Leigh Christou

Income tax for internationally mobile employees

Any company with employees working overseas needs to consider the local tax rules as well as compliance with UK employment tax rules.

For income tax, the basic principles from which to start are that an individual who is resident in a country will generally be taxed in that country on their worldwide income, but regardless of residence, an individual who is physically present and working in a country will be liable to tax in that country on income received for performing that work.

From these principles, it immediately becomes clear that a person who is resident in one country while temporarily working in another country could be liable to tax in both countries in respect of the same income.

To help resolve the obvious problems this may cause, most countries have negotiated treaties, referred to as double taxation agreements (DTAs) with each other. These agreements seek to determine the country in which an income is taxable or (in cases where income is taxable in both countries) will tell us which country gets to apply tax first, with the second country then allowing relief for the tax already suffered.

The world can thus be divided into two broad categories, each with its own rules: countries with which the UK has a DTA and those with which it does not.

Double taxation agreements (DTAs)

The UK has more than 130 double taxation agreements or treaties with countries around the world. Each treaty will contain articles determining the tax treatment of a variety of specific incomes and gains, and the employment (sometimes called 'dependant services') article will usually be either Article 14 or 15 and though the precise terms of each treaty will vary slightly, the majority follow a common format which is based on the OECD Model Treaty which reads as follows:

'(1) Subject to the provisions of Articles 16 (directors), 18 (pensions), and 19 (government service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.'

In other words, the starting point, except where special rules apply for particular occupations (eg, directors, civil servants) or income (eg, pensions), is that the country in which the work is actually performed gets priority of taxation, unless certain conditions apply, usually set out in the second paragraph.

'(2) Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned;

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) the remuneration is not borne by a permanent establishment which the employer has in the other State.'

This second paragraph effectively tells us that if the employee is only in the other country for a short time and their employer is not present in that country, then the employee is only taxed in the country where they are resident.

Note that although the maximum number is almost always 183 days in total, it is important to check the period during which these days are counted as this varies from treaty to treaty – for example it may be over a rolling 12 months, the fiscal year or a calendar year.

Also note that all three conditions must be met for this easement to apply. If so, the individual is taxed only in the country of residence and there is no tax in the country where they are working, unless a specific exception from the general rules applies.

'(3) Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.'

This final paragraph lists the special circumstances or occupations which may be treated differently (and how), and usually relates to transport workers of various types.

Treaty operation

The DTA tells us which country gets to tax the employment income first. This is almost always (unless the three conditions of Paragraph 2 are satisfied) where the work is being performed. Unless the treaty specifically says that income is taxable '... *only* in the state ...' then the income is also taxed in the country where the individual is resident, but double taxation relief should be given in that country.

No agreement

In the absence of a DTA, normal domestic legislation applies.

• if the individual is UK resident, they will be taxed on worldwide income;

• if the individual is not UK resident, the UK will always charge tax in respect of income (including benefits in kind) for employment performed physically in the UK.

Payroll operation

Having determined where the individual is taxed, we then need to consider how tax is applied. This may be under PAYE or through self-assessment, depending upon the circumstances.

There is a wide variety of HMRC scheme-types to cope with all the possible liabilities, made more complex by the differences between income tax (PAYE) and National Insurance contributions (NICs). Unfortunately, the operation of PAYE and NICs do not necessarily go together.

It may be that the employer or the employee is independently responsible for the operation of both PAYE and NICs, or for NICs but not PAYE, or for neither. The determining factor will be whether the employer is present in the UK, or in the EU, or in neither.

For the full list of scheme types, see HMRC's PAYE Manual at page PAYE20080.

PAYE (income tax) liability

If the employer is not UK resident and has no place of business in the UK, the employer cannot be made (or even allowed) to operate a PAYE scheme for tax though may still be liable to operate a scheme for NICs.

Consequently, in this circumstance the employee could choose either to operate a PAYE scheme on a voluntary basis (called a DPGEN scheme) or to report the income via a self-assessment tax return.

NICs liability

Within the EU and Switzerland, the terms of the UK–EU Trade and Cooperation Agreement provide that an employer who is present within the EU is required to operate the terms of the social security scheme applying to the country concerned, even if they do not have a place of business in that particular country.

Thus, an employer based in Germany could be liable to operate UK NICs (but not PAYE) on workers seconded to the UK even though it may not have a place of business in the UK. The appropriate scheme type for this is 'NI only'. Similarly, a UK employer sending employees to work in Germany would need to operate German social security even if it has no place of business in Germany.

Beyond the EU and Switzerland, (that is, in reciprocal agreement and rest of the world countries) the employer is not responsible (or liable) for operating NICs in a country unless the employer has a place of business in that country.

So, an overseas employer cannot be liable for employer NICs or for the operation of NICs if it has no place of business in the UK. In these cases, only employee's NICs are due and the employee is personally liable to account for them using a special scheme type. This will either be a DCNI scheme (for NICs only) or a DPNI scheme if the employee chooses to operate both PAYE and NICs on their own earnings.

Should you have any queries, please do not hesitate to contact us

Leofric House, Binley Road
Coventry, CV3 1JN
Tel: +44 (0)24 7625 1333
Fax: +44 (024) 7625 1777

Euston House, 12 Euston Place
Leamington Spa, CV32 4BN
Tel: +44 (0)1926 88 88 65
www.leigh-christou.co.uk

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