Application and Professional Skills

Chartered Institute of Taxation
Excellence in Taxation

Human Capital Taxes

(Ensure this number matches your candidate number on your desk label and on your candidate attendance form)

LON	Centre Code
0 9 0 5 2 0 1 9	Date of Examination

☐ Tick box if you have answered in accordance with Scots Law

☐ Tick box if you have answered in accordance with Northern Ireland Law

Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your paper not being marked. You must:

(a) Write on the answer pages using BLACK or BLUE ballpoint pen only.

(b) Write on one side of the page.

(c) Not write in the margin areas indicated.

(d) If you have used additional pages, please add your candidate number and the question title to these pages.

(e) Do not put blank pages into the envelope at the end of the exam.

Please do all of the above before the end of the examination.

Question Title

Human Capital Taxes

Your Candidate No.

To: Janet Green

From: Tom Smith

Subject: Report on forthcoming IT project

Dear Janet

Please find enclosed our report on the ~~proposed~~ forthcoming IT project. The report covers an analysis of the start dates, whether UK or Overseas employees would be more beneficial from a tax perspective, as well as an analysis of the proposed assignment packages, and details on various administrative points.

This report is for use by Grange Stevens Group Ltd only and cannot be relied upon for any purpose other than originally specified.

If you have any questions on the report, please let me know.

Kind regards

Tom Smith

Question Title

Human Capital Taxes

Your Candidate No.

Executive Summary

To summarise the points contained within this report:

- A start date of 6th April 2020 would be more beneficial as it would mean the individuals would be UK resident and entitled to personal allowances, which would reduce any employer-paid tax gross ups. It would also reduce the admin costs of payroll.
- A modified payroll scheme should be applied for ~~to~~ in the UK in order to report the income and benefits of the overseas employees.
- Due to the lack of a tax treaty and the higher effective tax rates of Sofcland, we recommend limiting the number of employees to be transferred from here.
- Changes should be made to the assignment packages to better take advantage of UK tax reliefs available for those working in the UK on assignment.

Question Title	Your Candidate No.
Human Capital Taxes	

UK Tax Position

The basic UK tax position is that employees are taxable from the day they begin working in the UK. In this sense, the start date does not impact from when the individuals become taxable, and nor does their residence position.

The impact of residence comes primarily from the availability of the personal allowance. As none of the overseas countries have a treaty provision for granting personal allowances to UK non-residents, this means that being resident will actually lead to lower tax liabilities for the individuals (or in this case the company, as the individuals will be tax equalised).

In addition, there is a UK payroll obligation for these employees from day one. They do not meet the conditions of the OECD Employment Income Article paragraph 2, as they will be in the UK for over 183 days, and their costs will be borne by the UK entity.

Failure to operate PAYE can lead to penalties, as you may be aware, however there are more relaxed rules where a Modified PAYE scheme is in place. This relaxation is that payroll can be operated on an estimated basis, and the submission deadline is extended to 14 days after the ~~previous month end~~ end of the previous tax month, i.e. the 19th May, for payments made in April.

Question Title	Your Candidate No.
Human Capital Taxes	

Modified Payroll

The conditions to apply for an Appendix 6 Modified PAYE scheme are that:

- the individuals must be paid outside the UK, in a foreign currency
- the individuals must not be UK domiciled
- the individuals must be tax equalised.

As these conditions are likely to be met for your overseas employees, we would recommend putting in place a Modified PAYE scheme for the duration of the UK assignments.

Whilst the Modified scheme can be operated on an estimated basis, there must be a reconciliation during the tax year. It makes sense for this to be done either at the end of the 7 months, or the end of the tax year.

One of the conditions of being included on a Modified PAYE scheme is that UK Tax Returns must be filed by the individuals, for all of the years they are included on the payroll. Therefore, limiting to one year is more cost-efficient for the company.

UK Residency Positions of Overseas Employees

The Statutory Residence Test (SRT) is the means of establishing residency for individuals in the UK. Under SRT, there are three steps and you stop as soon as one of the tests are met. ~~If we assume a~~ As mentioned in the ~~Chart of~~ UK Tax Position section, it is more beneficial from an employer perspective that the individuals are UK resident. Do note however that there may be personal tax implications for the individuals as a result of becoming UK resident, and so we would recommend a tax briefing being conducted to ascertain whether their personal circumstances would impact on the optimal UK tax position.

If we assume that the individuals start their assignments on 1st January 2020, their assignments would straddle the 2019/20 and 2020/21 tax years. Each year must be analysed under SRT separately.

There would be 95 UK days of presence in 19/20 and 117 in 2020/21, if we assume an assignment end date of 31 July 2020. The individuals would not meet the conditions of the automatic overseas or UK tests, and so we should consider Sufficient Ties.

For ~~both years~~ 19/20, they would be considered 'Arrivers' and therefore require 3 ties to be resident, with between 91 and 120 days. The ties

Question Title

Human Capital Taxes

Your Candidate No.

are as follows:

- Accessible Accommodation in the UK
- UK resident Family
- Substantive Employment in the UK
- More than 90 UK days in either of the previous two tax years.

For 19/20, they would only have 2 ties - Substantive employment and accessible accommodation, as they will have over 40 UK workdays, and 91 or more consecutive days where accommodation is available to them. in the UK. They will therefore be non-resident.

For 20/21, they would still be considered 'Arrivers', but would this time have the 3 ties they need as the 90 day tie would also be met. They would therefore be considered UK resident.

If instead we assume a later start date of 6th April 2020, we would only consider 2020/21, and with a 7 month assignment, the individuals would be automatically UK resident as they would have over 183 days of presence in the UK.

There would not be any opportunity to split the year in either scenario, as all split year departure cases require the individual to be resident in the prior tax year. They would therefore be full year residents.

Question Title

Human Capital Taxes

Your Candidate No.

Analysis of Employment Package / Benefits

Pension

Employer pension contributions are an exempt benefit in the UK, provided they are into a qualifying scheme. A qualifying scheme is one that only ~~permits~~ allows employees to access them on retirement or death. As the ~~Schemes~~ international schemes in this case are more flexible and allow access more readily, the contributions would be taxable on the individuals. No relief would be available under S307 ITEPA 2003, or via Migrant Member Relief. It may therefore be worth paying the individuals a pension allowance instead, as this would give them the cash directly, which they may consider more favourable. Alternatively, the company could tax equalise the pension contributions to avoid any personal liabilities.

Cars

The provision of a car allowance constitutes earnings, and would be subject to PAYE withholding via payroll. No Class 1 NIC applies due to the 52 week exemptions.

Accommodation

The Oxford office would be considered ~~the home office~~ a temporary workplace for the individuals that are not normally based in Oxford, including those from other UK offices. Under the temporary workplace provisions,

Question Title

Human Capital Taxes

Your Candidate No.

'essential living costs' such as accommodation, utilities, travel to/from work, and subsistence, are allowable as a deduction against their taxable income. Therefore the accommodation costs will not be taxable, other than for the Oxford-based individuals.

For the overseas individuals, ~~the~~ as the equalisation policy does not cover accommodation, they would receive the benefit of this tax relief. It may therefore be worth expanding the equalisation policy to cover accommodation as well. So as to use this relief as a means to offset the UK tax liability.

For the UK employees, the accommodation benefit should be included on their P11Ds and subject to Class 1A. The individuals can claim relief for the benefits via self-assessment, so they should be made aware of this.

For the Oxford-based employees, it may be more beneficial to offer them ~~the~~ taxi fares home, as provided they are leaving after 9pm, these are an exempt benefit. Do note that this only applies for up to 60 days per tax year, so any further occasions would be taxable and would need to be reported on their P11Ds and subject to Class 1A NIC.

Flight Allowance

An allowance would be taxable by default in the UK. The home leave provisions only apply where the employer bears the cost of the flights in the first instance, and therefore you should restructure the package to instead pay for the flights directly, or reimburse the costs using the expense process. This will allow full tax relief for the individuals for up to 2 return trips for their family each year. If this is insufficient, the employees can have unlimited ~~[illegible]~~ return trips covered by the home leave provisions.

Travel Insurance

This would be exempt from UK tax under the exemptions for business travel.

Telephone

A round sum allowance would be taxable and subject to PAYE. If you instead provide the employees with a mobile phone, this would be an exempt benefit. They would be able to use the phone for both private and business calls.

Assignment Allowance

The assignment allowance would be taxable in the first instance and relief would only be available for qualifying relocation costs, which are usually genuine relocation expenses such as, costs associated with disposal of previous property, costs of finding new property, transporting belongings, short-term storage, etc. It would be more efficient to offer the

Question Title	Your Candidate No.
Human Capital Taxes	

individuals a reimbursement of any such qualifying expenses. The UK limit for tax relief on such expenses is £8,000.

Medical Insurance

Any overseas medical insurance provided would be taxable in the UK. ~~to the~~

Visas / Work Permits

The costs of these will not be taxable on the individuals. They would be an exempt benefit under S373 ITEPA 2003.

Tax Returns

It should also be noted that the provision of tax returns is a taxable benefit. The VAT inclusive amount should be included on Forms P11D and taxed via self-assessment or modified payroll.

Question Title	Your Candidate No.
Human Capital Taxes	

Social Security

Certificates of Coverage should be acquired for those individuals travelling to the UK on assignment. All individuals should be exempt by default on the basis they are working in the UK temporarily, for 52 weeks.

The individuals from Sofaland will not be able to get Certificates of Coverage, as there is no Social Security Agreement in place between the UK and Sofaland. The 52 week exemption does still apply however.

Question Title	Your Candidate No.
Human Capital Taxes	

UK Employees vs Overseas Employees

The main differences from a tax perspective from hiring UK employees rather than overseas employees would be:

- No costs of tax equalisation (e.g. gross ups)
- Lower assignment costs (benefits package, etc.)
- Relief for pension contributions available
- Detached Duty Relief available for those not based in Oxford, giving a good tax break for the employees, or alternatively allowing the company to not provide as many benefits (e.g. accommodation).
- Employer NIC due on any allowances, benefits, etc. at 13.8%.
- No need to set up potentially burdensome modified payroll or pay for tax returns or Certificates of Coverages.

As many of the benefits would be exempt from tax anyway, and given the lower salaries and no NIC liabilities for the overseas employees, it ~~[illegible]~~ is likely to be most beneficial to ~~[illegible]~~ transfer people from overseas to the UK, even with the additional costs of gross up taxes, tax returns and Certificate of Coverage applications.

Given the potential additional costs, it may be worthwhile in not transferring individuals from Sofaland, however.

See Appendix 1 for further breakdown of overseas assignee costs.

Other Considerations

P11Ds

UK Form P11Ds should be submitted for the overseas employees as well as the UK based employees. No Class 1A will be due as the individuals will all be exempt from UK NIC, but the forms are still due for reporting purposes. In modified payroll cases, the submission deadline is extended to 31st January following the end of the tax year.

Transfer Pricing

Where costs are being recharged for salaries, benefits, recruitment costs, Grange Stevens should be mindful of not inadvertently causing a transfer pricing issue, by recharging costs to gain a tax advantage, i.e. by using non-arms length prices.

Any such amounts would need to be adjusted via the Corporation Tax Return.

Foreign Tax Returns

UK taxes should be available as a credit against any foreign taxes suffered in the individuals' home countries. ~~Therefore~~ Where the effective tax rate is lower in those countries, this should result in no tax liability

Question Title

Human Capital Taxes

Your Candidate No.

however the effective rate of tax in Sofaland is 40%, as opposed to just 20% in the UK, assuming various tax reliefs are claimed. This will mean there is still a residual tax liability in Sofaland for those employees. This should be considered regardless of who is picking up the costs, as it may represent an additional outlay either way.

Question Title

Human Capital Taxes

Your Candidate No.

Next Steps

We would recommend discussing this report internally and our suggestions would be to:

- delay the start dates to 6th April 2020 to take advantage of UK personal allowance availability and reduce admin costs associated with modified payroll reporting.

- Set up UK tax consultations with the employees to discuss their personal circumstances, so we can perhaps reconsider some aspects of this advice.

- Adjust the assignment packages to better take advantage of available UK tax reliefs.

- Apply for Modified PAYE. We are happy to assist with this.

If you require any further advice please let me know.

Tom Smith.

Question Title

Human Capital Taxes

Your Candidate No.

Appendix 1 - Adjusted Cost of Overseas Employees

Salary	32,000 *
Employer Pension/Pension Allowance	3,000 *
Car Allowance	2,500 *
Accommodation	7,500
Travel	2,000
Flight Reimbursement	1,200
Travel Insurance	1,000
Telephone	600
Medical	500 *
SubTotal	50,300
Add: Gross Up	6,537
Add: Tax Returns (600 x 34)	20,400
	77,237
UK Taxable Income *	38,000
Less: PA	(11,850)
Net Income	26,150
Gross Up	6,537
Gross Income	32,687

Gross	Net	Tax
32,687	26,150	6,537