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Application and Professional Skills

Human Capital Taxes

Suggested Solution

Report to Bethany Frank, Group HR Director, Greenson Group Ltd

Introduction & Scope

This report is provided to Bethany Frank in response to her e-mail dated 5 November 2020. The contents are based on the information in that e-mail and the accompanying attachments.

This report reviews the UK tax and cost implications of each of the two proposals for a revised graduate programme. We have also commented on the UK tax implications of the existing programme.

Our advice below is provided under the terms and conditions of our engagement letter with Greenson Group Ltd under which we provide UK tax advice. We have not been engaged to provide tax advice in relation to any of the other countries in which the Greenson group operates.

Executive Summary

Existing graduate programme

The Non-UK Graduate Trainees on your current programme are liable to UK tax on their employment income and therefore Greenson Group Ltd has underpaid PAYE income tax. We recommend a full review of the programme from the start date and the payment of any outstanding PAYE liabilities. For the remainder of the period for which the programme is to continue you should budget for tax costs and operate PAYE where needed. Based on the plan for 2020/21 presence we expect that this will cost up to £36,480 plus penalties and interest to cover the period from the programme's commencement in April 2019 through to the end of the 2020/21 programme.

We also recommend that for the remainder of the programme you seek to agree a bespoke tax exempt per diem rate and a short-term business visitor agreement with HMRC. This would reduce the administration needed from both you and your employees as any tax relief would be given automatically. You would not be required to operate PAYE on these amounts and your employee would not be required to claim a refund on their tax return.

Analysis of proposals for amended trainee programme

We have assessed each proposal against the key criteria mentioned in your e-mail

Cost:

Per our comparative calculations (Appendix D) Proposal B comes out as £1,500 cheaper than Proposal A for the same assignment and therefore appears to be the most cost-efficient approach.

Administration:

Proposal B would also be the simplest to administer. All taxes would be paid via the UK payroll with no need for additional support.

As a result, our recommendation would be to pursue Proposal B. However, it should be noted that this approach may leave the graduate trainees with less disposable income than in previous years which will need careful communication.

We have only reviewed the programme from a UK perspective, and you should also seek advice from your advisers in the other countries in which Greenson Group is established.

Existing Graduate Programme

Income Tax

As the trainees are working in the UK they have taxable UK source employment income. As they are working in the UK under the control and direction of Greenson Group Ltd, it is your responsibility to operate PAYE on their employment income whilst in the UK.

Relief may be claimed if there is a Double Taxation Agreement which will provide an exemption. There is no Double Taxation Agreement in place between Brazil and the UK.

There is a Double Taxation Agreement in place between South Africa and the UK which may enable us to exempt trainees from South Africa from UK income tax if qualifying conditions are met.

To qualify for exemption individuals must;

- Remain tax resident in South Africa
- Spend 183 days or fewer in the UK in a rolling 12-month period
- Have their employment costs borne by an employer located outside of the UK

Per your e-mail your South African trainees each have two UK assignments during the year which would total 168 days of presence (7 days x 12 weeks x 2 assignments). It is possible that they may remain under the 183-day treaty threshold. As it is a rolling 12-month test this can only be confirmed when days of presence for the previous and subsequent 12 months are known. Additionally, if they have spent any of their annual leave in the UK this will also count towards the 183-day test.

In addition, some of the costs of the assignment are recharged to the host entity. Treaty exemption will not be possible for these amounts. However, as discussed below it is possible that they may be exempt from UK taxation in any case.

Please note that even if the individuals qualify for treaty exemption, in the absence of an agreement with HMRC, their income should be subject to PAYE and the treaty exemption claimed on a tax return.

As these trainees have a permanent workplace elsewhere and intend to work in the UK for fewer than 24 months the UK will be treated as a temporary workplace and as such all flights, immigration, accommodation, and travel insurance are exempt from UK taxation and will not be subject to PAYE (otherwise known as Detached Duty Relief).

Amounts paid for Per diem may ultimately be exempt from UK taxation if it directly correlates to deductible work-related expenses such as subsistence for the trainee. However, in the absence of an agreement with HMRC the full payment should be subject to PAYE and relief for specific expenses should be claimed on an individual tax return.

If Greenson Group Ltd fund any UK taxes due on the trainees' employment income and do not seek reimbursement from the trainees, the taxes themselves will also be considered UK taxable income.

As previously mentioned, trainees with taxable income are likely to need to file a UK tax return to generate the necessary refunds. If the preparation of a UK tax return is funded by Greenson Group Ltd this will also be a taxable benefit. HMRC's agreed notional benefit in kind amount for tax equalised employees is £700 per annum (please note the actual compliance fees may exceed this amount).

<u>Social Security</u>

There are no social security agreements in place between the UK and either Brazil or South Africa.

As the trainees are employed outside of the UK, they will be exempt from both employer and employee NIC for the first 52 weeks of any stay in the UK. If there is a sufficient break between UK rotations we can consider that a new 52 week period will have started for this purpose. As a result, we consider that none of the trainees will trigger a NIC liability.

<u>Estimate of exposure (Appendix A)</u>

We have estimated the potential PAYE due for Greenson Group Ltd for 2020/21 as £18,240. This is a worst case estimate including all four non-UK trainees as taxable in the UK and including the per diem as fully taxable. Assuming a similar pattern for the first year the same amount, plus penalties and interest, may be due for the 2019/20 tax year.

The amount due will reduce if an agreement can be reached with HMRC about the Per Diem allowance. It will reduce further if the South African trainees are exempt from UK taxes on their salary income and HMRC agree you may apply the treaty exemption for payroll purposes (see recommended actions below).

Recommended actions

Action 1 – Make PAYE tax payments to HMRC for the remainder of 2020/21.

Action 2 - Rectify past periods. As we are still within the tax year the 2020/21 underpayment can be corrected via this year's payroll filings by updating the year to date figures in your next regular payroll "Full Payment Submission". The 2019/20 underpayment should also be corrected via the payroll by either making an Earlier Year Update (EYU) or filing an additional Full Payment Submission.

Action 3 – Seek to enter into an Appendix 4 Short Term Business Visitors agreement with HMRC. If agreed, this will allow Greenson Group Ltd not to operate PAYE on the salary income paid to the South African trainees by Greenson Africa if they meet the conditions for treaty exemption.

Action 4 - Apply to HMRC for an agreement that the per diem payments may be paid without operating income tax or NIC on the basis that they are fully used on qualifying expenses. To do this you may be required to provide samples of expenses incurred by the trainees while in the UK. This would apply to both the South African and Brazilian trainees.

With these agreements in place you would need only operate PAYE on the salary income for the Brazilian trainees. This should be operated from day 1 of their assignment to the UK. For the South African trainees, you will only need to make a report providing details about their presence in the UK to support the claim for treaty relief.

When making the agreements we should consider requesting that they be applied retrospectively to the start of the programme. HMRC may not grant this request.

Action 5 – investigate the position in Brazil and South Africa as you may have tax exposures in those destination as well. Please note that where UK employed trainees have non-UK taxes paid on their behalf this must be included in UK payroll as subject to income tax and UK class 1 NIC. The individuals can claim a foreign tax credit on the submission of a UK tax return. Alternatively the employee can apply to HMRC for advance Double Taxation Relief through their PAYE code where they remain UK tax resident. While there is a formal Appendix 5 PAYE scheme which would allow you as an employer to take into account any foreign payroll taxes on UK resident employees, we do not recommend you put this in place as you have so few impacted employees.

We appreciate this is unwelcome news. However, Greenson Group Ltd do have an obligation to rectify matters as these amounts are legally due. If HMRC uncover these errors later, a higher penalty can be expected (up to 100%).

Proposals for Assignment Programme Revisions

For each of the proposals we will review UK tax related actions that would be required, and any advantages or risks that we perceive from a tax and other perspective.

For a global picture of the implications of the graduate programme it is important that you also seek advice from professionals with expertise in the Brazilian and South African tax systems.

UK inbound assignees – Income Tax

Proposal A

As the trainees remain employed in their home country and their costs are not borne by the UK company, the South African trainees could potentially be eligible for exemption from UK income tax under the terms of the DTA. However this is unlikely to be achievable in practice. It would take careful management to ensure that that their presence in the UK remains at 183 days or fewer in the UK during a rolling 12 month period. Additionally, with this more significant assignment period, even if the day count is managed there is a risk that the UK authorities would consider that the individuals should be considered integral to the UK business and under transfer pricing rules the UK entity should have borne their employment costs during their assignment. If so, they would be considered economically employed in the UK and treaty relief would not be applicable.

The Brazilian trainees will always be chargeable to income tax in relation to the period spent in the UK due to the lack of a DTA.

We would recommend you plan for all trainees to create a UK income tax and PAYE obligation. P11Ds will also be required for any taxable non-cash benefits.

The trainees would remain eligible for Detached Duty relief during their rotation as they would maintain a permanent workplace elsewhere through their continuing link to a home country employer and would have an intention to be at the Manchester Greenson Group Ltd offices of fewer than 24 months.

Proposal B

All trainees will be subject to income tax on their employment income as treaty exemption will not be possible under a local employment arrangement.

There will be no eligibility for Detached Duty Relief on the basis that the time in the UK will be substantially the whole of a separate UK employment. The weekly additional allowance will be fully taxable. However, travel and immigration costs for coming to the UK will still be covered by specific legislative exemptions.

Personal allowances are likely to be available under both proposal A and B as the trainees are likely to be UK tax resident if they spend more than 183 days in the UK during the tax year.

<u>UK inbound assignees – Social Security</u>

Proposal A

Both Brazilian and South African trainees will be exempt from UK NIC for the first 52 weeks of any stay in the UK. Should any trainee have three consecutive UK based rotations both employee and employer social security would commence from week 53.

Proposal B

All trainees will be subject to UK social security on the basis that this is a UK employment.

<u>UK inbound assignees - Tax related actions required</u>

Proposal A

UK PAYE should be operated via a shadow payroll. This is an arrangement used to simply account for tax as opposed to a requirement to pay employees locally. As the trainees will be tax equalised we recommend that this is done through entering into an Appendix 6 modified payroll agreement with HMRC. This arrangement allows some relaxation of the RTI payroll reporting requirements by permitting estimated PAYE to be accounted for over the year with accurate 'truing-up' at the end of the year. We would be happy to assist you with registering for and operating the shadow payroll under an Appendix 6 arrangement.

If a modified payroll is used, all trainees will be required to submit a UK tax return.

A tax equalisation process should be set up formally applying hypothetical tax in the trainees' home country.

Proposal B

UK PAYE should be operated via the normal UK payroll. A gross up should be performed via the UK payroll to ensure that the company bears the tax on the additional net weekly allowance.

As long as all income tax is withheld via the payroll the individual will not be required to file a UK tax return unless HMRC ask them to do so.

<u>UK inbound assignees - Tax planning opportunities</u>

Ensuring that assignees remain present in the UK for at least 183 days in a tax year will result in their being considered UK tax resident and therefore eligible for a personal allowance. At current rates this will reduce their UK taxable income by £12,500.

Proposal A

As discussed earlier, apply for a bespoke scale rate agreement with HMRC to exclude the per diem from taxable income without further need for a tax return claim.

Proposal B

No additional opportunities specific to proposal B.

UK inbound assignees - Estimate of UK tax costs (Appendices B & C)

Proposal A

We have estimated the UK tax cost of a 6 month assignment to the UK of a non UK trainee as NIL assuming the planning points recommended above are actioned.

Proposal B

We have estimated the UK tax cost of a 6 month assignment to the UK of a non UK trainee under Proposal B as £6,728.

UK outbound assignees

Proposal A

It is likely that overseas taxes will be charged due to increased length of rotations. Trainees are also unlikely to break UK residence during the 6 month period of a rotation, although this will depend on specific personal circumstances.

A process should be set up formally apply tax equalisation in the UK payroll submissions. This includes a deduction of hypothetical tax, the inclusion in income of any overseas taxes paid and a gross up calculation performed to reflect any UK taxes being paid on behalf of the employee by the UK employer.

There will be an ongoing liability to UK NIC for the first 52 weeks for any assignments to South Africa or Brazil. Should any UK employed trainee have three consecutive assignments to these countries, UK NIC would cease after 52 weeks and would not be payable during the third assignment. Social security may be payable in Brazil and South Africa throughout all the assignments.

Proposal B

While the trainee is likely to remain UK tax resident, there will not be a requirement for the UK company to operate PAYE on their earnings as there would not be an ongoing employment arrangement with the UK company. We would expect that the employees will be subject to tax and social security withholding in their host location.

Employees will be required to submit a UK income tax return reporting their overseas income and claiming a foreign tax credit for any overseas taxes paid.

You may wish to consider whether you would offer the individual support with their UK and overseas tax filings in any case. If so, this would constitute a taxable benefit at the cost of the tax preparation fees paid by the company.

Advantages of Proposal A

Retention of home country employment retains entitlement to the Detached Duty Relief exemption for travel, accommodation and subsistence.

Assignees are excluded from the UK pension auto-enrolment rules.

Assignees will be able to remain in a single pension scheme throughout the programme.

Risks of Proposal A

If the home country is bearing all the costs of the assignment there may be a lost opportunity to reclaim VAT on any relevant employee expenses. However, given that the key items being paid for directly by the employer are the rental of an apartment and travel costs both of which do not normally carry VAT then this does not seem to be a significant risk.

It is arguable that host country should be bearing some of the cost as they will be getting the benefit of the labour of the trainee during the rotation. This may result in potential challenges for the home country regarding the deduction of labour costs against corporate profits. It is recommended that you seek advice from your corporate tax advisers.

Advantages of Proposal B

This arrangement is less complex to administer from a tax perspective as other than the net to gross calculation for the allowance the individual will be paid in a manner similar to a domestic employee.

Risks of Proposal B

As the UK company will be employing these individuals directly, they will be subject to the UK pension auto-enrolment rules and you will be obliged to enrol them in a UK pension accordingly. Costs of the mandatory minimum employer and employee contribution rates are 3% and 5% respectively. We have estimated the employer pension costs for a six month assignment to the UK as £794.

Trainees may finish the programme having contributed into three different pension schemes in three different countries. This may prove to be complicated to manage when they come to retire.

The benefits that would be provided under Proposal B are considerably less than those under the current scheme, even taking into account the increase in salary. This may cause unhappiness amongst trainees if they become aware of the disparity.

Proposal A: £30 per day x 7 x 26 = £5,460 + housing £14,040 = £19,500 p/a

Proposal B: £300 x 26 = 7,800 + 2,500 additional income = £10,300

Appendix A - Current Graduate Scheme - Potential Tax Liability - Graduate Trainee 2 UK rotations

(24 weeks in the UK, assumes total annual workdays =240)

	£
Income Tax (W1)	4,560
Employee/Employer NIC	NIL – 52 week exemption
TOTAL	4,560

(W1) Income Tax Calculation		£
Gross Salary	(£25,000*24*5/240)	12,500
Per Diem - £30 per day (DDR claim not applied)	(£30*24*7)	5,040
Tax Return Support		700
Net Income		18,240
Less PA (NIL - assume remains NR and not eligible for PA)		0
Taxable income		18,240

Net income Tax @ 20%	3,648
Gross up at 20/80	912
Gross income tax	4,560
Potential exposure for 4 trainees	18,240

Appendix B: Proposal A – Non-UK Graduate Trainee on a 6-month rotation during the tax year

	£
Gross salary (£25,000 *6/12)	12,500
Hypothetical Tax (@flat 10%)	(1,250)
Per Diem (Assumed exempt with HMRC Scale Rate Agreement)	NIL
Tax Return Support (HMRC benefit figure for equalised employees)	700
Net Income	11,950
Less PA*	(12,500)
Taxable Income	NIL
Income Tax	NIL

* assuming in UK for 183 days or more in the tax year and therefore UK tax resident

Appendix C - Proposal B – Non-UK Graduate Trainee on a 6-month rotation during the tax year

	£
Income Tax Gross up on weekly allowance (W1)	2,294
Employee Class 1 NIC Gross up on weekly allowance (W1)	1,376
Employer Class 1 NIC on total cash income (W2)	3,057
Employer pension contributions on total cash income (W3)	794
	7,522

W1 - Income Tax and Employee NIC Gross up on weekly allowance	£
Net weekly allowance (£300 * 26 weeks)	7,800
Tax and NIC Gross up @ 32/68	3,671
	11,471
BR income tax @ 20%	£2,294
Employee NIC @ 12%	£1,376

W2 - Employer NIC on total cash income	£
Salary * 6 months' worth	15,000
Gross Weekly Allowance	11,471
	26,471
Annualised rates used for illustration purposes	
Earnings up to secondary threshold (£8,632 *6/12) @ 0%	0
Earnings above secondary threshold @ 13.8%	3,057

W3 - Employer pension contributions on total cash income	
Salary * 6 months' worth	15,000
Gross Weekly Allowance	11,471
	26,471
Mandatory employer contributions @ 3%	794

Appendix D

	Proposal A	Proposal B
	£	£
Scenario for comparison	One 6 month UK rotation during the tax year	One 6 month UK rotation during the tax year
Projected costs as per proposal	40,500	30,300
Hypothetical taxes withheld	-1,250	0
Home country taxes paid by Greenson Group	0	0
UK Income Tax and NIC borne by Greenson Group	0	6,727
Employer pension contributions	0	794
	39,250	37,821

Notes:

1- The cost of tax compliance costs should also be added to the above. We would be happy to provide a quote for our assistance.