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Answer-to-Question-_1_

**Report on the Tax Implications of the Off-Payroll Working Rules
in relation to Mr Peter Wong**

Prepared for RDJ Pharmaceuticals UK Ltd on 9th November 2022

1) INTRODUCTION

This report is provided in response to the email received from Claire Swan on 29 October 2022 and covers the issues raised regarding off-payroll working rules, and how they may affect Peter Wong.

The advice contained in this report is based on the law as at 9th November 2022, and is prepared for RDJ Pharmaceuticals UK Ltd. No other person or entity may rely on its contents.

For the remainder of the report, RDJ Pharmaceuticals Ltd will be referred to as "RDJ UK" and RDJ Pharmaceuticals Inc will be referred to as "RDJ US".

2) EXECUTIVE SUMMARY

- RDJ UK and Peter Wong Services Ltd are subject to the off-payroll rules laid out in Chapter 10 of ITEPA 2003, Pt 2

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- Peter Wong should be considered as an employee of RDJ UK, especially once he takes over Jane Brown's duties and becomes more integrated in the organisation.

 - Income tax and National Insurance should be withheld going forwards for any payments made to Peter Wong in respect of services carried out through his intermediary

 - RDJ UK should disclose to HMRC as soon as possible the late and underpaid PAYE/Class 1 National Insurance, and ensure any relevant Full Payment Submissions are corrected

 - RDJ UK should ensure that a formal employment contract is drawn up as soon as possible

 - RDJ UK should complete a review of all other contractors/self employment individual who they contract with, to ensure the off-payroll working rules are met with regards to these individuals

 - RDJ should consider a non-tax advantaged share plan in respect of awarding Peter Wong options in the company, and to ensure any of his concerns regarding his cash flow are met

 - Peter Wong should seek to amend the corporation tax return for his intermediary, and his self-assessment tax return as soon as possible

3) GENERAL POSITION - OFF PAYROLL WORKING

(3.1) Overview of off-payroll working rules

The off-payroll working rules were originally brought in as an attempt to nullify any potential tax advantages that were being gained by individuals providing employment services through intermediaries.

There are three separate areas of the legislation which seek to apply the off-payroll working rules to slightly different situations involving intermediaries.

The first set of rules to apply are found in Chapter 10 of ITEPA 2003, PT 2.

These "Chapter 10" rules apply as a priority compared to the rules laid out in Chapter 8 and 9 of ITEPA 2003, PT 2.

In determining whether the rules in Chapter 10 apply, the following conditions must apply:

- the end-client (i.e. RDJ UK) is either a public authority, or a medium or large business with a UK connection;
- there is an individual who is providing services to the client,

and the services are being provided under arrangements with an intermediary

- if there was a direct contract between the individual and the client, the individual would have been regarded as an employee

In consideration of the first condition, given RDJ UK and RDJ US form a group, we must apply the small company thresholds to both RDJ UK and US.

As such, RDJ UK Ltd will be in scope of the off-payroll working rules in Chapter 10 on account of the following:

- RDJ UK and RDJ US' combined annual turnover is over £10.2 million;
- RDJ UK and RDJ US' combined average number of employees is over 50;
- The current net assets of the group exceed £5.1 million

(3.2) Determination of employment status

As discussed above, for every intermediary with which RDJ UK engages with, it must be considered whether the individual providing the services through the intermediary would be considered an employee, in the absence of the intermediary.

This review should be done at or before any contract is entered

into with the intermediary.

The outcome of this review should be provided to the intermediary, and the recipient can question any determination that is made. If questions are raised, RDJ UK need to reply within 31 days in writing.

Whether an individual is considered employed or self-employed is not in the legislation, and instead HMRC guidance and case law is relied upon.

Importantly, it is not a matter of choice and the ultimate determination will depend on the specifics of the engagement. There is no single test for employment.

If the individual in question is considered an employee, then RDJ UK must operate PAYE and National Insurance in respect of their employment earnings.

In addition, the individual will likely fall into the auto-enrolment provisions and have the relevant employment rights (discussed below).

(3.3) Taking each of the factors of employment in turn

Mutuality of Obligation

There is insufficient information provided to determine whether Peter Wong can refuse to complete any specific work, and whether RDJ UK is obliged to provide Peter Wong with work.

Right of Control

From the output of HMRC's CEST for Peter Wong, it looks like both Peter Wong and RDJ UK have certain elements of control over how the work is done and where the work can be done.

Therefore, it is inconclusive in whether this factor indicates employment or self-employment.

Provision of Own Equipment

Employees are generally not required to provide their own equipment for the job. Therefore, given Peter Wong is provided with a company email and laptop, and also does not have to buy equipment before RDJ UK pays them, this is an indicator of employment.

Right of Substitution

Employees are generally not able to provide a substitute to provide the contracted services. Therefore, despite Peter Wong never having set a substitute to do his work, given RDJ UK has the right to reject any potential substitute, this would be an

indicator of employment.

Financial Risk

Employees are generally not expected to risk any of their own capital in the performance of their duties.

From the information provided, it indicates that Peter Wong is not at great financial risk as a result of working with RDJ UK as he's not buying lots of assets to carry out the job, or is paying for materials.

The only financial risk is that if Peter Wong does not complete the work correctly, he has to correct it unpaid.

This points towards self-employment.

Opportunity to Profit

Given Peter Wong gets paid either an hourly, daily or weekly rate, this is similar to receiving a salary from RDJ UK as he's not paid by the job.

Therefore, this points towards employment.

Degree of Integration into Organisation

It is recommended that consideration is made of whether Peter Wong is "part and parcel" to the organisation and to what extent they are integrated into RDJ UK.

Given Peter Wong has been invited to the Christmas Party, comes to the lab to attend meetings, and uses a company laptop and email are all indicators of employment. Generally, self-employed contractors would have little integration with the client.

Peter Wong also mentions that his commitment to RDJ UK has increased, another indicator of employment and integrations into RDJ UK.

Right to Terminate the contract

There is little information provided in respect of whether there is a right to terminate the contract with Peter Wong.

Therefore, this test is inconclusive. Further information should be provided in order for the review to be completed in respect of this point.

The number of paymasters

It is mentioned that up until April 2021, Peter was providing services to several other organisations at the same time.

Typicically, employees have only 1 paymaster and therefore the fact that Peter potentially has more than 1 would be an indicator of self-employment.

It is recommended, however, that further information is provided in respect of these potential other paymasters. For example, what is Peter actually doing for them and to what extent? It would especially be important to determine how many paymasters Peter has from April 2021 onwards.

(3.4) Conclusion of employment status

On balance of the above discussion, and based on expectations that Peter Wong is due to become more integrated with RDJ UK, Peter Wong appears as an employee of RDJ UK.

If RDJ UK wishes to proceed with Peter Wong remaining as a contractor, it is recommended that the terms of the engagement are re-looked at and designed to ensure that Peter Wong is deemed as self-employed.

Following this re-design, it is recommended that RDJ UK then consult again with HMRC's online tool to confirm this. This should avoid any future underpayments of PAYE and National Insurance for RDJ UK.

(3.5) Covering Jane Brown's Responsibilities

From November 2022, if Peter Wong begins to cover off some of Jane Brown's managerial responsibilities and starts to report directly to the board, then Peter's determination as an employee is likely to further strengthen, on the basis of Peter Wong becoming even more further integrated into the organisation, and his right of control over his work slightly decreasing, given he now has to report directly to the board.

It is recommended that a formal employment contract or agreement is put in place, so all parties are clear on what Peter's contracted hours are, how and where Peter Wong should be working, and also include details of his place of work, his remuneration, his notice period, and any holiday entitlement.

It is recommended that formal legal advice is obtained on the extent of what should be included in this contract.

(3.6) Qualifying Intermediary

Finally, in determining whether RDJ UK should operate and PAYE/National Insurance in respect of any deemed direct payments made to Peter Wong, it must be considered whether Peter Wong Services Ltd is a qualifying intermediary.

Given Peter Wong Services Ltd is wholly owned by Peter Wong, more than 5% of the ordinary share capital is owned by Peter Wong, and

therefore it is a qualifying Intermediary.

(3.7) Other contractors

It is recommended that RDJ UK repeats the above analysis of any other contractors or self-employed individuals with which it engages with regularly.

Please do get in touch if any further assistance is required in this regard.

4) PETER WONG

(4.1) Deemed Direct Payment

Given RDJ UK is considered the "deemed employer" of Peter Wong, they must operate PAYE and National Insurance in respect of Peter Wong, as they are the lowest qualifying "feepayer" above the intermediary.

As calculated in Appendix 1, the direct deemed payment made to Peter Wong is therefore £111,200 (minus qualifying expenses).

It is recommended that Peter Wong is added to the RDJ UK payroll as soon as possible, and a starter checklist is completed in order to determine the appropriate tax code that should be operated.

PAYE and National Insurance should start to be withheld and paid over to HMRC by 22nd of each month, if the payment is electronic.

A P60 and P45 (when relevant) should also be issued to Peter Wong.

The relevant amount of primary and secondary Class 1 National Insurance that should have been withheld by RDJ UK is outlined in Appendix 2.

The relevant amount of PAYE that should be have been withheld by RDJ UK is outlined in Appendix 3. Any payments of account should be taken into consideration when calculating the final UK tax liability for Peter Wong for 2021/22.

(4.2) UK Employment Benefits

Any UK employment benefits that RDJ UK provide to their employees should also be provided to Peter Wong, including Private Medical Insurance, pension contributions and life insurance.

The Private Medical Insurance should be reported on Peter Wong's P11D, and tax paid via self-assessment (if not payrolled) on the cost of the benefit of £1,000.

The Private Medical Insurance should also be reported on the P11Db. RDJ UK will be paying employer's Class 1A National

Insurance on this benefit at a rate of 13.8%.

The Life Insurance benefit is exempt from tax and UK National Insurance.

(4.3) Corporate Tax Deductions for RDJ UK

The direct deemed payment is deductible for RDJ UK as it is incurred in the cost of its business.

(4.4) Income/corporate tax for Peter Wong/Peter Wong Services Ltd

It is recommended that Peter Wong amends the corporation tax return for Peter Wong Services Ltd to account for the fact that he will now be subject to PAYE via RDJ UK payroll on the deemed direct payment.

The deemed direct payment will be deductible in arriving at Peter Wong Service Ltd's taxable profits for corporation tax purposes.

Peter Wong Service Ltd has 12 months from the end of its due filing date to submit any amendments.

In addition, it is recommended that Peter Wong should amend his self-assessment return to ensure that he is not suffering too

much tax on the salary he's paying himself, and the deemed direct payment that RDJ UK will be subjecting to PAYE.

As Peter Wong Services Ltd is also paying Peter dividends, this must be taken into consideration to when considering income which is at risk of double taxation.

5) RDJ UK SHARE OPTION PLAN

If RDJ wish to reward or incentivise specific workers, share options can be which essentially their employees to acquire shares in the future for a fixed price.

It is recommended that RDJ UK considered the following two potential share option plans:

(5.1) Non-tax advantaged share options

Non-tax advantaged share options are completely flexible as to when they can be exercised, how many options can be granted and the price which is payable on exercise.

There will be no UK tax or National Insurance upon grant.

However, if the options are granted at a discount, the tax charge upon exercise will be calculated on the market value of the

shares at exercise, less any price that Peter Wong pays.

Given the shares will likely be in RDJ US, they will be readily convertible assets on account of the fact that they are listed on the New York Stock Exchange and can be easily sold.

Therefore, any UK tax should be withheld via PAYE and Class 1 National Insurance is also due via the payroll.

If Peter Wong did not have enough cash to cover the tax due, it is recommended that RDJ UK consider offering Peter Wong a loan. No taxable benefit would arise provided it did not exceed £10,000.

The value of the shares would also be deductible for corporation tax purposes for RDJ UK.

In terms of any future sale of the shares by Peter Wong, capital gains tax would be due on the sale.

If Peter Wong owned more than 5% of the capital, and held the shares for a minimum period of 2 years, he would likely be eligible for business asset disposal relief. This would mean that any gain would be calculated at 10% and not 20%. Consideration of whether Peter Wong has already exceeded his lifetime limit of £1,000,000 should be made.

(5.2) Company Share Option Plan (CSOP)

There are two tax-advantaged share option plans that enable companies to reward specific employees. However, given the size of RDJ UK, only the CSOP is relevant.

Unlike a non-tax advantaged plan, no discount is allowed on the grant of the options.

Similar to a non-tax advantaged plan, no income tax or National Insurance would arise on the grant of the options.

Furthermore, no income tax charge will arise if the options are exercised between 3 and 10 years following the date the option was granted.

If the options are exercised outside of this 7 year period, then the income tax charge will be calculated similar to how it is calculated for non-tax advantaged options.

Upon selling of the shares, a capital gain will arise and this should be paid via self-assessment. There are no obligations for RDJ UK in respect of any future sale of the shares.

In order for RDJ UK to proceed with a CSOP, the share option plan must be registered with HMRC and RDJ UK should certify that all the conditions are met for the scheme to be run.

These conditions include:

- the employer can only invite full-time directors and employees, or part-time employees (part-time directors are excluded);
- only individuals who don't have a material interest in the company are allowed to participate (must not own more than 30% of share capital already);
- maximum value of shares over which options can be held by an employee are £30,000

If RDJ UK wishes to operate a CSOP and grant options to Peter Wong, it is recommended that RDJ UK ensures that Peter Wong meets works for an average of at least 25 hours a week in order for him to meet at least the "part-time" employee criteria.

The scheme should be registered by 6 July following the end of the tax year in which the options are first granted.

Any costs in setting up the CSOP, and also the cost of the shares awarded to the employees upon exercise are allowable as corporate tax deductions.

(5.3) Reporting

Under both share plan options, RDJ UK needs to submit annual

returns to HMRC by 6 July following the end of each tax year in respect of all share awards.

For CSOPs, RDJ UK would need to provide information around the dates on which options were granted, option prices and any dates of exercises.

Penalties will apply if RDJ fails to submit the relevant annual returns.

(5.4) Comparison and recommendation

Whilst the initial set-up of a CSOP might be more burdensome, if one of RDJ UK's concerns is the retention of Peter Wong, this could be the preferred option, given the obvious tax advantages if Peter continues his employment with RDJ UK for a minimum of three years following the grant of the options.

However, it also has its disadvantages. There is a limitation in that Peter Wong cannot have options over more than £30,000 worth of shares, and the exercise price can't be lower than the market value of the shares at the date of grant.

Given one of Peter Wong's concerns is about his own costs, if a non-tax advantaged share option plan is chosen, Peter Wong has the flexibility of choosing when he exercises his options, and therefore this may help with his cash flow as he's able to plan

ahead for funding any tax liability that may arise.

In addition, there is no limit on the options that can be granted to Peter Wong.

Therefore, it is recommended that a non-tax advantaged share options plan is considered in favour of a CSOP, in light of Peter Wong's cash flow concerns.

6) INTEREST AND PENALTY EXPOSURE

There are several penalties that may apply to RDJ UK:

- Incorrect Full Payment Submission Penalties;
- Late tax and National Insurance penalties;
- Interest on any tax and National Insurance paid late

(6.1) Incorrect Full Payment Submission (FPS)

Penalties may be charged in respect of the incorrect FPS based on whether HMRC view the error of not including Peter Wong as:

- Careless
- Deliberate but not concealed
- Deliberate and concealed

Reductions in the relevant penalties may be provided depending on whether the disclosure is prompted or unprompted.

It is recommended that RDJ UK notify HMRC as soon as possible about the incorrect FPS that have been submitted, and assist HMRC in calculating any underpaid tax/National Insurance, and also in allowing HMRC access to records if necessary.

(6.2) Late tax and National Insurance penalties

HMRC can also levy penalties in respect of late payments of tax and National Insurance.

These depend on the number of defaults that arise during the tax year.

If the tax is more than 6 months or 12 months late, then additional 5% penalties calculated on the underpaid tax or National Insurance will arise.

(6.3) Interest on any tax and National Insurance paid late

HMRC are likely to charge late payment interest at 2.6% on any PAYE or Class 1 National Insurance that has been paid late.

Interest will run from the date the payment was due, to the date

the payment was made.

7) OTHER MATTERS FOR CONSIDERATION

(7.1) Auto-enrolment

On the basis that Peter Wong is considered an employee of RDJ UK, he will be in scope of the automatic enrolment rules.

RDJ UK should enrol Peter Wong as soon as possible into their qualifying pension scheme. If Peter Wong wishes to opt out he can, however RDJ should ensure that it completes its cyclical re-enrollment duty every 3 years.

(7.2) National Living Wage/Minimum Wage

Given Peter Wong is now considered as in an employment the national living wage rules will also apply to Peter Wong.

RDJ UK should ensure that they are compliant with the minimum National Living Wage in respect of Peter Wong.

However, given the level of remuneration of Peter Wong, this is unlikely to cause any issues for RDJ UK.

(7.3) Apprenticeship Levy

Any remuneration by way of direct deemed payment to Peter Wong will now be included in RDJ UK's secondary Class 1 National Insurance employer bill, and therefore Apprenticeship Levy will now also be payable on this.

(7.4) Employment Law

Peter Wong will also now be in scope of UK employment law, meaning he will now potentially have entitlement to statutory sick pay, paternity leave, parental leave, adoption leave, etc.

He will also be entitled to statutory holiday pay and RDJ UK must provide him with a safe working environment.

8) NEXT STEPS

RDJ UK should take the following next steps:

- ensure Peter Wong is included in the UK payroll going forwards;
- disclose to HMRC by way of letter the incorrect full payment submissions and outline any tax/National Insurance that is due;
- depending on which share option is chosen, register the relevant share option scheme with HMRC and ensure annual returns

are completed going forwards;

- ensure Peter Wong is automatically enroled in RDJ UK's qualifying pension scheme;
- ensure a relevant employment contract is drawn up to protect both RDJ UK and Peter Wong from any future liabilities
- ensure a complete review is undertaken of all other contractors, in respect of the off-payroll working rules

APPENDIX 1

Direct Deemed Payment for the period April 2021 - March 2022

Invoice total	114,000
Less: Expenses/Materials:	
<u>Stationary/Printing</u>	<u>(2,800)</u>
Deemed Direct Payment	111,200

APPENDIX 2

Summary of outstanding National Insurance in relation to Peter Wong

Class 1 National Insurance due on £111,200 by Peter Wong

$$\begin{aligned} &= 0 - 9,568 \times 0\% = 0 \\ &= 9,568 - 50,270 \times 12\% = \text{£}4,884 \\ &= 50,270 - 111,200 \times 2\% = \text{£}1,128.60 \end{aligned}$$

Total = £6012.60

Class 1 National Insurance due on £111,200 by RDJ UK

$$\begin{aligned} &= 0 - 8,840 \times 0\% = 0 \\ &= 8,840 - 111,200 \times 13.8\% = \text{£}14,126 \end{aligned}$$

APPENDIX 3

Summary of outstanding PAYE due in relation to Peter Wong

$$= 111,200 \times 40\% = \text{£}44,480$$