect the tax advice provided. The report is intended for Havarn CA Ltd's use only.

Executive Summary

We recommend that Mr Farrell is employed by Havarn CA Ltd. There is no particular advantage to him being employed by Milvarn UK Ltd. If the UK project bid is not successful, Havarn CA Ltd will have no ongoing UK payroll or corporate obligations. In addition, there is no requirement for Havarn CA Ltd to register for VAT if the UK project does not go ahead.

To enable the bid process for the UK installation project, Havarn CA Ltd can use Milvarn UK Ltd to front the project. However, employing Mr Farrell by Milvarn UK Ltd, would not solve all the potential issues. Since other Havarn CA Ltd staff will be in the UK, the same corporate risks arise. To avoid these, Havarn CA Ltd must second these staff and they could as easily second Mr Farrell too. Seconding all staff would limit the corporate and VAT registration requirements and associated costs for Havarn CA Ltd, as Milvarn UK Ltd would manage the majority of these.

Nevertheless, if Havarn CA Ltd would prefer to bid for the UK project without involving Milvarn UK Ltd at all, then Havarn CA Ltd could create and register a permanent establishment (PE) in the UK as well as register for payroll and VAT. If the UK project goes ahead without Milvarn UK Ltd's involvement, Havarn CA Ltd will automatically create a PE in any case. Whilst this would increase their compliance burden and cost, it would enable them to retain the 10-year servicing contract. Havarn CA Ltd would have to consider the probability of the bid being successful and if the profit from the servicing contract justifies these additional costs.

Finally, the contract offered to Mr Farrell must comply with UK employment law as well as Canadian law. It is recommended, therefore, that this is reviewed by a UK employment lawyer. In addition, the remuneration package can be restructured such that it is more efficient for UK tax purposes, since the UK is where Mr Farrell will pay the majority of his taxes.

Our Analysis

General tax position for Tony Farrell

Before we consider the options in detail, we must consider Tony Farrell's residence position and his liability to tax.

He is currently UK tax resident and we presume UK domiciled. He is a UK national, living in the UK and he will return regularly to the UK. He will not satisfy any of the automatic overseas tests. He will maintain his home in the UK while working abroad and will only stay in hotels or temporary accommodation while working abroad. He therefore meets the only home test under the automatic UK tests and he will therefore remain a UK tax resident.

This means he will be liable to UK tax on his worldwide income and gains. TaxAdv Canada Ltd has indicated that he would be liable to Canadian tax when working in Canada. Mr Farrell will be able to claim a foreign tax credit for the Canadian taxes paid to the extent these do not exceed the UK tax due on the income for working abroad.

The same would be true for any other foreign taxes paid in the US. However, there would be potential for exemption under the employment income article of the double tax treaty between the UK and the USA as, presumably, he would not be employed by a local employer in those cases.

Option 1: employment by Havarn CA Ltd

Liability to UK withholding tax ("PAYE") and National Insurance ("NI")

The UK system of withholding income tax from an employee's salary is known as PAYE. Although Mr Farrell would be liable to UK income tax on his salary, the employer is only liable to operate a UK payroll and deduct PAYE if they have a presence for PAYE purposes. If the Canadian company sets up a UK office or creates a permanent establishment (PE), then it will automatically create a PAYE presence. However, the definition of a PAYE presence is broader than this.

Provided Havarn CA Ltd do not use Mr Farrell's home address as a contact address for the company and they have no right to use his home as their business premises, they will not have a PAYE presence. We would advise that the company does not reimburse Mr Farrell for use of his home, e.g., contribute to his mortgage or rent, or that Mr Farrell does not invite customers to correspond with him at his home address.

The UK social security system is known as National Insurance or NI. Ordinarily, both the employee and the employer are required to contribute. However, similar to PAYE above, if Havarn CA Ltd does not have a UK presence, then employer's contributions are not due and Havarn CA Ltd is not obliged to operate a payroll. Mr Farrell would have to contact HMRC himself and set up an employee's NI-only payroll directly with HMRC. We would be happy to assist Mr Farrell in doing this, or alternatively we can operate the whole payroll for him.

Therefore, at this point in time, there is no obligation on Havarn CA Ltd to register a payroll in the UK.

Corporate Registrations

Unlike some of the jurisdictions Havarn CA Ltd has previously experienced, there is no requirement in the UK for a foreign company to register at Companies House (the UK corporate registry) or for VAT (the UK value-added tax) simply because Havarn CA Ltd employs a UK resident.

The situation, however, will change if the UK project goes ahead.

Impact of undertaking the UK project: Havarn CA Ltd's presence in the UK

Havarn CA Ltd will have a presence in the UK for at least 15 months. They will have an office and workshop available to them, as provided by the customer on their premises. This will be considered a fixed place of business, with a sufficient degree of permanence (over 6 months). This automatically creates a PE in the UK under both UK domestic law and Article 5 of the UK/Canada Double Taxation

Convention. Although there are two separate phases to the project, the tax authorities will consider the whole period from 1 May 2025 to 23 July 2026 as the duration of the project. Their presence at the UK customer's premises will commence in Phase 1, and possibly before as Mr Farrell will be there before to assess requirements.

Havarn CA Ltd will be required to register this PE at Companies House. They will also be required to submit financial statements and other documents as necessary. An annual corporate tax return for the PE will also be required to be submitted to HMRC and corporation tax paid. We can, of course, help you to complete these.

We shall discuss the VAT requirements in more detail below.

In addition, as stated above, a UK PE also automatically becomes a PAYE presence. Havarn CA Ltd will become liable to operate a UK payroll deducting PAYE and NI from Mr Farrell and any other staff in the UK. Havarn CA Ltd will also become liable to employer's NI contributions at 15.05% uncapped. There could be a maximum of 10 employees in the UK (if Havarn CA Ltd provides all the project staff) and the cost of operating a payroll for this number of employees should also be borne in mind.

There are therefore considerable additional employment costs for Havarn CA Ltd of undertaking the UK project.

Option 2: employment by Milvarn UK Ltd

As explained above, without the forthcoming UK project, there would be no need for the UK company to get involved with the employment of Mr Farrell. However, with the UK project, employment by the UK company makes it easier for the bidding process since the customer requires a UK registered company and a UK project manager.

Nevertheless, it would create issues for the period from now until the start of the UK project, when Havarn CA Ltd wishes to use Mr Farrell for their contracts in Canada and the USA. There would need to be an intercompany secondment agreement, to set out the terms between the two companies, Similarly, there would need to be a secondment letter provided to Mr Farrell setting out the terms and salary package whilst working outside the UK.

Care should also be taken over transfer pricing. As related companies, the value of labour provided should be valued at cost plus a mark-up, not simply the actual salary costs.

However, there would still be issues for Havarn CA Ltd because they would be sending three other staff to the UK project. This would still create a PE and the same registration and reporting requirements. Therefore, employment of Mr Farrell by Milvarn UK Ltd would still not solve all the issues if the UK project goes ahead.

Alternative Arrangement 1 under Option 1

If Milvarn UK Ltd are involved in the project, Havarn CA Ltd could limit their UK presence by seconding their employees to Milvarn UK Ltd. This would avoid creating a PE and the subsequent corporate reporting and payroll requirements.

As the host employer, Milvarn UK Ltd would be required to operate the UK payroll. However, this should be easier for them to do and would create minimal additional cost in adding a few employees to their existing payroll.

Again, an intercompany agreement would be required to set out the terms between the two companies and secondment letters to the individual employees. The same transfer pricing issues arise as discussed above.

Havarn CA Ltd could employ Mr Farrell as they wish and second him as well as the other specialist staff. As a seconded employee, he would be working for and under Milvarn UK Ltd's day-to-day control, which should satisfy the customer's requirement to have a Milvarn UK Ltd person as project manager.

Alternative Arrangement 2 under Option 1

If the bid for the UK project is going to be successful, and presuming the parent company agrees, Havarn CA Ltd could consider setting up a UK office. Rather than working from home, Mr Farrell could be provided with office space rented by Havarn CA Ltd. There are a number of shared workspace and office providers. It would entail an additional cost; however, it could afford the opportunity to avoid the UK company's involvement in the project altogether.

Setting up a formal office would require Havarn CA Ltd to register with Companies House, operate a UK payroll and account for VAT as previously described. However, they will have to do this anyway if they create a PE. A registered UK office is what the customer requires and so there would not be a requirement to use the UK company. Havarn CA Ltd could also undertake the 10-year service contract for the coming years without the need to use the UK company.

There would be a need to operate a UK payroll for Mr Farrell and also any other Canadian employees sent to work in the UK. Employer's NI would be due for Mr Farrell, but not for any other staff as they should be able to obtain a certificate of coverage to remain in the Canadian social security system, as the arrangement would be a secondment for less than 5 years.

Conclusion - Comparing Option 1 and Option 2

We recommend Option 1 because:

- Havarn CA Ltd would prefer to employ Mr Farrell directly.
- Prior to the UK project going ahead (if it does), the UK payroll burden is limited to the employee NI-only payroll. This is likely to be easier to handle than the administrative burden of the alternative (that is, for Mr Farrell to be employed by Milvarn UK Ltd and seconded to Havarn CA Ltd)
- If the UK project goes ahead, under Option 1 the other Canadian staff required can be treated in the same way as Mr Farrell. By contrast, under Option 2 the other Canadian staff will need to be treated separately and will trigger additional compliance obligations for Havarn CA Ltd.

Under Option 1, we suggest that, if Havarn CA Ltd wants to make the bid without the involvement of the UK company, they should register a UK office.

If Milvarn UK Ltd is going to stay involved with the bid, then Option 1 is still the better option but Mr Farrell and the other Canadian staff should be formally seconded to Milvarn UK Ltd.

VAT

There is generally no need for Havarn CA Ltd to register for VAT simply because it is employing Mr Farrell. However, with the UK project arising, some VAT reporting and payments would become due, including import VAT.

Havarn CA Ltd will be shipping goods to the UK (the mobile platforms) and also supplying services (the servicing, both immediately and over the 10-year maintenance period). Goods and services are treated differently under VAT rules. The place of supply is of key importance to determine the liability and entity responsible for accounting for the VAT.

Initial servicing and 10-year Maintenance Contract

It is important to establish the place of supply for any services. Since this project is a business to business transaction, the place of supply is where the customer belongs, i.e. the UK. UK VAT is therefore due.

Were Havarn CA Ltd not to register for VAT, then the UK customer would be required to operate a reverse charge mechanism, whereby the customer accounts for the output VAT and reclaims the same amount as input VAT on their VAT return. This normally avoids the need for a non-UK business to register for VAT.

However, given Havarn CA Ltd have the UK PE/office, the UK PE would register and operate the reverse charge and the invoices to the customer would be a straightforward UK to UK supply with standard rate VAT.

It would be recommended to register for VAT, so that VAT suffered on other purchases, e.g. office supplies, can be reclaimed.

Mobile platforms

The place of supply will be outside the UK and Havarn CA Ltd will not ordinarily be required to register for VAT or have any UK VAT obligations.

However, we have to consider the UK import VAT. Ordinarily, the import VAT on goods is paid by the importer, typically the UK based customer, who would be VAT registered. The VAT can be postponed until the customer completes their next VAT return, which is better cashflow, or the VAT can be paid at the point of importation. The customer pays the import VAT and also claims the VAT paid on the mobile platform as input tax in its VAT return. However, the customer has stated that they will not act as the importer, so it is probably better if Havarn CA Ltd registers for VAT, acting as the importer and accounting for the import VAT.

As a PE is likely to be established, then that entity could register for VAT, but in any case, it is possible for a foreign company to register for UK VAT, as a Non-Established Taxable Person (NETP). Consequently, it would charge VAT to the customer on its invoices.

For any business importing goods it is also necessary to get an EORI number, which is used for the customs documentation. This can be applied for with the VAT registration.

We can, of course, assist Havarn CA Ltd in obtaining the VAT registrations required and completing the VAT returns.

Other Considerations

We must also look at other items being considered as follows:

Employment Law Aspects

Havarn CA Ltd cannot simply employ Mr Farrell under their usual terms for Canadian employees. The contract will also have to comply with UK employment law and meet the UK minimum standards, for example, in respect of holiday entitlement. It is therefore recommended that Havarn CA Ltd engages a UK employment lawyer to check the contract complies.

Compensation Package

As Mr Farrell will be liable to UK tax on his salary package, care should be taken that any benefits and expenses take account of the UK position. It will be important to establish Mr Farrell's workplace under UK tax law and thus what travel and subsistence expenses he can receive tax-free.

From a UK tax perspective Mr Farrell will be site based. The place of work shown in his contract should be stated as site-based. The flights (including home leave flights) and accommodation paid for by the company will not be UK taxable as they are regarded as necessary travel and subsistence, as each site is a temporary workplace. Even the UK customer site will be a temporary workplace as it will last for less than 24 months.

The per diem allowance will not be taxed in the UK provided it is less than the scale rates published by HMRC. These rates vary not just by country but also by location within each country. It would be necessary to check the rate for each specific site. Mr Farrell may also be able to claim up to £10 per night for incidental expenses, whilst working outside the UK. The subsistence rates allowable while working at a UK site would be considerably less than any overseas rates, unless a bespoke agreement is made with HMRC. We can discuss this further, if the UK project is won.

Pension and Medical

The UK has a compulsory minimum pension requirement known as auto-enrolment. Employees, who are ordinarily working in the UK, must be offered a company pension scheme. There are minimum contribution levels for both the company and the employee. Mr Farrell works directly for a Canadian company under a Canadian contract to work ordinarily outside the UK. He will have some UK workdays and does reside in the UK. Nevertheless, we would suggest that he is not ordinarily working in the UK and thus this pension requirement does not apply.

Were Mr Farrell to work for a UK employer or long term in the UK, then enrolment into a UK pension scheme would be required, although Mr Farrell can choose to opt out.

It is possible for an overseas employer to pay contributions to an employee's personal pension plan. This would be a tax-free benefit and avoid the employee's NI on a cash amount. Otherwise, we would suggest that the 5% uplift to salary is separated out as an allowance. If it is added to his base salary, it will increase the amount of overtime payable. The same could be said for the medical coverage payment. The provision of emergency medical cover whilst working overseas, is not a taxable benefit. We would also advise that it is made clear in the employment contract that Mr Farrell has been compensated for pension and medical coverage and is not entitled to any further benefits. Since medical coverage will be important whilst working in Canada and the US, we would recommend that a clause is included in the contract that he must obtain coverage and provide a copy to Havarn CA Ltd as proof.

If you have any questions regarding the content of this report, please do not hesitate to ask for further information.