Q&A

Extending short term business visitors relief to overseas branches

Speed read

Businesses with internationally mobile employees will welcome the government's latest consultation, published on 14 May 2018, regarding the tax and administrative treatment of short term business visitors (STBVs). The policy drivers for reform are focused on ensuring the UK is seen as open for business and reducing administrative costs and burdens. The government recognises that the current rules do not provide relief for employees resident in non-treaty countries who visit the UK for work purposes, nor for employees of a foreign branch of a UK employer who visit the UK on business. The consultation puts forward two proposals: (1) extending the PAYE special arrangement UK workday rule to 60 days; and (2) a new tax exemption for STBVs from overseas branches (the option likely to be favoured by business). The consultation ends on 6 August 2018. The government is unlikely to implement either proposal before April 2020.

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HMRC is consulting on extending the relief for STBVs. What is the relief, and why is it needed?

The relief for STBVs is needed in countries ('host states'), such as the UK, which tax non-residents on their earnings from any employment duties performed for their foreign employers in the host state, even for just a day. Taxing such short visits is inappropriate, because:

- the compliance burden for the employees and the host state tax authority would be wholly disproportionate to the tax collected (often covered by personal allowances);
- the foreign employer will not normally have a permanent establishment (PE) in the host state, so the host state would be taxing the employee but giving no relief from corporate income tax to the employer; and
- such taxation is likely to adversely affect inward investment into the host state.

The relief is provided by double tax treaties. Under article 15(2) of the OECD Model Tax Convention ('OECD Model'), remuneration derived by a resident of a contracting state from an employment exercised in the host state is taxable only in the residence state if:

(a) the employee is present in the host state for a period or periods not exceeding 183 days in any 12 month period commencing or ending in the fiscal year;
(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the host state; and
(c) the remuneration is not borne by a PE which the employer has in the host state.

Whilst the relief under article 15(2) addresses the main problem of short term business visits to the UK outlined above, it does not provide relief for employees resident in non-treaty countries or employees of the overseas branch of a UK employer, who visit the UK on business. Employees from an overseas branch fail condition (b) in article 15(2), because their employer is UK resident. These gaps in the relief are addressed in the consultation.

Are there any other problems with the relief?

Almost all of the difficulties with the operation of the STBV relief spring from the relatively recent phenomenon of the international hiring out of labour, which would not have been envisaged by the original framers of the treaty relief. As mentioned above, the original relief was directed at employees who briefly visited the host state on behalf of their foreign employer and on its business. However, as drafted, article 15(2) is capable of applying where a non-UK resident company hires out or seconds its employee to its UK resident subsidiary or affiliate (the 'host employer') to work for a time in the UK host employer's business and under its direction and control.

Whether foreign employer has a UK PE

The first problem is whether the UK activities of the employee hired out by the foreign employer constitute a UK PE of the foreign employer; and whether the UK has to give tax relief to the UK host employer in respect of remuneration it is precluded from taxing. The difficulty with identifying a PE of the foreign employer in the UK is that the seconded employee works simultaneously in two businesses: the secondment business of the foreign employer; and the trading business of the UK host employer. STBV relief would only normally be precluded if the seconded employee's work in the UK constitutes a UK PE of the foreign employer's secondment business.

There is conflicting case law on whether such work is capable of giving rise to a PE in the host state (compare *W Dudney v R* (1999) 99 DTC 147 with *Hotel Manager* (1993) IR 80-81/91). There is a statement by HMRC in its *Double Taxation Relief Manual* at DT1923 that, in the case of a claim for STBV relief, it would not usually regard a foreign company seconding staff to a UK resident affiliate as giving rise of itself to a UK PE issue for the foreign company.

Whether UK affiliate is the seconded employee's 'economic employer'

The most intractable difficulty arising from the international hiring out of labour is a product of the PE issue. If the foreign employer does not have a UK PE, the seconded employee's UK source earnings should be exempt from UK tax under article 15(2); and the UK will have to give tax relief for the secondment fee charged (for transfer pricing reasons) by the foreign employer to the affiliated UK host employer in respect of the employee's UK work. HMRC expressed its objection to this outcome in *Tax Bulletin 17*.

When this problem surfaced, the OECD amended its commentary on article 15(2) by providing that, in abusive cases (foreign intermediaries set up to provide a sham formal employment), the host state should regard the host state user of the employee's services as the employee's 'employer' for

article 15(2)(b) purposes. This is because, even though the host employer was not the employee's formal employer, it controlled the employee's activities and obtained the benefits and bore the risks and responsibilities of the employee's work (see JF Avery Jones et al, *IBFD Bulletin*, October 2000, p 503). The employee was, therefore, sufficiently integrated into the host employer's business for the host employer to be regarded as the employee's 'economic employer'. If the employee's 'employer' for article 15 purposes was not his or her formal employer but his or her economic employer and that economic employer was resident in the host state, the relief was denied, because the condition in article 15(2)(b) was not satisfied.

Following the amendment to the OECD commentary on article 15, HMRC (then the Inland Revenue) amended its practice to introduce the 'economic employer' concept into the STBV relief in relation to both past and future treaties but without restricting it to abusive cases (*Tax Bulletin 17*; DT1922). This, however, caused some consternation in industry. Accordingly, in October 1996, HMRC published a further practice to the effect that, if an employee is present in the UK on fewer than 60 days in a tax year, and that period does not form part of a more substantial period during which the employee is present in the UK, the UK host employer should not be regarded as the employee's 'economic employer' for article 15(2) purposes. As HMRC later explained: 'The position of very short term visitors caused concern, and *Tax Bulletin 25* dealt with this in October 1996' (T*ax Bulletin 68*).

As the economic employer concept is concerned with the degree of an employee's integration in the business of the host employer, this 60 day rule is artificial and arbitrary. It is based on a day count, rather than on a workday count, though the degree of an employee's integration in the business of the host employer is more likely to be affected by workdays than total days spent in the UK. More importantly, the test only considers days spent in the UK. An employee could be seconded to work for a UK host employer for an entire year but only spend 59 of the days in that year in the UK. The degree of the employee's integration in the UK host employer's business would be substantial but the 60 day rule would not be infringed.

Subsequently, the OECD made further amendments to its commentary on article 15 to make it clear that the term 'employer' in article 15(2)(b) should be interpreted according to article 3(2) of the OECD Model. Article 3(2) provides that any term not defined in the OECD Model is, unless the context otherwise requires or an anti-abuse test applies, to have the meaning that it has under the tax law of the state applying the treaty. Some academic writers believe that the context always requires otherwise; and that, accordingly, 'employer' should be given an autonomous treaty meaning determined in accordance with the rules of the Vienna Convention (*Vogel on Double Taxation Conventions*, p 1145; *HMRC v Fowler* [2017] UKUT 219). However, the OECD made it clear in its amendments to the commentary (as confirmed by Vogel at p 1147) that 'employer' should be construed, under article 3(2), in accordance with the domestic tax law of the state applying the treaty. In the case of the exemption under article 15(2), this is the host state, as it is required to restrict its taxing rights. Where, under the law of the host state, a seconded employee is not regarded as an employee of the host employer, the OECD commentary suggests that contracting states add a provision to their treaties which excludes the article 15(2) relief in cases where the employee is seconded to a host employer in the host state, the employee's work is controlled by the host employer and the employee is integrated into the host employer's business. There is such a provision in the UK/Denmark treaty and a similar provision in the UK/Yugoslavia treaty was considered in *Kljun v HMRC* [2011] UKFTT 371.

UK tax law does not give any special meaning to the term 'employer' but, instead, gives it the same common law meaning that it has in UK contract and employment law. In particular, apart from a sham arrangement, UK tax law does not normally imply a direct contract of employment between a seconded employee and a UK host employer, because it is rarely necessary, in the tripartite setting of seconded worker, contractual employer and end client, to imply a direct contract of service between the worker and the end client (*James v Greenwich London Borough Council* [2008] EWCA Civ 35). HMRC argued this point in *Adecco (UK) Ltd v HMRC* [2015] UKFTT 600, quoting *Greenwich* and other similar cases. Furthermore, UK tax provisions such as the PAYE rules for host employers or the intermediaries legislation (IR35) do not deem the employee to be an employee of the end client. Indeed, IR35 would be redundant if UK tax law deemed a seconded worker to be an employee of the end client. In certain cases, an end client in the public sector can be regarded as a seconded worker's employer, but this deeming provision has a very narrow scope and (even if extended to the private sector) should not normally apply to employees seconded from one company in a multinational group to another.

Apart, therefore, from special circumstances in individual cases, the 'economic employer' concept is simply inapplicable to non-UK resident employees seconded to UK host employers and, accordingly, article 15(2) should normally be applied in the UK without reference to that concept. HMRC accepts, at DT1922, that the meaning of 'employer' in article 15 is that given by the domestic law of the host state but, nevertheless, continue to apply the 'economic employer' concept in the UK.

It can, therefore, now be seen that HMRC's artificial and arbitrary 60 day fix to the 'economic employer' problem is a case of a practice mending a broken practice introduced to give effect to a treaty concept that does not apply in the UK!

How does HMRC apply the STBV relief administratively?

Self-assessment and PAYE

Where a non-UK resident employee visits the UK on behalf of his or her foreign employer and no UK host employer is involved, the STBV relief should normally be a question of self-assessment. Under UK law, treaty benefits must be claimed and this is confirmed by DT1920. A certificate of residence from the foreign state may be required (HMRC's *International Manual* at INTM154040).

In cases involving a UK host employer, the PAYE system will be engaged, as UK host employers are obliged to operate PAYE, from day one, on the seconded employee's entire remuneration, unless they obtain a direction from HMRC as to the proportion of the remuneration, attributable to UK duties, on which PAYE should be operated (ITEPA 2003 s 690).

NT code

However, if the employee is resident in a treaty jurisdiction and intends to comply with the 60 day rule, the UK host employer can apply for an NT code for that employee, such that PAYE is not operated, provided a treaty claim will be made (see *PAYE Manual* at PAYE81625 and *Fryett v HMRC* [2014] UKFTT 220).

EP Appendix 4: the 60 day rule

If the UK host employer will be playing host to significant numbers of internationally mobile employees, it can apply for an EP Appendix 4 agreement with HMRC. Administratively, this arrangement is the main means by which the STBV relief is provided in the UK and it works very well, given the substantial number of employees to which such agreements apply. Employees can be included in an EP Appendix 4 agreement if they:

- are entitled to article 15(2) relief (apart from the 'economic employer' concept);
- are not employed by (or, presumably, a director of) the UK host employer;
- will comply with the 60 day rule; and
- are paid via the non-UK resident employer's payroll.

Where the agreement applies, the UK host employer does not need to operate PAYE on the employee's earnings (and may claim a tax deduction for the secondment fee) (PAYE81630; PAYE82000). The *PAYE Manual* seems clear that treaty claims must still be made. However, the current consultation document states that an EP Appendix 4 arrangement relieves the employee of the need to make a treaty claim. Nobody will object to a practice that supports the notion that the UK is open to international business but the practice looks concessionary.

Perhaps the main difficulty with EP Appendix 4 is determining whether an employee's visits to the UK for fewer than 60 days form part of a more substantial period of UK presence. HMRC provides some useful examples but inevitably it does not cover all permutations.

Furthermore, in a case where specifically named employees are present in the UK for 60 days or more but the UK host employer will not in fact ultimately bear the employees' remuneration, the part of the remuneration not ultimately borne by the UK host employer can fall within the PAYE relaxation in EP Appendix 4. However, in these cases, the requirements for the provision of information to HMRC are more onerous and may involve the employee providing HMRC with a certificate of residence.

PAYE81950: the 30 day rule

HMRC has recently introduced a further PAYE relaxation for non-UK resident employees who do not qualify for STBV relief, because they are employed in a foreign branch of a UK employer or are not resident in a treaty country and cannot, therefore, be included in an EP Appendix 4 arrangement. To qualify, the employee's UK workdays in the tax year must total 30 days or less and he or she must not be within class 1 NICs or act as a director of the UK employer or host employer (see PAYE81950). Guidance would be welcome on how many hours of work in a day make it a workday and the extent to which half UK workdays should be counted.

Under this special arrangement, the operation of PAYE is delayed until month 12 of the tax year. The idea is that, where income is ultimately covered by personal allowances, delaying the operation of PAYE will prevent the unnecessary deduction of tax earlier in the year. This will reduce the administrative burden on both sides, and will also prevent the need for a self-assessment return to claim a tax refund.

What is the government proposing?

The government recognises that the current rules do not provide relief for employees resident in non-treaty countries who visit the UK for work purposes, nor for employees of a foreign branch of a UK employer who visit the UK on business. The consultation puts forward two proposals:

1. Extending the PAYE special arrangement to 60 UK workdays

The first proposal is to extend the 30 day rule (described at PAYE81950) to 60 UK workdays. This will provide an administrative easement for STBVs from foreign branches of a UK employer or STBVs who are not resident in a treaty country and enable more businesses to delay the operation of PAYE until month 12 of the tax year. In many cases, the earnings are likely to fall within the personal allowance, so reducing compliance burdens.

2. New tax exemption for STBVs from overseas branches

The second proposal provides an exemption from income tax for certain STBVs from overseas branches. This would remove the anomaly that currently exists between individuals arriving in the UK for business from an overseas branch versus an overseas subsidiary. A series of conditions would be necessary to limit the circumstances in which this tax exemption would apply. The conditions put forward would require that the individual is:

- resident for tax purposes in a country with which the UK has a DTA under which Article 15 is competent;
- working in a foreign PE of a UK company and coming to work in the UK for the UK company on a short term or temporary basis; and
- expected to stay in the UK for 183 days or less in any 12 month period.

HMRC would want to continue receiving employee information regarding exempt STBVs, so the government proposes the EP Appendix 4 reporting requirements are followed.

What might the preferred solution be?

The first proposal is likely to be the government's preferred solution. In a packed legislative programme, this proposal has the advantage that it would require minimal effort to amend PAYE81950. This is because under reg 141 of the Income Tax (PAYE) Regulations, SI 2003/2682, HMRC can make arrangements for PAYE if it is considered 'impracticable' to collect. The guidance could be simply updated to reflect 60, rather than 30, UK workdays. Furthermore, as the proposal is merely an administrative easement, it will have no impact on tax receipts for the exchequer.

The second proposal will be favoured by businesses. It removes a longstanding inconsistency in treatment between overseas branches and subsidiaries of UK companies, and with it brings reduced compliance for the UK company and prevents the possibility of double taxation on the individuals. The proposal does have a cost associated with it for this reason, as the government would forgo the PAYE tax collected in respect of the STBVs within the exemption.

Who stands to benefit from the potential reform?

Internationally mobile employees and the businesses that employ them stand to benefit most. The first proposal – extension to 60 UK workdays – would provide an administrative easement for the UK company and the STBVs who qualify for the 60 UK workday rule. The second proposal – exemption from income tax for STBVs from overseas branches – would prevent double taxation on the employee or the need to claim a foreign tax credit and reduce administration for the UK company. In a post-Brexit environment, the government also stands to benefit by positioning the UK as open for business to internationally mobile employees.

When will the rules be implemented?

The consultation is at stage one. This means there is no commitment to reform the rules at this stage. If, following this initial consultation (which ends on 6 August 2018), the government decides to implement one of the proposals, then the earliest you could expect to see this implemented is April 2020, assuming the government follows its new Budget timetable. ■