Chartered Institute of Taxation
Excellence in Taxation

Offshore Employment Intermediaries
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) sets out below its comments on the HMRC consultation on proposed employment tax and NIC obligations to apply to offshore employers and, in cases of default, on moving these obligations to onshore intermediaries and end-users, and on the associated record-keeping and filing requirements.

2 Executive summary

2.1 We agree with the principle that employees working in the UK should be paying income tax and NICs in full accordance with UK legislation. If that is not happening then it is appropriate that robust action should be taken to ensure that this is so.

2.2 We believe that in general the existing legislation works effectively to ensure that PAYE and NICs are collected for UK-based employees whether on a 'voluntary' basis or by direct application of the 'host employer', agency or intermediate employer rules.

2.3 We understand that differences of opinion have arisen between taxpayers and HMRC as to the application of the existing rules in certain circumstances, particularly in terms of whether there is the requisite degree of 'personal service'. However, we would recommend consulting on amending the existing rules to broaden their scope beyond 'personal service' rather than introducing a new set of obligations.

2.4 We believe that the proposal to require *offshore employers* to account for NICs and comply with employer PAYE obligations will not assist in improving compliance. This is because those offshore employers that currently do not comply are unlikely to comply with legislation that cannot be enforced in the country where they are established.

2.5 We believe that this proposal will introduce significant administrative burdens all round (including for HMRC) and we would query the position taken in the 'Summary of Impacts' that '*this measure is expected to have a negligible impact on businesses who will have a small increase in their administrative burdens as they*

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will have to assure their supply chains'.

2.6 In particular, we agree with HMRC's position as stated on page 7 of the consultative document that *'being able to establish the facts behind the labour supply chain can be a key challenge for the end user as well as for HMRC'* and we think that further work should be done in assessing the true administrative burdens that will be imposed on UK engagers in having to comply with the proposed legislation.

2.7 A particular difficulty will arise if the end user sees fit to insist on a retention to cover the risk of the default of the offshore employer or the insolvency of the 'relevant intermediary'. This will disrupt cash flow through the supply chain and effectively arises because the UK engager can never be certain that they will not be exposed.

2.8 As noted above, we would recommend building on the existing host employer, agency and intermediate employer rules to address the personal service issue rather than introducing new legislation. In particular, so that in all cases it is clear that it is the UK end user that has the responsibility for accounting at source for PAYE/NIC due on the earnings of its workers, rather than it being a case of someone else having that responsibility but the UK end-user being on the line if that person fails to discharge their responsibility. Otherwise this will lead to uncertainty and an open-ended contingent liability on the end user for the PAYE/NIC involved. Alternatively, we suggest that any transfer of liability should not apply beyond the relevant (UK) intermediary so that the end user is not in the line of fire.

2.9 We have a particular concern in relation to arrangements involving non-UK based contractors with their own personal service companies ('PSC') who come to work in the UK and where their PSCs are established in the contractor's home country. Whilst the position is not entirely clear under the existing rules (not least given IR35), end users would not wish to find themselves having to require individual offshore PSCs to apply PAYE/NIC under the proposed new approach (with the end user being on the line if the PSC did not do so).

2.10 We recommend that HMRC consult further with the Oil & Gas industry in terms of the proposals to extend secondary NIC to apply to payments made to those working on floating platforms (ie as well as fixed platforms). This proposal will increase industry costs and may act against the engagement of UK workers which would seem to be a counter-productive result in terms of the interests of UK plc.

2.11 The justification for the proposal for Oil & Gas workers given on page 18 of the consultative document is that *'it is difficult for both the contractor companies who supply the workers and for HMRC to be able to apportion the time spent on these different types of installation'*. Surely if this is simply an issue of apportionment it should be possible to agree an appropriate methodology short of a blanket imposition of NIC in relation to earnings attributable to work on both floating and fixed platforms? The suggestion in meetings with HMRC is that in fact this proposal may be more a point around reversing the result of the decision in *Oleochem* than simply an issue of apportionment. We should be grateful for clarification from HMRC on this point.

2.12 We understand the proposal to transfer liabilities of non-UK EEA-based employers that go into liquidation or file for bankruptcy to a UK based 'relevant intermediary' or end user (if there is no relevant intermediary) is not to be progressed. This is to

be welcomed as it would appear to us to go against the Treaty on the Functioning of the European Union (Freedom of Establishment and Free Movement of Services) in that it would discriminate between UK and non-UK/EEA-based employers.

2.13 Finally, we are unclear as to whether the current proposals are in fact subject to consultation as to approach, or whether the approach has already been decided. The suggestion on page 2 of the consultative document is that the approach has already been decided as reference is made to this being a 'technical consultation' (and we note the publication of accompanying NIC and PAYE legislation). We think that it would have been better for the Government to have to consulted as to approach, particularly so that appropriate consideration could be given to the associated administrative burdens on business (and HMRC), and we hope that the points that we make will nevertheless be taken on board in deciding on what ultimately should be done.

3 General comments

3.1 In principle, the geographical location of an employer or employment intermediary that provides workers for UK-based end users should not be of concern. An employer or employment intermediary should be free to establish its place of business wherever it choses and the UK should not place restrictions to prevent this. The Forward to the consultative document recognises this point – but also the point, with which we agree – that where there is avoidance of PAYE/NIC then steps need to be taken to address such avoidance.

3.2 The existing legislation which governs the position where offshore employers and offshore intermediaries are concerned essentially places the obligation to account for PAYE and NICs on the UK-based end user. In most cases we believe the existing legislation works effectively to ensure that the right amount of PAYE/NIC is collected.

3.3 For example, where a non-UK group company 'seconds' an employee to work for another group company in the UK there will invariably be arrangements in place for a company within the group to account for PAYE and NICs as necessary.

3.4 Where a worker contracts to work for an employment intermediary based outside of the UK and that intermediary then provides the worker's services to a UK based end user, the end user will clearly be aware that there is an offshore element involved. The end client should therefore expect to make arrangements for the relevant PAYE/NICs to be accounted for.

3.5 If the offshore employer fails to account for the PAYE and NICs on a 'voluntary' basis then, in our view, there are a number of provisions that could apply under the existing legislation by which HMRC could enforce collection. These include the host employer rules at ITEPA 2003, Section 689, the agency rules at ITEPA 2003, Sections 44-47 and the rules on mobile UK workforce at ITEPA 2003, Section 691, coupled with the NIC rules on agencies and on foreign employers in the Social Security (Categorisation of Earners) Regulations 1978 (SI 1978/1689) Schedule 3, Paragraphs 2 and 9 respectively and on intermediate employers in the Social Security (Contributions) Regulations (SI 2001/1004), Schedule 4, Paragraph 3.

3.6 Indeed page 17 of the consultative document, referring to internationally mobile

workers, notes that '*in the vast majority of cases…income tax and NICs is accounted for and paid by the UK subsidiary (host) company under the existing legislation at S689 ITEPA 2003 and, for NICs, the host regulations. These arrangements work well and we do not propose to stop them*'. This is albeit HMRC have since announced on 5 August that it does propose to repeal ITEPA 2003, Section 689 which we find confusing.

3.7 The main focus appears to be around the avoidance of employer NICs, as page 8 of the consultation document says that '*in many cases the offshore employer makes 'voluntary' payments of income tax and employee (primary) Class 1 NICs through the PAYE system but fails to make payments for the employer (secondary) NICs*'. That being so, we would suggest strengthening the NIC rules rather than adding a new layer of complex legislation with the administrative bureaucracy that inevitably comes with this.

3.8 In particular, currently the NIC liability of the end user depends on whether the worker is providing their 'personal service' to the end user. And we note from the consultation document (page 9) that '*while HMRC has had some success in tackling these types of arrangements, especially where large companies have outsourced their entire payrolls offshore, it is often problematic and time consuming to establish the facts*'.

3.9 We understand that there have been examples where umbrella companies have been used to supply workers with a right of substitution included, making it difficult in some cases to establish the personal service requirement. If this is the case we would recommend amending the NICs (and associated PAYE) legislation to ensure that the rules work as intended. In particular, we would suggest replacing the requirement for personal service with a 'works for' approach, along the lines intended under ITEPA 2003, Section 689 (and indeed retained under the proposed approach) but with the responsibility for collection remaining, as now, with the *end user*.

4 **The proposal**

4.1 The proposal is that in the first instance the offshore employer will take on PAYE employer obligations and be the secondary contributor for NIC purposes as if it were a UK employer. It is not, however, apparent how that will change current practice. If offshore employers are currently not complying with the letter/spirit of the law why would they do so going forward? In this respect we note the decision in *Clark v Oceanic Contractors Incorporated,* HL, 1982, 56 TC 183 which discussed the enforceability of the PAYE rules in terms of whether a company has a sufficient UK presence.

4.2 It seems to us that the purpose of the proposal is really to facilitate the position whereby if a non-EEA (or Switzerland or Isle of Man) offshore employer does not 'voluntarily' comply the liability moves to the UK based employment intermediary ('the relevant intermediary') or, ultimately, if there is insolvency to the end user.

4.3 But if that is the case then why not simply bolster the existing legislation to go straight to the end user and require them to meet their PAYE/NIC obligations in the first instance? The proposal to ultimately threaten to move historic debt and prospective employer obligations to the end user seems to do no more than existing legislation. But in terms of administrative complexity, we think that (i)

having to distinguish between EEA/non-EEA offshore employers, (ii) the position for the Isle Of Man, and (iii) the contingent liability hanging over the end user, the position becomes very complicated.

4.4 The end user would still be responsible, as now, for understanding the labour supply chain and ensuring it is made aware, in advance of engaging a worker, that there is/is not an offshore employer involved (and whether EEA/non-EEA based) in that supply chain and factoring in that consequently they could become liable to account for and pay the PAYE and NICs. They will therefore need to keep accurate records of precisely what is paid to the individuals concerned in case ultimately they become liable. Indeed such may be the concern that the end user decides they have no alternative but to impose a retention equal to the amount of PAYE/NIC for which they could ultimately be responsible. Clearly, this would severely disrupt cash flow through the supply chain. And yet if the PAYE/NIC obligation was *directly* imposed (as now) then there would be no contingent liability – PAYE/NIC would either be due/accounted for directly by the end user, or it would not.

4.5 An alternative approach would be to allow transfer of debt but only as far as the relevant intermediary. At least then the end user could rest assured that it was not in the line of fire. The problem at the moment is that the end user is always potentially on the line – this is worse in many ways than having had to account for the relevant PAYE/NIC in the first place (as applies now) – at least the matter is then closed.

4.6 Under the proposed approach the rules would operate where *'B works for another person ('C') who is not B's employer…*' As noted above, this is a similar approach as already adopted in ITEPA 2003, Section 689 for PAYE and indeed in the intermediate employer regulations for NIC at SI 2001/1004, Schedule 4, paragraph 4. But whether the existing legislation is reinforced (as we suggest) or the new approach is adopted we think it is vital to be clear and distinguish between a spectrum of possible scenarios which are/are not intended to be caught.

4.7 For example, an end user may request assistance from a firm of US management consultants who supply an individual who spends three weeks in the UK advising the end user about choices they need to make concerning a potential new IT system. This may be contrasted with the position where an end user requires on-site assistance for two years with the implementation of a new IT system and recruits someone via a US IT services agency who works as part of their existing employee team. In the first case we suspect the intention would be that the rules on potential transfer of debt etc would not apply given these are advisory services and the individual is not integrated into the UK team, but simply advising on behalf of the US firm. In the second case, the new rules presumably would be intended to be engaged (albeit so would the existing host employer rules)? Are we correct on this? If so, we think the legislation needs to distinguish between these sorts of cases.

4.8 We have a particular concern where end users require their contractors to work through the medium of a personal service company ('PSC'). In a UK context this will typically be so that the end user is protected from exposure to PAYE/NIC and, instead, the IR35 rules operate at the PSC level (dependent on the nature of the work with the end user and whether there would be a 'hypothetical employment contract' absent the PSC). These arrangements will typically also apply where a contractor is based overseas and establishes a PSC in France, Germany, Australia, etc. Whilst IR35 in any event applies to these companies, as it is not

possible for a UK end user to know what payments (if any) of earnings may be made to the contractor by the PSC, in practice we understand that HMRC accept that the existing host employer and other PAYE/NIC rules that can apply (but only where earnings are in point) are not engaged. It is unclear what would happen under the new legislation in this respect but we would request that there is a derogation to exclude PSCs because otherwise the administration imposed on the non-UK contractors and their PSCs will be considerable. We accept that where 'managed service companies' are involved then the position is different.

5 Specific Sectors

5.1 *Internationally Mobile Workers*

As noted above and in the consultation document at page 17, the existing arrangements for expat workers seconded to the UK work well.

5.2 Consequently, 'normal' expat employee arrangements should not change and we understand that this is HMRC's intention. This is to be welcomed. However, whether simple legislation can be drafted to achieve this we think will be a challenge. Coupled with different situations for EEA/non-EEA employers we think that the new approach will, as we have stated above, become rapidly complicated.

5.3 As mentioned above, we are surprised that it is proposed to repeal ITEPA 2003, Section 689 in the light of the comments in the consultative document and the experience of our members that Section 689 works well.

5.4 *Mariners*

We understand from page 16 of the consultative document that in principle no changes are proposed. We welcome this but we do have concerns around the proposals for Oil & Gas workers (see below) which we do regard as a change to the *status quo* on mariners.

5.5 *Oil & Gas workers on the UK Continental Shelf*

We note that the government is intending to extend the host employer legislation and secondary NICs liability to include workers on floating platforms. This is because it is '*difficult for both the contractor companies who supply the workers and for HMRC to be able to apportion the time spent on these different types of installations*'.

5.6 We would recommend that HMRC consult further with the Oil & Gas sector as to whether apportionment is really an issue. If not, this would suggest that the rules do not need to be changed; rather, a methodology needs to be agreed by which apportionment can be dealt with in a more straightforward manner than is currently the case.

5.7 That said, we understand from discussions with HMRC that the issue may go beyond one of apportionment and that HMRC wish to reverse the decision in the *Oleochem* case which held that the secondary NIC mariner exemption applied to those working on floating (but not fixed) platforms. Our concern here is that the imposition of additional costs of secondary NIC in these circumstances may mean that businesses may be more reluctant to hire UK based workers, to the overall

detriment of UK plc. There may also be a material effect on existing contracts as it may not be possible to deal with a change in NIC liability under those contracts, effectively eroding the margins of the affected businesses.

6 Record Keeping Requirements

6.1 One of the main problems with the proposal is that the consultation document recognises that the involvement of an offshore employer is often hidden or disguised (page 9) but then seeks to impose a record keeping and reporting requirement on an intermediary (or end user where there is no intermediary). In such cases how is the end user going to be able to correctly analyse the contractual chain? HMRC accept (again on page 9) that this is a key challenge so it is unclear how businesses (small, medium and large alike) are going to manage to do this.

6.2 What is being proposed is, in effect, a requirement for both the intermediary and end user (just in case the employer obligations ultimately fall on the end user) to analyse every step in the contractual chain, and obtain and retain full details of this and of all payments made in that chain (otherwise they will have to estimate the payment ultimately received by the worker). But, as noted above, if the offshore element is hidden from them this is unlikely to be possible. At the very least, the administrative burden and delay in. For example, engaging a temporary worker whilst the relevant contracts and information are obtained and analysed is likely to disrupt many businesses' normal operations.

6.3 As we say above, why not simply tighten the existing PAYE/NIC rules and require the end user to account for PAYE/NIC on the payments it makes (to the individuals direct, or via the offshore employer or any intermediary). It would then know that all its obligations had been discharged and would not have to worry about any contingencies.

7 Treaty on the Functioning of the European Union (TFEU)

7.1 TFEU Article 49 (Right of establishment) prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State. This extends to agencies, branches and subsidiaries. Article 56 (Services) provides that restrictions on freedom to provide services within the Union shall be prohibited. A host State may continue to apply its rules equally to all those active in its markets but the host State should not discriminate between national and non-national firms.

7.2 The consultation document at page 16 proposes that offshore employers' historic debt and prospective employment obligations and secondary NICs liabilities could, potentially, be transferred from the offshore employer to a UK based end client or employment intermediary where an EEA employer enters into insolvency or bankruptcy proceedings. This would, in our view, potentially conflict with freedoms of establishment and provision of services under the TFEU.

7.3 We understand that the government do not intend to take this proposal forward and we welcome this as we think it would discriminate between EU and UK based employers.

8 The Chartered Institute of Taxation

8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 16,800 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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