ICAEW KNOW-HOW
TAX FACULTY

OFF PAYROLL WORKING: CROSS-BORDER ISSUES: ICAEW'S PRACTICAL Q&As

TAXGUIDE 07/20

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This guidance note comprises questions put to HMRC in December 2019 and our suggested responses. Pending HMRC replying, we have inserted below extracts from HMRC's guidance.

This guidance is based on our current understanding of the prospective measures and should be treated as provisional.

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In all of the following scenarios the end client is medium or large, ie subject to the off-payrolling rules, unless otherwise stated.

In the scenarios in Section A we have not discussed the interaction of tax treaties on the income tax position. This is because we have a separate question, in Section B, regarding the interpretation of treaties.

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TAXguides are published by the Tax Faculty to provide practical guidance to businesses and tax practitioners on important developments to tax practice and policy.

CONTENTS

SECTION A – SIX SCENARIOS

Scenario 1

UK resident client engages contractor's PSC.

Contractor and the contractor's PSC are resident in Germany.

No duties are performed in the UK.

Q1: If these facts applied to a direct employment, no income tax is chargeable on any earnings so there is no need for the employer to operate PAYE. If the contractor is a deemed employee, will there be no UK tax liability and therefore no obligation on the client to operate PAYE? Are there any RTI reporting requirements?

Suggested response:

1. Provided the end client has taken reasonable care to confirm that the contractor is resident in Germany and that no duties are performed in the UK, there will be no UK tax liability on the payment for the duties performed. There will be no requirement to pay UK NIC because the worker is not gainfully employed in the UK. As there is no UK social security due, there is also no requirement to pay the apprenticeship levy on any payments. There is no requirement to perform an employment status determination or to issue a status determination statement (SDS) or to put in place a disagreement process for such a contractor.
2. Payments to the contractor's PSC should not be reported via RTI and there is no need to apply for an NT code number for the contractor.

HMRC's guidance:

HMRC's guidance at ESM10025 confirms that no tax is due. It states that:

"The worker must be a person who is within the UK charge to tax and/or liable for Class 1 NICs.

"Where a worker should be subject to UK tax and NICs (based on existing domicile and residency rules), then UK domestic legislation applies to the engagement. This means the engagement could be subject to Chapter 10 (tax) / Part 2 (NICs) rules. A client does not need to consider whether Chapter 10 / Part 2 rules apply where there is no liability to tax and NICs in the UK."

Scenario 2

UK resident client engages contractor's PSC.

Contractor and contractor's PSC are resident in Germany and not UK resident under the UK's domestic legislation. The contractor is expected to perform 25% of the work in the UK.

Q2: What are the client's off-payroll working obligations?

Suggested response:

3. The client will be obliged to undertake an employment status determination and issue it to the worker and account for PAYE if the contractor is a deemed employee. There will also need to be a dispute resolution process put in place.
4. The client will be classed as an employer under s690 ITEPA 2003 and can apply under s690(2) ITEPA 2003 (Employee non-resident etc.) to HMRC for a direction to operate PAYE on just the 25% UK-related income. Without such a direction the client should operate PAYE on 100% of the fee paid unless the end client can accurately measure the percentage of the work performed in the UK and operate PAYE on that percentage so that there is no underpayment of PAYE. If the client is liable to pay the apprenticeship levy the client will also be liable for the apprenticeship levy in respect of the fees paid to this contractor's PSC.

5. If the worker had an A1 certificate confirming that the worker was liable to German social security, no UK social security would be due. If no UK social security is due then there would also be no requirement to pay apprenticeship levy.

HMRC's guidance:

HMRC's guidance does not fully cover this scenario. Guidance at ESM10025 sates that:

"Worker in the UK

"A worker carrying on duties in the UK for an end client will normally fall within scope of the UK charge to tax and be within the off-payroll intermediaries' legislation. There are some exceptions for non-UK residents visiting the UK briefly

•*https://www.gov.uk/tax-come-to-uk(link is external)*
•*https://www.gov.uk/tax-return-uk(link is external)*

"Class 1 NICs should be deducted unless the worker coming to the UK can present documentation proving that they pay social security contributions in another country for which special rules apply or domestic legislation deems NICs not to be due. For example, a non-UK resident worker provides their services in the UK, but holds a certificate of coverage for another country. In this situation the worker would be liable for NICs in the UK, but are exempt because of the certificate of coverage."

Scenario 3

UK resident client engages contractor's PSC.
Contractor is UK resident but non-UK domiciled and contractor's PSC is UK resident.
Contractor performs 75% of the work in the UK.

Q3: What are the client's off-payroll working obligations?

Suggested response

6. Where the contractor meets the conditions for the remittance basis and the conditions in s26A ITEPA 2003 are met so that s26 ITEPA 2003 is satisfied, the client can benefit from what is commonly referred to as Overseas Workday Relief (OWR) and apply for a s690 ITEPA 2003 determination to operate PAYE only on the 75% UK-related payments. This is subject to at least 25% of the payments being made into an offshore bank account and the payments not being remitted to the UK.
7. Many individuals who qualify for OWR are not liable to UK NIC. If the individual had an A1 or other certificate of coverage exemptingthe individual from UK National Insurance no National Insurance contributions would be due. There would also not be any apprenticeship levy liability.
8. If an appropriate certificate is not held UK National Insurance and the Apprenticeship Levy would be due on 100% of the payments and not just 75% of the payments for UK duties.

HMRC's guidance:

As in Scenario 3, HMRC's guidance does not fully cover this point.

Scenario 4

German resident client engages contractor's PSC.

Contractor and PSC are resident in UK.

All duties are performed in UK.

Q4: What are the client's off-payrolling obligations?

Suggested response:

9. We believe that the aim of the legislation is that the client is obliged to account for PAYE (s61R ITEPA03 (not amended in draft FB legislation)). We should welcome clarification of how HMRC will ensure compliance, as, following the principles in Clark (HMIT) v Oceanic Contractors Inc. [1982] BTC 417, explained in HMRC's guidance PAYE81610 PAYE operation: international employments: employers' presence in UK, UK PAYE legislation cannot be enforced on an entity with no UK PAYE presence. We therefore consider that in this scenario the obligation to determine whether the engagement is within IR35 falls on the PSC in the same way as if the client were small.

HMRC's guidance:

HMRC's guidance confirms the above answer. ESM10025 states:

"Client wholly overseas

"Where a medium or large-sized non-public sector client is based wholly overseas, so there is no UK connection in the form of being UK resident or having a permanent establishment then the rules at Chapter 10, Part 2, ITEPA 2003 do not apply (see ESM10006). The worker's intermediary should consider whether Chapter 8, Part 2, ITEPA 2003 applies for these engagements."

Scenario 5

As for Scenario 4 save that 75% of the duties are performed in the UK.

Q5: What are the client's off-payrolling obligations?

Suggested response

10. As for scenario 4 we do not believe that the obligation to determine employment status can fall on the end client following the principles of the Oceanic case (Clark (HMIT) v Oceanic Contractors Inc. [1982] BTC 417). If the contractor works 25% abroad and meets the conditions in s26A, the PSC would be able to apply to HMRC under s690 for a determination to be able to operate PAYE on only the UK proportion of the earnings paid by the client to the PSC if at least 25% of the earnings were paid into a non UK bank account..
11. Many individuals who qualify for OWR are not liable to UK NIC. If the individual had an A1 or other certificate of coverage exempting the individual from UK NIC no NIC would be due. There would also not be any apprenticeship levy liability.
12. If an appropriate certificate is not held then UK NIC and the apprenticeship levy would be due on 100% of the payments and not just the 75% of the payments for UK duties.

HMRC's guidance:

HMRC's guidance doesn't fully cover this scenario.

Scenario 6

German resident client engages contractor's PSC via an agency.

Agency, contractor and contractor's PSC are resident in UK.

All duties are performed in UK.

Q6: What are the client's off-payrolling obligations?

Suggested response

13. If the client were UK resident, it would issue an SDS to the agency (the draft law at new s61N(5) needs changing to clarify this point) and the worker, and the agency as fee payer would be obliged to account for PAYE if appropriate.
14. As the client is non-UK resident and has no UK PAYE presence, following the principles of the Oceanic case, the end client cannot be made to issue a SDS. Does the agency/fee payer, therefore, have to make the employment status determination and issue an SDS? No, as the off-payrolling legislation does not impose any obligation on the agency to issue an SDS.
15. In this scenario, despite the provisions of s61R ITEPA 2003 relating to deemed payments, we should welcome clarification of how HMRC will ensure compliance, as, following the principles in Clark (HMIT) v Oceanic Contractors Inc. [1982] BTC 417, explained in HMRC's guidance PAYE81610 PAYE operation: international employments: employers' presence in UK, UK PAYE legislation cannot be enforced on an entity with no UK PAYE presence. The UK courts will not be able to require the overseas resident client to issue an SDS or operate PAYE or instruct the fee payer to do so.

HMRC's guidance:

ESM10025 states:

"Client wholly overseas

"Where a medium or large-sized non-public sector client is based wholly overseas, so there is no UK connection in the form of being UK resident or having a permanent establishment then the rules at Chapter 10, Part 2, ITEPA 2003 do not apply (see ESM10006). The worker's intermediary should consider whether Chapter 8, Part 2, ITEPA 2003 applies for these engagements."

SECTION B – TAX TREATIES AND THE OFF-PAYROLLING RULES

You will see from the above examples that, if the end client is not a UK resident and has no place of business in the UK, we believe that the end client cannot become the deemed employer and does not have an obligation to issue an SDS. However, if the end client had a UK branch, then we can see that the courts might uphold the obligation for the end client to issue an SDS etc.

Under such circumstances, does HMRC accept that, where the SDS is issued and the worker is deemed to receive deemed employment income, the end client becomes become the employer for the purpose of treaty relief?

Consequently, if the scenario is that the end client is resident in, say, Germany but the worker and the contractor's PSC are resident in the UK, then, when looking at whether Germany can tax the deemed employment income, following the decision in *Fowler and The Commissioners for Her Majesty's Revenue and Customs* [2018] EWCA Civ 2544 would HMRC view the end client as the

employer and consider that the employment income article should apply? In other words, exemption from German taxation would not be possible because the employer, ie the end client, is resident in Germany.

Likewise, please confirm that if one were looking at exemption from UK taxation where the worker was treaty resident in Germany, the end client would be considered the employer and, if no costs were borne by the UK branch, treaty relief could be due if the other conditions of the employment income article were met.

The above view is based on the latest decision in the Fowler case and consequently we would like to know whether HMRC is appealing the decision in Fowler.

The other issue that should be considered is that although HMRC may view the payments from the end client as employment income, the other treaty partner such as Germany may not view the income in that way but as self-employment income. Under such circumstances will HMRC accept the other treaty partner/German view on the basis that the OECD commentary on the employment income article states:

"8.1 It may be difficult, in certain cases, to determine whether the services rendered in a State by an individual resident of another State, and provided to an enterprise of the first State (or that has a permanent establishment in that State), constitute employment services, to which Article 15 applies, or services rendered by a separate enterprise, to which Article 7 applies or, more generally, whether the exception applies. While the Commentary previously dealt with cases where arrangements were structured for the main purpose of obtaining the benefits of the exception of paragraph 2 of Article 15, it was found that similar issues could arise in many other cases that did not involve tax- motivated transactions and the Commentary was amended to provide a more comprehensive discussion of these questions.

8.2 In some States, a formal contractual relationship would not be questioned for tax purposes unless there were some evidence of manipulation and these States, as a matter of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.

8.3 If States where this is the case are concerned that such approach could result in granting the benefits of the exception provided for in paragraph 2 in unintended situations (e.g. in so-called "hiring-out of labour" cases), they are free to adopt bilaterally a provision drafted along the following lines:

Paragraph 2 of this Article shall not apply to remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and paid by, or on behalf of, an employer who is not a resident of that other State if:

a) the recipient renders services in the course of that employment to a person other than the employer and that person, directly or indirectly, supervises, directs or controls the manner in which those services are performed; and

b) those services constitute an integral part of the business activities carried on by that person.

8.4 In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 b) and c). Subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise, ***it is a matter of domestic law of the State of source to determine whether services rendered by an individual in***

that State are provided in an employment relationship *and that determination will govern how that State applies the Convention.*

8.5 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for purposes of domestic tax law even though these services are provided under a formal contract for services between, on the one hand, the enterprise that acquires the services, and, on the other hand, either the individual himself or another enterprise by which the individual is formally employed or with which the individual has concluded another formal contract for services.

8.6 In such cases, the relevant domestic law may ignore the way in which the services are characterised in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.

8.7 ***Since the concept of employment to which Article 15 refers is to be determined according to the domestic law of the State that applies the Convention*** *(subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise), it follows that a State which considers such services to be employment services will apply Article 15 accordingly. It will, therefore, logically conclude that the enterprise to which the services are rendered is in an employment relationship with the individual so as to constitute his employer for purposes of subparagraphs 2 b) and c). That conclusion is consistent with the object and purpose of paragraph 2 of Article 15 since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.*

8.8 As mentioned in paragraph 8.2, even where the domestic law of the State that applies the Convention does not offer the possibility of questioning a formal contractual relationship and therefore does not allow the State to consider that services rendered to a local enterprise by an individual who is formally employed by a non-resident are rendered in an employment relationship (contract of service) with that local enterprise, it is possible for that State to deny the application of the exception of paragraph 2 in abusive cases. "(emphasis added)

HMRC's guidance:

HMRC's guidance does not cover these points.

ABOUT THE AUTHOR

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