The Chartered Tax Adviser Examination

May 2019

Application and Professional Skills

Human Capital Taxes

Suggested solution

DRAFT REPORT TO JOHN GARDNER ON STAFFING OF THE PROJECT FOR THE NEW IT SYSTEM FOR JANET'S REVIEW

Report for: Grange Stevens Group Ltd

For the attention of: John Gardner, HR Director

Date: 30 April 2019

Subject: Tax Advice for Staffing on IT Project

This report is based on the information provided at our recent meeting and your subsequent email dated 25 April 2019.

This report is based on legislation and guidance applicable at the time of writing this report. Please note that this report is for the use of Grange Stevens Group Ltd only and other parties should not rely on the report. It should also be noted that this report is limited to the UK tax and social security implications of the proposed staffing arrangements and we recommend that you seek overseas tax advice from the relevant locations as necessary.

INTRODUCTION

You have asked for our advice in relation to the staffing of your IT project which is to commence on 1 January 2020. You have advised us that you have flexibility for the start date and could delay this until after 6 April 2020 and that you will source staff from your existing employee base, either from the UK or overseas.

EXECUTIVE SUMMARY

We have considered whether it is more cost effective to use UK or overseas staff and also when it would be best for your project to commence.

We agree that it would be significantly cheaper to use a team from your overseas offices, specifically from Sofaland.

See below for a summary of total costs per head:

	10% tax locations		**Sofaland**	
	Jan 2020 start	**April 2020 start**	**Jan 2020 start**	**April 2020 start**
International team	65,481	62,782	52,083	49,313
UK team	67,704	68,060	67,704	68,060
Difference per head	**£ 2,223**	**£ 5,278**	**£ 15,621**	**£ 18,747**

Of course, if the project over-runs by say one month, all above costs could increase by approximately 14%.

We recommend a wholly Sofaland team for the IT project with a start date of 6 April 2020. However, if the aim is to include representation from your global business we recommend using a team mainly from the Sofaland with at least one representative from another of the overseas locations or the UK.

1. NATIONAL INSURANCE

UK Class 1 National Insurance contributions for both the employees and Grange Stevens Group Ltd would continue as normal for all UK employees regardless of which UK office they come from within the Group.

For employees assigned from a country with which the UK has a reciprocal social security agreement, a certificate of coverage should be obtained to maintain the employees and their respective home employer in their home country social security scheme so no UK contributions will be due. Where no reciprocal agreement exists, the UK allows an exemption for the first 52 weeks from National Insurance so again, contributions will not be due.

When considering the overall cost, home country social security needs to be included plus the costs of obtaining the certificates of coverage; see Appendix 1. For the purposes of these calculations we have assumed that home country social security will only be calculated on the individual's basic package (salary, car allowance and medical insurance). These assumptions are not guaranteed to be correct and I recommend that you review the overall situation with suitably qualified adviser in the relevant country.

2. LIABILITY FOR UK EMPLOYMENT TAX

For a UK sourced team, the existing PAYE and National Insurance obligations will continue.

For an overseas team we need to consider what duties they may undertake and whether UK tax will be due.

Where an employee works in the UK for a UK business, then the UK business is liable to operate PAYE even though they are not the employer. This means that employees assigned from your overseas sites will be deemed to work for you and you will be obliged to operate PAYE.

PAYE would be due from day one, however, in recognition of possible exemption from UK tax under a Double Tax Agreement, you may apply to HMRC for an "Appendix 4" agreement which relaxes PAYE obligations if the following conditions are met:

- The employees are resident in a country which has a Double Tax Agreement with the UK;
- The employees are expected to stay in the UK for less than 183 days in any 12-month period;
- The employees are coming to work in the UK for a UK company or the UK branch of an overseas company or are
- legally employed by a UK resident employer, but economically employed by a separate non-resident entity; and
- The remuneration specified for the employees concerned, and who are present in the UK for 60 days or more, is not ultimately borne by a UK branch or UK permanent establishment of a non-resident employer.

We need to consider all conditions below as it is important to note that all tests need to be met; if any one test fails, there is no need to proceed to the next test.

Double Tax Agreements

All your international subsidiaries are in countries which have a Double Tax Agreement with the UK with the exception of Sofaland. For assignees from Sofaland, Grange Stevens Group Ltd would have an obligation to account for PAYE from day one. An Appendix 4 agreement would not be suitable for those employees.

For the employees for whom a Double Tax Agreement is relevant, any part of a day spent in the UK is counted. As the project is scheduled to last for seven months employees are likely to spend more than 183 days here even if they return home for occasional weekends. In the event of an extension, exceeding 183 days in any rolling 12 month period is even more likely which means exemption from UK tax would fail and UK tax would be due. Please note that the method of counting days is different to the midnight test used as part of the UK statutory residence test.

If the total days were less than 183, we move to the next test.

The Employer

HMRC use the principle of economic employer when interpreting the OECD model Double Tax Agreement; considering many factors in determining which business economically receives the benefit and takes the risk for employees.

You are planning to recharge costs from the overseas group companies to Grange Stevens Group Ltd, meaning that costs are borne in the UK. Grange Stevens Group Ltd managers will be responsible for employees on this project, handling appraisals and performance reviews: this indicates that the employees are integral to Grange Stevens Group Ltd and working "for" a UK company. Our opinion is that Grange Stevens Group Ltd will be considered the employer for PAYE purposes for all overseas employees and exemption under a Double Tax Agreement would not be applicable for any of the international employees, resulting in a liability to UK tax for each employee and an obligation to account for PAYE. An Appendix 4 agreement is not applicable.

3. OPERATION OF PAYE

As noted above, the PAYE obligations for a UK sourced team would be unchanged.

For an overseas sourced team, there is an option to use a "modified" EP Appendix 6 PAYE arrangement whereby the operation of the payroll is relaxed in return for Grange Stevens Group Ltd committing to calculation and reporting obligations. Grange Stevens Group Ltd would pay to HM Revenue and Customs estimated PAYE in equal monthly instalments during the tax year with a reconciliation at the year end. We would strongly recommend this approach not only for the relaxed nature of a modified arrangement but also to separate these more complex arrangements from your existing UK payrolls to reduce the risk of penalties.

As no withholding exists when employees are working outside Sofaland for more than three months, hypothetical tax could be taken as a deduction against taxable pay. In other words the individual's gross pay is reduced by the amount of tax they would have paid in their home country but instead of this being remitted to the tax authorities it is retained by the company to offset against the taxes paid on their behalf in the destination country. This would be taken at the effective rates of income tax on employment income which you have provided; 10% for all countries apart from Sofaland which is 40%. Any UK taxes paid by Grange Stevens Group Ltd would be considered additional taxable UK income here in the UK.

For employees from the 10% tax countries, you should fund the payment of UK tax as a loan which is settled if employees are able to obtain a refund in their home location by claiming tax relief for the UK tax paid. A formal loan arrangement is recommended for which you should seek legal advice.

Based on our calculations the amount of tax is unlikely to exceed £10,000 so no action is needed for P11D purposes. If the loan exceeds £10,000, beneficial interest should be included on forms P11D.

When the individuals make their home country tax filings they should make a claim for double tax relief and remit any refund received to their employer. As relief under a double tax agreement will be restricted to 10%, the remaining loan should be written off which is taxable.

<u>Tax Returns</u>

Employees may need assistance with their home country tax returns and to reconcile their "stay at home" tax position. As discussed we can coordinate this through our network and provide a fee quote to assist you with running your modified payroll if required.

Employees within this scheme are required to complete UK self assessment tax returns. We can prepare these returns; we would need to amend our current engagement letter to include tax return services and our fees for both the home and host returns will themselves form a taxable benefit for the employees, thereby increasing costs further.

The costs of the UK taxes payable by Grange Stevens Group Ltd should also be factored in; see Appendix 2 and 3 below for calculation of tax and total costs for 10% tax locations and Sofaland.

<u>Pension</u>

You are correct that the employer's UK pension contributions would not represent earnings.

For the international pension scheme, the ability for the employees to take loans or early withdrawals would deny the scheme equivalent tax-free status in the UK making the employer's contributions taxable income.

4. EXPENSES AND BENEFITS

<u>Travel and Subsistence</u>

Where employees are assigned to a new workplace for a period of up to 24 months, temporary workplace relief would apply. As the Oxford site will be a temporary workplace and the payment of travel to and from that workplace will be tax-free. This applies both to those existing UK employees who are not already based in Oxford or those seconded from overseas to work on the project.

The cost of business travel also includes subsistence costs attributable to the journey in question. The full cost of meals whilst travelling or staying away on business is allowable as part of the costs of travel. For the overseas employees coming to work in the UK any employer paid costs of their visa or work permits would also fall under this exemption. No reporting is needed for business travel on forms P11D and the amount is not liable to Class 1A NIC.

We understand you are proposing an additional cash allowance for international employees which allows family to visit them whilst they are seconded the UK. This does not meet the conditions of home leave relief as to qualify flights would either have to be provided by Grange Stevens Group Ltd or reimbursed based on actual expenses. As such this allowance would be liable to tax in the UK. We recommend that you pay expenses or arrange the flights direct so that up to two return flights per year could be tax-free. Note that family members which qualify for tax free travel are restricted to the employee's spouse, civil partner or child (aged under 18 at the start of the journey into the UK).

<u>Accommodation</u>

For employees seconded temporarily to Oxford, accommodation may also be provided tax-free subject to certain limits under temporary workplace relief. The tax-free element is limited to accommodation appropriate for each employee, for example a one bed property for an employee travelling alone. Costs for accommodation larger than needed for a single employee would be liable to tax so we recommend that any employees are each provided with one bedroomed accommodation and not accompanied by their families.

We recommended that hotel or rented accommodation are not provided for the employees seconded to the project who are already based at Oxford as this will be a taxable benefit in kind, reportable on P11D and liable to employer's Class 1A NIC at 13.8%.

Assignment Allowance

The assignment allowance payable to employees from overseas would not be exempt from tax under the UK relocation provisions as it is a round sum payment and also relocation expenses would not be relevant as employees would only be seconded to Oxford for seven months so it is unlikely that employees would be moving their home as a result of the project.

We recommend that you consider reimbursing employees for their subsistence costs which are tax-free in the UK instead of paying the assignment allowance.

Car Allowance

We note that you are currently offering a cash allowance to all employees. This would be liable to tax and Class 1 NIC as regular employment income for UK-based employees and to UK tax and overseas social security for overseas employees.

Travel Insurance

The travel insurance is not a taxable benefit in the UK as the insurance provides cover for Grange Stevens Group Ltd for costs associated with the delay or cancellation of travel by employees on business.

Telephone

Any round sum cash allowance paid to employees would be liable to tax and Class 1 NIC and has been included in the amount of taxable income. It is recommended that telephone costs are instead claimed by employees through the tax-free £5 per overnight exemption which is permitted by HMRC. This exemption allows for the tax-free reimbursement of personal items such as laundry, telephones or newspapers which employees may claim when working away from home. This could also be extended to UK employees seconded to Oxford.

5. PROJECT START DATE

If you use UK based staff, the start date will have little impact on overall costs because you are paying the existing staff anyway. As total costs would increase as a result of the backfill temporary jobs, there may be some benefit in advancing or delaying work. For example, corporation tax relief for the extra costs would be advanced if some are incurred before 31 March, but this would need to be balanced with the cashflow effect of advancing the expenditure. The rate of corporation tax reduces by 1% to 18% from 1 April 2020 so costs are slightly cheaper with a 1 January 2020 start date.

Assuming no previous visits to the UK, a 1 January 2020 start date would mean overseas employees are likely to remain non-resident in the UK for both the 2019/20 and 2020/21 tax years therefore ineligible for UK personal allowances; non-EU nationals and double tax treaties preclude UK non-tax residents the right to a personal allowance. There will also be two years' worth of UK payroll and tax return costs.

A 6 April 2020 start date is likely to mean overseas employees become tax resident under UK domestic rules, giving entitlement to personal allowances, exempting the first £11,850 of their income. As the project would take place entirely in 2020/21 you would only incur one year's worth of payroll and tax return costs.

I would also comment that while we believe it is likely that the individuals are likely to be considered non UK domiciled and eligible for overseas workday relief this is not relevant for this project as all the duties are anticipated to be performed in Oxford.

6. COSTS OF UK TEAM VERSUS OVERSEAS TEAM

From the workings you will see that using a UK team for the project would cost at most £68,060 per employee (Appendix 1).

The costs for an overseas employee from Sofaland would be £52,083 for a January 2020 or £49,313 for a start date from 6 April 2020 (Appendix 2).

The cost per employee of using an overseas team from any of your 10% tax locations would be £65,481 for a January 2020 start date or £62,782 for a post 5 April 2020 start date (Appendix 3).

The Sofaland costs are significantly lower due to the reduced UK tax gross-up due to a 40% tax hypothetical tax deduction and the entitlement to personal allowances if the project starts from 6 April 2020.

The maximum possible savings which would be achieved by Grange Stevens Group Ltd using a Sofaland team compared to a UK team is £18,747 per employee.

We have not included any mark-up on the costs for the overseas team, however, we recommend that you consider your transfer pricing policy with regard to the recharge of costs from overseas to the UK. As you know transfer pricing applies as Grange Stevens Group Ltd would be obtaining a service in the form of seconded employees from within the group, ie not at arms length. Where a benefit is deemed to arise, the legislation requires an adjustment be made to profits to eliminate the distortion. Advance clearance could be obtained from HMRC if required so we suggest the position is reviewed and agreement requested if necessary. We are able to assist with this if required.

7. CONCLUSION

At £49,313 per employee, using a team wholly from Sofaland would give the lowest overall cost. However, as a more diverse team is required, we would suggest using mostly Sofaland team members with at least one employee from UK and a 10% tax location with a start date after 5 April 2020.

I trust this report provides sufficient analysis and of course, you should take this analysis alongside your HR research to help you decide what is right for the business as a whole and the required outcome of this project.

If you would like us to carry out any further analysis of any other staffing scenario or indeed provide cost estimates for different combinations of UK and international employees, please let us know.

Appendix 1: UK Staff Costs

	01/01/2020	06/04/2020
	£	£
Costs per Exhibit B	73,300	73,300
Backfill recruitment costs @ 20% of salary	9,700	9,700
Total cost before adjustment for corporation tax relief	83,000	83,000
Less CT saving (Deductible amount x 19% for costs 1/1/19 to 31/3/19 and 18% after 31/3/20)	(15,296)	(14,940)
Cost after all taxes	**£ 67,704**	**£ 68,060**

Appendix 2: Calculation of comparative costs for one staff member – Sofaland

	01/01/2020	06/04/2020
	£	£
Costs per Exhibit B	50,300	50,300
Assignment Allowance	5,000	5,000
Hypotax (40% of salary, car allowance and medical insurance)	(14,000)	(14,000)
Home country employer social security (W3)	4,200	4,200
UK income tax payable by employer (W1 & W2)	8,150	5,038
Tax compliance costs - UK - Tax Return	1,200	600
Tax compliance costs - Overseas Tax Return	600	600
Visa costs	2,000	2,000
Backfill recruitment costs @ 20% of salary	6,400	6,400
Total cost before adjustment for corporation tax relief	63,850	60,138
Less CT saving (Deductible amount x 19% for costs 1/1/19 to 31/3/19 and 18% after 31/3/20)	(11,767)	(10,825)
Cost after all taxes	**£ 52,083**	**£ 49,313**

Appendix 3: Calculation of comparative costs for one staff member - Other Overseas Locations 10% Tax Location

	01/01/2020	06/04/2020
	£	£
Costs per Exhibit B	50,300	50,300
Assignment Allowance	5,000	5,000
Hypotax - none as home country taxes remain		
Home country employer social security (W3)	7,000	7,000
UK income tax payable by employer (W4 & W5)	1,455	833
Future predicted tax loan write-off (W4 & W5)	5,820	3,300
Tax compliance costs - UK - Tax Return (x2 if 1/1/20)	1,200	600
Tax compliance costs - Overseas Tax Return	600	600
Certificate of Coverage	500	500
Visa costs	2,000	2,000
Backfill recruitment costs @ 20% of salary	6,400	6,400
Total cost before adjustment for corporation tax relief	80,275	76,563
Less CT saving (Deductible amount x 19% for costs 1/1/19 to 31/3/19 and 18% after 31/3/20)	(14,794)	(13,781)
Cost after all taxes	**£ 65,481**	**£ 62,782**

Appendix 4: Workings

W1 & W2 UK income tax payable by employer - Sofaland	W1			W2
	01/01/2020			06/04/2020
	Total	2019/20	2020/21	2020/21
UK taxable employment income	£	£	£	£
Costs per Exhibit B	50,300	21,557	28,743	50,300
Less non taxable (accommodation, travel and travel insurance)	(10,500)	(4,500)	(6,000)	(10,500)
Assignment Allowance	5,000	2,143	2,857	5,000
Hypotax (40% of salary, car allowance and medical insurance)	(14,000)	(6,000)	(8,000)	(14,000)
Tax compliance costs - UK - Tax Return	1,200	600	600	600
Tax compliance costs - Overseas Tax Return	600		600	600
	32,600	**13,800**	**18,800**	**32,000**
Less personal allowance				(11,850)
Total Taxable Income	32,600	13,800	18.800	20,150
Grossed up UK basic rate tax @ 20/80	**£ 8,150**	**£ 3,450**	**£ 4,700**	**£ 5,038**

W3 Home Country Overseas Social Security	Sofaland	Other 10% Locations
	£	£
Salary, car allowance and medical insurance	35,000	35,000
Hypotax (as W1)	(14,000)	
Amount liable to social security	21,000	35,000
Employer Social Security @ 20%	**£ 4,200**	**£ 7,000**

W4 & W5 UK income tax payable by employer – 10% locations	W4			W5
	01/01/2020			06/04/2020
	Total	2019/20	2020/21	
UK taxable employment income	£	£	£	£
Costs per Exhibit B	50,300	21,557	28,743	50,300
Less non taxable (accommodation, travel and travel insurance)	(10,500)	(4,500)	(6,000)	(10,500)
Assignment Allowance	5,000	2,143	2,857	5,000
Tax compliance costs - UK - Tax Return	1,200	600	600	600
Tax compliance costs - Overseas Tax Return	600		600	600
	46,600	19,800	26,800	46,000
Less personal allowance				(11,850)
Total Taxable Income	46,600	19,800	26,800	34,150
UK tax @ 20%	9,320	3,960	5,360	6,830
Loan Amount (*Note all loans below £10k threshold)	9,320			6,830
Expected home country double tax relief (W6)	(3,500)			(3,500)
Future predicted tax loan write-off	**5,820**			**3,330**
Grossed up UK basic rate tax @ 20/80	**£ 1,455**			**£ 833**

W6 Expected home country double tax relief	
	£
Salary, car allowance and medical insurance	35,000
Expected home country DTA @ 10%	**£ 3,500**

ASSESSMENT NARRATIVE

Structure

A simple pass or fail will be awarded.

Identification and Application

The following are the relevant topics for assessment with their weightings:

1	5%	Identification of the issues around NIC for UK employees, existence of reciprocal arrangements and the need to obtain certificates of coverage or 52 week exemption from UK NIC for all overseas locations. Need to operate social security on packages for international employees.
2	20%	Explanation of the liability to UK income tax including operation of PAYE for Grange Stevens Group Ltd and whether an appendix 4 agreement is applicable, impact of double tax treaties and who the employer would be. Concluding that appendix 4 is not applicable
3	20%	Identification of the need to operate PAYE and use of an appendix 6 agreement, withholding tax needed in international locations with the exception of Sofaland, tax equalisation calculation and need for employees to file a SATR. Pension and employer contributions being taxable.
4	25%	Identification of the issues regarding expenses and benefits including travel and subsistence and TWR, accommodation. Assignment allowances, Travel Insurance and Telephone expenses including the taxable position on all.
5	10%	Comparison of the impact of January 2020 or April 2020 start dates including additional tax returns needed for Jan 2020 v more likelihood of personal allowances for non-EU nationals becoming UK resident.
6	20%	Calculation of the costs of the project per employee including Jan or April 2020 start dates and use of UK v international teams. Includes narrative and comparison of costs and potential savings which could be made by using a UK team. Link to the diversity of needing at least one employee from Sofaland. Comment on transfer pricing issues which may be in play.

A grade of 0,1,2,3, or 4 is awarded to each topic. The weighting is applied to that grade to produce a weighted average grade. This is then converted to a final absolute grade by rounding up or down to the nearest grade. Thus, scores in the range 2.5 to 3.49 will be a grade 3. In this example, the candidate will score a grade 3 overall and secure a pass for this skill.

Relevant Advice and Substantiated Recommendations

The following are the topics for assessment with their weightings:

60%	Recommendations regarding whether to use a UK or international team, especially in view of the fact that the client's pre-conceived idea is that an international team is cheaper.
20%	Recommendation regarding the start date of the project.
10%	Recommendation regarding which international team would be better to use, e.g. recommending that Sofaland employees would be cheaper than any other international location

10%	Recommendations regarding the amended structure of the package to make more tax efficient. Including flights v home leave, assignment allowance v relocation, TWR and housing not for Oxford employees and telephone.

The final grade will be determined for this skill in the same way as for Identification and Application.