UNITED KINGDOM EMPLOYMENT INCOME TAX CHANGES MAY AFFECT INTERNATIONAL GROUPS

Some current developments in United Kingdom tax law and Her Majesty’s Revenue and Customs practice will affect international groups that send their non-United Kingdom-based employees on business trips to the United Kingdom or second United Kingdom employees abroad to work for an affiliate.

“Merely Incidental” Activities

If a non-United Kingdom (UK) resident employee works in the UK – in other words, physically performs some of his employment duties in the UK – then, in principle, unless those UK activities are “merely incidental”, he is liable to UK income tax on the remuneration attributable to that UK work.

A double tax treaty may sometimes provide relief. However, if the employee is resident in a country that has not entered into a comprehensive tax treaty with the UK (for example, Brazil, Bermuda or Dubai) or if he has a dual employment contract arrangement and the UK work is performed under a contract with a UK employer, then no treaty is likely to protect him from the UK income tax liability.

In August 2012, Her Majesty’s Revenue and Customs (HMRC) revised its guidance on the meaning of “merely incidental”.

The case law is clear that the test is qualitative, not quantitative. If the work done in the UK is subordinate or ancillary to that done overseas, it is “merely incidental”. On the other hand, if the work done in the UK is of the same kind as that done outside the UK or, if not the same, of equal importance, it will not be “merely incidental”, however short the UK visit.

The updated guidance (in the HMRC Employment Income Manual at Paragraphs 40203 and 40204) is now more detailed and includes more examples of situations falling either side of the line. Generally, the effect is to narrow the scope of what HMRC regards as “merely incidental”. Previously, HMRC said that time spent in the UK by an overseas representative of a UK company to make reports or receive fresh instructions was “merely incidental”. However, this guidance has been tightened up. The example is given of a junior employee who works for an overseas subsidiary of a UK company and, on occasional visits to the UK headquarters, presents a report that has been prepared by the overseas business on local trade conditions or results, in a situation where the individual has no control over the overseas activities and is only required to pass on the report from his overseas employer and take instructions from the UK parent company back to the overseas employer; these duties are regarded as “merely incidental”. However, the guidance now says that if the individual is reporting on results where the performance of the overseas business is part of his personal core duties and responsibilities, then the making of that report will not be “merely incidental”.
Modern working practices, and especially communications, make it harder to restrict UK business trips to “incidental” duties. If an employee, who usually works outside the United Kingdom, visits the UK and while there arranges a meeting with a customer outside the UK, then that is “merely incidental”. However, if the employee replies to a substantive email from a customer (for example, requesting information or advice), while in the UK, then the answering email is not a “merely incidental” duty.

Any preparation work carried out in advance of a meeting, call or presentation with customers, colleagues, board-members or shareholders, or follow-up work after any such meeting, call or presentation, is not “merely incidental”, even though it does not involve interaction with anyone else. On the other hand, reading generic business emails that do not relate directly to the employee’s role or responsibilities, while in the UK, is “merely incidental”.

No change of law has occurred in this area but the expanded HMRC guidance does serve to focus attention on an area of tax liability that is often overlooked in practice.

Whether or not the income tax liability is solely the responsibility of the employee to report and pay, or whether the tax has to be accounted for by the employer on his behalf under the Pay As You Earn system, will depend on his legal employment contract arrangement and whether he is factually “working for” a UK business.

There are similar, although not identical, national insurance contributions issues, including potential employer’s liabilities, which are charged at 13.8% of the relevant remuneration.

As a practical matter, to avoid unexpected tax liabilities or tax compliance breaches, the scope of an employee’s activities during business trips to the UK should be restricted and recorded. In addition, care should be taken over the structuring and drafting of the employment contract, the drafting of the intra-group services agreement under which the individual employee is engaged in the delivery of those services and the intra-group recharging of payroll costs. These may all constitute evidence of the nature of the UK activities.

**New Statutory Tax Residence Test**

Also in summer 2012, the UK Government confirmed its intention to introduce a statutory test for individual tax residence and published draft legislation.

A revised draft of the legislation is expected to be published in December 2012, with the new law due to be enacted in 2013 and take effect on 6 April 2013.

The intention is to provide greater certainty in determining the UK tax residence status of an individual. At the moment, the concept is largely based on case law, supplemented by piecemeal statutory provisions.

The draft legislation echoes many of the features of the existing law. However, in certain situations, an individual’s status may be different under the proposed new regime.
In particular, where residence status is not clearly determined one way or another by simply counting the number of days on which the individual is present in the UK during the relevant tax year, the general position under current law (ignoring the case where an individual leaves the UK to work full time abroad) is that one looks at all the UK connecting factors in the round. Under the new law, the relevant UK connecting factors are to be codified into a set list of five ties, and a mechanistic formula, based on a combination of the number of connecting factors and the number of days spent in the UK, will then determine residence status.

In addition, the case law has tended to demand a “distinct break” in an individual’s lifestyle if he has been UK tax resident in prior years and is now claiming to have ceased to be resident. The UK Government proposes to codify the “adhesive” qualities of residence, meaning that it will be harder for a “leaver” to cease to be UK tax resident than for an “arriver” to become UK tax resident.

The personal tax residence status of an individual employee should not usually directly affect the employer’s tax liabilities. However, the implementation of the proposed new statutory residence test may affect employers indirectly, in that employees may become more sensitive about the length of time that they are being asked to work in the UK because of the potential impact on their personal tax position. Companies may find that employees become concerned about crossing particular day count thresholds.

One such threshold is the 15/16 day break point. Regardless of the number of UK ties, under the current version of the draft legislation, there is a straightforward rule that if the individual spends fewer than 16 days in the UK in the relevant tax year, then he will not be UK tax resident. This may mean that non-UK-based employees who are being asked to undertake business trips to the UK for more than approximately 2 weeks per annum may become concerned about the impact on their personal tax position.

Employees who are being sent to work abroad and are hoping to rely on the “full time work abroad” test for non-UK tax residence, will be anxious to restrict their UK return visits, so as to keep within the relevant day-counting thresholds. At the moment, an individual who has been UK tax resident can become non-resident if he goes to work full time abroad for a period that includes a complete tax year and he is not present for more than 90 days in the UK in the tax year. An unlimited amount of time can be spent in the UK on “incidental” duties. In addition, HMRC practice has been to ignore up to 10 days of substantive duties in the UK. Under the proposed new test, there is an allowance for up to 20 working days (meaning a day involving at least 3 hours of work) per annum. HMRC is considering whether the 20-day limit might be increased to 25 days, or the 3-hour floor raised to 5 hours. However, in any case, training and reporting activities, which were previously ignored as being “merely incidental”, will now count towards a UK workday.

Again in the context of foreign secondments, another potentially relevant threshold is at the 39/40 workday break point. A “leaver”, who has been UK tax resident in one or more of the last 3 years, whose family stays behind in the UK home and who cannot qualify as non-resident under the “full time work abroad” route referred to above, will be likely to want to keep his annual UK workdays below 40. Given that 3 hours (or possibly 5 hours) of work on any day will create a “UK workday” and that business travel time, or personal travel time used for work matters such as dealing with emails, will count as work time, this will potentially put pressure on the obligation to make frequent/lengthy business trips to the UK.
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