

US/UK Tax Issues for Internationally Mobile Executives

James E Gregory and Jennifer Wheeler*

In an increasingly global marketplace, international assignments have become commonplace and cross-border employment and tax issues have come to the fore. Because of their common language, culture and financial prominence, the links between the United States and the United Kingdom are especially well-developed and, as a result, there is a constant flow of high-level managerial and executive talent between these two countries. This article focuses on some of the most common tax issues that are raised by the assignment or transfer of executives between the US and the UK. Inevitably, it also addresses more general issues applicable to internationally mobile executives working in either the US or the UK as well as specific issues that may impact executives who are leaving their home country of the US or the UK for a temporary international assignment anywhere in the world.

* James E Gregory is a partner in the New York office of Proskauer Rose. He can be contacted by telephone on +1 212 969 3023 or by e-mail at jgregory@proskauer.com. Jennifer Wheeler is a partner in the London office of Proskauer Rose. She can be contacted by telephone on +44 (0)20 7539 0647 or by e-mail at jwheater@proskauer.com. The authors would like to thank Abraham Gutwein (agutwein@proskauer.com) and Gary Silber (gsilber@proskauer.com) for their assistance on this article.

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This article does not seek to address any and all of the issues that internationally mobile executives and their employers will need to address in the context of transfers to and from the US and the UK. Specifically, it does not deal with the complex issues that may arise from the various forms of employee benefits and incentives often awarded to executives in both the US and the UK.

US tax issues

This section discusses US tax issues that pertain to UK executives working temporarily in the US, including the differing US tax issues faced by UK executives based on their status as US tax residents or non-residents, plus the impact of the tax treaty between the US and the UK.¹

Unlike most other countries, including the UK, the US taxes citizens and resident aliens on their worldwide income, regardless of source. Because most other countries (including the UK) have a system based primarily on source, foreign-source income earned by US citizens or residents is often taxed in the foreign jurisdiction where the services are provided and then taxed again in the US.

This potential double taxation is mitigated in many cases by treaty arrangements between the US and the other country that could claim the ability to tax income earned within its borders. Most treaties are generally consistent in their pattern and treatment of various key issues, such as the determination of residence and income source and the taxation of earned income and retirement benefits. The US/UK Tax Treaty will be discussed in further detail below.

In addition to the treaty network, the US employs a foreign tax credit system whereby, in general, foreign taxes paid on foreign-source income may be used as credit against US taxes otherwise imposed on such foreign income under the US worldwide system.

Residency

For UK executives employed in the US, a key threshold determination is whether such executive will be treated as a tax resident or non-resident of the US.

Residents and non-residents are taxed in the US according to very different rules regarding income, deductions and tax rates. As discussed below, a

1 Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains (US–UK), 24 July 2001 (the ‘US/UK Tax Treaty’).

non-resident alien is taxed by the US on US source income only. A resident alien, however, is subject to US tax on worldwide income, regardless of the source of payment of the income.²

Residency determination

Under US law, two separate tests are used to determine the tax residency of a foreign individual. If either test is met, the individual is a US tax resident and, subject to the applicable provisions of the US/UK Tax Treaty, is generally subject to the same tax laws as US citizens.³ The residency tests are:

- the lawful permanent resident, or green-card test; and
- the substantial presence test.

If either test is met for any part of a tax year, the individual is a US resident for that part of the year. Therefore, during the first and last years of a US assignment, the foreign individual may be both a non-resident for part of the year and a resident for part of the year. This situation of a 'dual-status taxpayer' will be discussed further below.

GREEN-CARD TEST

A foreign individual who is a lawful permanent resident of the US at any time during the calendar year is a US tax resident. Residency is effective from the first day the foreign individual is present in the US while possessing an alien registration card, or 'green card'.⁴ A green-card holder remains a US resident until the green card is revoked or administratively or judicially abandoned, even if the foreign individual returns to his home country prior to abandonment.

SUBSTANTIAL PRESENCE TEST

Substantial presence is based on the number of days a foreign individual is present in the US.⁵ To meet the substantial presence test, a foreign individual must be present in the US for at least 31 days during the current year, and 183 days during the three-year period that includes the current year and the two previous years. In counting the 183 days, each day of presence in the current year counts as one day; each day of presence in the preceding year counts as one-third of a day; and each day of presence in the second preceding year counts as one-sixth of a day.

2 Treasury Regulations, § 1.1-1.

3 Internal Revenue Code of 1986 (IRC), § 7701(b)(1)(A).

4 IRC, § 7701(b)(2)(A)(ii); Treasury Regulations, § 301.7701(b)-1(b).

5 IRC, § 7701(b)(3); Treasury Regulations, § 301.7701(b)-1(c).

If the substantial presence test is met for any calendar year, the executive is generally a tax resident for the entire calendar year; however, with respect to the first year of the executive's tax residency on account of substantial presence, the executive becomes a tax resident only from the first day that he is physically present in the US during that calendar year.⁶ Where a foreign individual can demonstrate a closer connection to their home country, up to ten days of US presence may be disregarded when determining the first day of US residency, although such days are still counted in the 183-day formula.⁷ Residency continues until the foreign individual moves away from the US, resumes his foreign residence and remains a non-resident for the next calendar year.⁸

EXCEPTIONS TO THE SUBSTANTIAL PRESENCE TEST

Presence in the US is ignored, however, in the circumstances described below.

- *Short stopovers.* Presence while in transit between two points outside the US is ignored if the person is in the country for less than 24 hours.⁹
- *Medical emergency.* A day of presence in the US is disregarded if the taxpayer is unable to leave the US on such day because of a medical condition which arose while such individual was present in the country.¹⁰

If excluding any of these days disqualifies the foreign individual from meeting the substantial presence test, the individual is not a US resident for that year.

In addition, an individual will not be treated as meeting the substantial presence test if he is present in the US for less than 183 days in the current year, he has a tax home in a foreign country, and he maintains a closer connection to that foreign country than to the US (eg, the executive maintains the family home, bank accounts, voting registration, personal belongings, driver's licence, etc in the home country).¹¹

IMPACT OF US/UK TAX TREATY

Under many US tax treaties, if a foreign individual is a tax resident of both the US and his home country then certain 'tie breaker' rules will apply to determine tax residence for treaty purposes. Generally, under the US/UK Tax Treaty, the individual will be deemed to be a resident only of the country in which he has a permanent home available to him. If he has a permanent

6 IRC, § 7701(b)(2)(A)(iii).

7 IRC, § 7701(b)(2)(B); Treasury Regulations, § 301.7701(b)-4(c)(1).

8 Treasury Regulations, § 301.7701(b)-4(b)(1).

9 IRC, § 301.7701(b)-3(d).

10 IRC, § 301.7701(b)-3(c).

11 IRC, § 301.7701(b)-2(a).

home available to him in both countries, he will be deemed to be a resident only of the country with which his personal and economic relations are closer, his so-called 'centre of vital interests'. If this 'centre of vital interests' cannot be determined, then he is deemed to be a resident of the country in which he has a 'habitual abode'; and if he has a 'habitual abode' in both countries (or neither of them), then he is a resident of the country of which he is a national. Finally, if he is a national of both countries, or neither of them, the competent authorities of both states are to settle the question by mutual agreement.¹²

Non-resident aliens

A non-resident alien is a foreign executive who is neither a US citizen nor a green-card holder and who does not meet the substantial presence test described above; or if he meets the substantial presence test, he is not treated as a US tax resident according to the 'closer connection' test described above or by operation of the 'tie breaker' rule set forth above.¹³ Non-resident aliens are subject to tax only on certain income derived from US sources and not on their worldwide income. Tax on US source income other than compensation (which is subject to employment tax withholding) is usually collected by the payor via a 30 per cent withholding tax.

Compensation

All US source compensation received, regardless of the form of payment, is included in gross income for a non-resident alien.¹⁴ This includes salaries, commissions, tips, bonuses, retirement benefits and certain fringe benefits. Benefits in kind are also included in gross income as compensation. For example, non-resident aliens whose employers provide or reimburse them for housing or automobiles are generally required to report the value of the benefit received or the amount of these payments in the employee's US gross income.

Reimbursed business expenses may generally be excluded from income. One category of reimbursed living expenses may also qualify as a reimbursed business expense that can be excluded from income: payments for expenses made to or on behalf of an employee while away from home (for this purpose

12 US/UK Tax Treaty, Article 4(4).

13 IRC, § 7701(b)(1)(B).

14 IRC, § 871(a)(1)(A).

generally defined as the location of one's business or employment, the 'tax' home concept) for one year or less.¹⁵

Generally, compensation for labour and personal services performed entirely within the US is defined as US source income, while compensation for services performed entirely outside of the US is defined as foreign source income.¹⁶ The 'place-of-performance' test applies irrespective of where the contract was made, the place of payment, or the residence of the payor.¹⁷

Compensation for services performed both within and without the US is allocated between US and foreign sources. Compensation paid to an entity or to an individual other than as an employee for personal services is allocated between US and foreign sources 'on the basis that most correctly reflects the proper source of the income under the facts and circumstances of the particular case'.¹⁸ In many cases, apportionment on a time basis will be the proper method under the facts and circumstances.¹⁹

Compensation paid to a foreign individual as an employee is typically apportioned on a time basis.²⁰ Thus, compensation for services performed in the US usually equals the product of total compensation and the ratio of the number of days of performance of services in the US to the total number of days of performance of services.²¹

The source of taxable fringe benefits is usually determined in the same way as the source of wages and salaries. However, the sources of six types of taxable fringe benefits – namely housing, education, local transportation, tax reimbursement, hazardous or hardship duty pay and moving expense reimbursement benefits – are determined on a 'geographical basis'.²² The meaning of 'geographical basis' varies from one fringe benefit to another. For example, the geographical source of a housing, education or local transportation fringe benefit is the taxpayer's principal place of work.²³

DE MINIMIS RULE FOR SOURCING COMPENSATION

Under an exception to the general compensation-sourcing rule, compensation received by a non-resident alien from US sources is exempt

15 IRC, § 162(a); Treasury Regulations, § 1.162-2.

16 IRC, § 861(a)(3); Treasury Regulations, § 1.861-4(a)(1).

17 Treasury Regulations, § 1.861-4(a)(1).

18 IRC, § 1.861-4(b)(1)(i).

19 IRC, § 1.861-4(b)(1)(i).

20 IRC, § 1.861-4(b)(2)(ii)(A).

21 IRC, § 1.861-4(b)(2)(ii)(E).

22 IRC, §§ 1.861-4(b)(2)(ii)(B) and 1.861-4(b)(2)(ii)(D).

23 IRC, §§ 1.861-4(b)(2)(ii)(D)(1), (2) and (3).

from tax if it does not exceed US\$3,000. If it exceeds this amount, all of the individual's US source compensation income is subject to tax. To qualify for this limited exception, a taxpayer must meet the following three requirements:²⁴

- the non-resident alien individual must be temporarily present in the US for a total of no more than 90 days during the taxable year;
- the total compensation received by the non-resident alien individual for the services or labour performed in the US must not exceed US\$3,000 in the aggregate; and
- the non-resident alien must perform the services or labour as an employee of, or under contract with, either
 - a non-resident alien, foreign partnership or foreign corporation not engaged in a US trade or business; or
 - a US citizen or resident alien individual, a domestic partnership or a domestic corporation, but only if the services or labour are performed for an office or place of business maintained by such individual, partnership or corporation in a foreign country or US possession.

Capital gains

Non-resident aliens are generally exempt from US capital gains tax; however, a non-resident alien may be subject to US capital gains tax in any one of the following circumstances:

- the capital gains are effectively connected with the conduct of a US trade or business;
- the non-resident alien is present in the US for 183 or more days during the year in which the gain is realised;²⁵ or
- the capital gain is from the sale of a US real property interest.²⁶

Withholding obligations

Generally, remuneration for services performed by a non-resident alien within the US is classified as 'wages' for withholding tax purposes and, in general,

24 IRC, § 861(a)(3); Treasury Regulations, § 1.861-4(a)(1)(i), (ii) and (iii).

25 Treasury Regulations, § 1.871-7(d). A foreign individual can be a non-resident alien while physically present in the US for 183 days if either a portion of the days are excluded for purposes of the substantial presence test or the individual is a non-resident on the basis of a treaty with his home country. Gain from the sale of the stock of US corporations or stocks which are traded on a US stock exchange may be treated as US source income if the non-resident alien has a 'tax home' in the US.

26 IRC, § 897.

for US tax purposes, an employer, whether foreign or domestic, is required to establish a US payroll account for each non-resident alien employee who receives compensation for services rendered in the US. The determination of who is the 'employer' is critical for this purpose. The amount withheld is then credited as an estimated prepayment against the employee's final US income tax due for the applicable year. Unless specifically exempted from withholding by law or by treaty, foreign employers will be subject to US withholding requirements even if they have no office or assets in the US.

The regulations under section 3401(a)(6) of the IRC provide, however, an exemption from wage tax withholding in the case of remuneration for services performed in the US that is exempt from federal income tax under an applicable income tax treaty. For example, in most treaties, including the US/UK Tax Treaty, an employee who is present in the US for not more than 183 days in a single year is exempt from US tax, without dollar limitation, so long as his employer is also resident in the treaty country (and this rule is expanded in the US/UK Tax Treaty to include any non-US employer).²⁷

Resident aliens

Income of resident aliens

If a foreign individual becomes a US resident for tax purposes, either for part of the year or for the entire calendar year, the resident is subject to tax on worldwide income for the portion of the year during which he is a US resident. Determining US gross income is relatively easy under these circumstances because all income, regardless of its source, is included.

LIVING ABROAD EXCLUSION

US resident aliens (and US citizens) living abroad may be able to claim an exclusion for earned income derived from a foreign jurisdiction, and an exclusion or deduction for housing costs,²⁸ under section 911 of the IRC. This exclusion is limited by an annually adjusted ceiling, which for

27 For this exception to apply, however, the foreign employee must supply the employer with a statement which must include, among other things: (1) a declaration that the wages to be paid are, or will be, exempt from income tax under a tax treaty; (2) the provision and tax convention under which the exemption is claimed; (3) the country of which the employee is a resident; and (4) sufficient facts to justify the claim for exemption. See Treasury Regulations, §§ 31.3401(a)(6)-1(f) and 1.1441-4(b)(2)(ii).

28 Amounts paid for directly or reimbursed by an employer are eligible for the exclusion, while unreimbursed amounts paid by the employee are eligible for the deduction. The amount of the deduction cannot exceed the limit applicable to the exclusion.

2012 is US\$95,100 for foreign-earned income and US\$13,314 for housing costs, amounting to US\$108,414, allocated for the applicable portion of the year(s) spent living abroad.²⁹ However, in no event may the sum of the foreign-earned income exclusion and the foreign housing cost amount exclusion exceed the individual's foreign-earned income for the tax year.³⁰

If a citizen or resident can show that his tax home is in a foreign country, there are two ways to qualify for the section 911 exclusion. First, a US citizen (and most residents)³¹ may establish that he has been a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year. Alternatively, a citizen or resident of the US may qualify for the section 911 exclusion if he, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days.³² Qualification under either test allows the individual to claim the section 911 exclusion for certain foreign-earned income and the attendant housing cost amount for the taxable years which contain the period spent living abroad.³³ The exclusion is elective.³⁴

INVESTMENT INCOME SURTAX

Beginning in 2013, US residents (and citizens) will also become subject to an additional surtax levied on their investment income. A Medicare surtax of 3.8 per cent will be levied on dividends, interest and capital gains recognised in taxable years beginning after 31 December 2012, but only to the extent that a taxpayer's income exceeds certain specified thresholds.³⁵ Employers and employees will need to include this additional surtax in their analysis of the tax costs of becoming a US tax resident.

29 IRC, § 911(b)(2); Revenue Procedure 2011-52, section 3.28, Internal Revenue Bulletin 2012-45.

30 IRC, § 911(d)(7).

31 Although resident aliens are excluded from the bona fide resident test under section 911, the US Internal Revenue Service (IRS) construes the non-discrimination provision contained in most income tax treaties to require the application of the bona fide residence test of section 911 to nationals of treaty countries. See Revenue Ruling 91-58, 1991-2 CB 340.

32 IRC, §§ 911(d)(1)(A) and (B); Treasury Regulations, § 1.911-2(a).

33 Treasury Regulations, § 1.911-3(d).

34 IRC, § 911(e)(1); Treasury Regulations, § 1.911-7.

35 IRC, § 1411. The surtax is levied on the lesser of (1) the taxpayer's investment income; and (2) the amount by which a taxpayer's modified adjusted gross income (MAGI) exceeds the threshold amount, which ranges from US\$125,000 to US\$250,000 depending on filing status. Income excluded under section 911 is added back to the adjusted gross income in order to determine the MAGI.

Foreign account reporting

It is worth noting that in the event a foreign executive becomes a US tax resident on account of his assignment to the US, and the executive holds an interest in a foreign bank account or other foreign financial asset, he may be required to file one or two reports with the IRS, pursuant to recent changes made under the Foreign Account Tax Compliance Act (FACTA). First, under a provision added to the IRC in 2010, and effective with respect to returns due for 2011, a US citizen or tax resident with an interest in a foreign financial asset may be required to include an information return on this asset with his income tax returns.³⁶ A person who fails to report a foreign financial account or asset may be liable for substantial penalties for any understatement of tax liability that is attributable to the account or asset and for the failure to file the information return.³⁷

Secondly, a citizen or resident who is an owner or co-owner of, has a financial interest in, or has signature or other authority over, a bank, securities or other financial account in a foreign country, which accounts have an aggregate value in excess of US\$10,000 at any time during the calendar year, must report such accounts annually.³⁸ This return is known as a 'Report of Foreign Bank and Financial Accounts' (FBAR). The IRS may impose a substantial penalty on persons who fail to file an FBAR. The FBAR requirement applies to all citizens and residents of the US. It also appears to apply to foreign individuals who are US tax residents under US law despite the fact that they may be treated as non-resident aliens pursuant to a tax treaty. The FBAR is due by 30 June of the year following the calendar year being reported.

Impact of section 409A of the IRC

One tricky area that practitioners and advisors should be aware of involves section 409A of the IRC. Section 409A of the IRC was first enacted in late 2004 and governs the taxation of deferred compensation. Because it applies alike to US citizens and tax residents who work outside of the US, it has a broad extraterritorial reach. Multinational employers and foreign employers who hire US taxpayers outside of the US, or who assign executives to the US who may become US tax residents, are often unaware of section 409A and its complex set of rules which may require early income inclusion prior to payment of the deferred compensation and impose an additional 20 per cent tax and

36 IRC, § 6038D.

37 IRC, § 6662(j).

38 31 Code of Federal Regulations, § 1010.350(a).

penalty interest on recipients of non-compliant deferred compensation (which is very broadly defined and may include severance payments and certain reimbursements). The requirements of section 409A are highly complex and beyond the scope of this article. Employers (and employees) are well advised to seek experienced counsel when dealing with deferred compensation matters.

Dual-status designation

It is possible for a foreign individual to be both a non-resident and a resident in the initial year and final year of his US assignment, a so-called 'dual-status' taxpayer.³⁹ However, dual-status taxpayers have the option to elect to be treated as US residents for the entire year.⁴⁰

Income for dual-status taxpayers is determined using the same rules for resident or non-resident aliens explained above. Only US source income is taxable for the part of the year during which the foreign individual is a non-resident alien.⁴¹ Once the foreign individual becomes a US resident, he is taxed on worldwide income.⁴²

A married dual-status taxpayer is not allowed to file a joint tax return.⁴³ Such taxpayers instead are taxed using the married filing separately rates to determine their tax liabilities for the residency period.

The limitations and restrictions of a dual-status taxpayer may result in a higher tax liability for married individuals. Therefore, a married dual-status taxpayer and his or her spouse may elect to be treated as full-year residents for tax purposes. The married couple may elect by using one of two joint-return elections or a combination of two elections.⁴⁴ The appropriate election depends on whether one spouse or both spouses are resident aliens at the end of the year.⁴⁵

Social security tax and totalisation agreements

The US Federal Insurance Contributions Act (FICA) provides a federal system of old-age, survivors, disability and hospital insurance to all eligible persons reaching retirement age (or other prescribed payment events). FICA is comprised of two taxes: social security tax and Medicare tax. The social security tax finances the old-age, survivors, and disability insurance portions of FICA. The Medicare tax finances the hospital insurance portion of FICA.

39 IRC, § 7701(b)(2); Treasury Regulations, § 1.871-13(a)(1).

40 IRC, §§ 6013(g) and 6013(h).

41 IRC, § 872(a).

42 IRC, § 7701(b)(1)(A); Treasury Regulations, § 1.1-1(b).

43 IRC, § 6013(a)(1); Treasury Regulations, § 1.6013-1(b).

44 IRC, §§ 6013(g) or 6013(h); Treasury Regulations, §§ 1.6013-6 and 1.6013-7.

45 Treasury Regulations, § 1.6013-6(a)(1).

All US citizens/residents and all non-residents employed in the US are subject to FICA taxes; there is no applicable minimum number of days worked or amount of wages earned.⁴⁶ Surprisingly, it is not entirely clear how employment taxes are sourced where an executive works both within and without the US. It would be logical to apply the 'place-of-performance' rule discussed above that applies to the determination of US source compensation for income tax purposes. Applying these rules, compensation for services performed in the US would be subject to FICA, whereas compensation for services performed abroad for a non-US employer would generally be exempt from FICA.⁴⁷

All US citizens and residents employed by a US employer outside the US are also subject to the FICA tax.⁴⁸ A 'US employer' is a domestic corporation, individual resident of the US, partnership at least two-thirds of whose partners are US residents, or trust whose trustees are all US residents.⁴⁹

The social security tax is calculated by applying the social security tax rate (currently 6.2 per cent) to the employee's wages up to the threshold amount (adjusted annually for inflation – currently US\$110,100), for a combined employer/employee rate of 12.4 per cent. Under a temporary provision, the employee portion of the social security tax has been reduced for 2012 to 4.2 per cent, resulting in a combined 10.4 per cent rate for 2012.⁵⁰

No maximum threshold exists for the Medicare tax, so the tax is calculated by applying the Medicare rate (currently 1.45 per cent) to the employee's total compensation, for a combined employer/employee rate of 2.9 per cent.⁵¹ Both the social security and Medicare taxes are assessed on both the employee and the employer, with the employer withholding the employee's portion and remitting all FICA taxes to the federal taxing authorities.⁵²

UK executives working in the US who otherwise may be subject to the social security laws of both the US and the UK may elect⁵³ to remain on the UK system, as explained in greater detail in the section on National Insurance contributions below. Similarly, a US executive who is temporarily transferred (ie, for up to five years) by a US employer to work in the UK may obtain a certificate of coverage under the US/UK Social Security Treaty to continue to be covered under the US system and be exempt from coverage under the UK system. The worker and employer would continue to contribute to the US system only.

46 IRC, § 3101(a).

47 *Ibid* § 3121(b).

48 *Ibid* § 3121(b).

49 *Ibid* § 3121(h).

50 Middle Class Tax Relief and Job Creation Act 2012, Pub. L. No. 112-96, Sec. 1001(a), 126 Stat. 158.

51 IRC, § 3101(b) [Employee] and 3111(b) [Employer]

52 Note that partners and other non-employees are subject to the self-employment income tax imposed under section 1402 of the IRC at a rate equal to the combined employer and employee FICA and Medicare tax rates.

53 Under the US/UK Social Security Treaty: see note 68 below.

US/UK Tax Treaty

Income from personal services

The US/UK Tax Treaty, in dealing with the taxation of income from personal services, distinguishes between ‘independent’ (self-employment) and ‘dependent’ (employment) personal services. The US/UK Tax Treaty also provides special treatment for individuals who are ‘artistes or athletes’ and for amounts received in certain circumstances in respect of the services of an artiste or athlete.

INDEPENDENT PERSONAL SERVICES

Generally, services rendered as a director of a corporation, or rendered by physicians, lawyers, engineers, architects, dentists, consultants and accountants, performing personal services as sole proprietors or partners, are independent personal services, whereas the income earned by the employees of such persons, or as an officer of a corporation, is considered to be income from dependent personal services.

Under the US/UK Tax Treaty, income derived by an individual who is a resident of the US or the UK from the performance of personal services in an independent capacity may be taxed by that country of residence, and such income will be exempt from tax by the other state unless the individual is present in the other state for a period or periods exceeding 183 days in the tax year, but only to the extent such income is attributable to services performed in the other state. In addition, income from personal services may be taxed in the other state if the individual has a ‘fixed base’ regularly available to him for the purpose of performing his activities, but only to the extent such income is attributable to services performed in the other state. The term ‘fixed base’ is synonymous with the term ‘permanent establishment’ as described in Article 5 of the US/UK Tax Treaty.

DEPENDENT PERSONAL SERVICES

Article 15 of the US/UK Tax Treaty deals with the taxation of income in respect of dependent personal services, which applies to employment rather than independent contractors, owners or directors. Subject to the US/UK Tax Treaty provisions governing pensions (Article 18) and government service (Article 19), salaries, wages and other similar remuneration derived by an individual who is a resident of either the US or the UK from labour or personal services performed as an employee (of any person) may be

taxed only by that state unless the employment is exercised in the other state. Except as provided in the next paragraph, remuneration derived with respect to services performed within the other state may also be taxed by the other state.

Remuneration derived by an individual who is a resident of one state in respect of employment exercised in the other state will be exempt from tax by the other state if: (a) the employee is present in the other state for a period or periods totalling less than 183 days in the taxable year; (b) the employee's 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 as such by a permanent establishment or fixed base which the employer has in the other state. Such income may nevertheless be taxed by the other state if the individual is a citizen of the other state, pursuant to the saving clause of paragraph 4 of Article 1 (General Scope). This has implications for US citizens who are taxed on their worldwide income.

In the US, remuneration from employment services is not viewed as having been borne by the permanent establishment or fixed base maintained in the US if the employee is performing stewardship or overseeing functions for the benefit of a resident of or a permanent establishment maintained in the UK. However, the remuneration will be considered to be borne by the permanent establishment or fixed base maintained in the US if the remuneration is paid for activities other than stewardship or overseeing functions and the permanent establishment or fixed base is entitled to claim the employee's remuneration as a deduction in computing taxable income for US purposes because the remuneration is definitely related and allocable to its gross income or a class of its gross income pursuant to section 861 of the US Tax Code and the regulations thereunder.

State and local taxation

Most US states and a number of local governments, cities and counties impose an income tax on residents and non-residents who derive income from sources within their jurisdiction. A resident of a state or locality is generally taxed on worldwide income, regardless of its source. A non-resident of a state or locality is taxed only on income from sources within the state, although some localities do not tax the income of non-residents at all.

US tax treaties do not cover state and local income taxation. Therefore, while a foreign executive may not be a US tax resident due to the application of a tax treaty, the executive, on account of being domiciled in a state or having a permanent place of abode in that state and being present a sufficient number

of days (generally more than 183), may be subject to state and local income taxation in circumstances where no US federal income tax would apply.

UK tax issues

This section addresses key areas of concern in relation to tax that has an impact on those moving from the US to work temporarily in the UK. Again, where applicable, there is also a focus on more general issues that apply to internationally mobile executives or to executives who may move temporarily from the UK.

Liability to UK tax

Liability to UK tax is determined in relation not only to UK residence but also to the concepts of ‘ordinary residence’ and ‘domicile’, the last two concepts being uniquely Anglo-Saxon. Most countries have a statutory definition of ‘residence’ for individuals but none of the above-mentioned terms is currently defined in UK law. However, it is important to note that the law in this area is in a state of development and this could be about to change. A consultation document and draft legislation were published in June 2011 with a view to introducing a statutory residence test and the abolition, except for very limited circumstances, of the concept of ‘ordinary residence’. Responses to this consultation and further draft legislation were published in June 2012 and the process continues with a view to enactment in the Finance Bill 2013. However, since this is not yet part of UK law, this article addresses issues of residence, ordinary residence and domicile only in the context of current law and makes no comment on the most recent proposals to change this. It should also be noted that there are no plans to introduce a statutory definition of domicile or to change the tax treatment of those regarded as non-domiciled from a UK tax perspective.

The absence of statutory tests for these key terms means that reliance is currently placed on case law and on the guidance⁵⁴ issued by Her Majesty’s Revenue & Customs (HMRC) which documents, in broad terms, HMRC’s approach to residence, ordinary residence and domicile, while emphasising that all cases will be fact-specific. Given the acknowledgement that each case turns on its facts, it is always vitally important that advice is taken before any assumptions are made regarding an executive’s residence, ordinary residence or domicile status. However, there are some key criteria to be aware of.

54 Currently HMRC6, formerly IR20.

An individual will be regarded as a UK resident if he is physically present in the UK for 183 days or more during the UK tax year⁵⁵ which, for historic reasons, runs from 6 April to 5 April. In contrast to the substantial presence test under US law, there are no exceptions to the UK presence rule. However, an individual will also be regarded as a UK resident if he is not physically present in the UK for 183 days but fulfils certain other criteria – these include property, family and social connections.⁵⁶ There is increased attention to these areas as opposed to strict day counting.⁵⁷ In terms of attention to mobile individuals, it is fair to suggest that HMRC is far more likely to scrutinise the position of an individual who has been a UK resident but then claims non-resident status than they are to one who has never been a UK resident. This is because it stands to reason that a ‘departing’ executive is far more likely to retain links to the UK, which might be suggestive of residence. Accordingly, former UK resident individuals who subsequently take the position that they are no longer resident need to take extra care. This position is reflected in the proposed legislation giving a statutory definition of residence where different rules apply to those leaving the UK.

Ordinary residence implies that a person’s presence in the UK is part of his settled and habitual pattern of life for the time being. This generally implies that a person is in the UK for a settled purpose, although this is not necessarily a permanent situation. An individual may be resident in the UK without being ordinarily resident or, less frequently, be non-resident but remain ordinarily resident.⁵⁸

Domicile is a different concept altogether and is where a person is regarded as having his settled home. Everyone has a domicile of origin – this is the domicile of their father at the time of their birth for those with married parents and of their mother for those with unmarried parents.⁵⁹ A person may subsequently abandon their domicile of origin but it is not uncommon for individuals to be resident in the UK for many years while still being domiciled elsewhere. Some individuals may even be domiciled outside the UK having lived in the UK all their life. Internationally mobile executives resident in the UK are invariably non-domiciled unless they come to regard the UK as their permanent, settled home, which will only happen in very limited circumstances. Again, it should be noted that individuals who have a domicile of origin abroad are less likely to be the subject of HMRC scrutiny into their domicile; and those who claim to have abandoned what was originally a UK domicile face a greater risk of enquiry in this area.

55 HMRC6, paragraph 2.2.

56 *Ibid.*

57 See *R (Gaines-Cooper) v HMRC* [2011] UKSC 47.

58 HMRC6, paragraph 3.2.

59 *Ibid* paragraph 4.3.1.

Part one above (US tax issues) deals with the application of the US/UK Tax Treaty to questions of residence. This may well serve to modify the above rules in the context of US nationals coming to the UK to work for a period of time.

Arrival in the UK

If, on arrival in the UK, an executive plans to remain for three years or more, then he will be both resident and ordinarily resident from the date of arrival.⁶⁰ If, on arrival in the UK, he plans to remain for an initial period of at least two years, then he will be resident from the date of arrival but not necessarily ordinarily resident; this will depend on the facts. If he comes to the UK for less than two years or for no fixed period, then his residence and ordinary residence will depend on the facts. However, if he is physically present in the UK for more than 91 days, on average, in three consecutive tax years, he will be both resident and ordinarily resident from the beginning of the fourth tax year.⁶¹ Obviously, this could also happen at an earlier date, depending on the facts.

Given the above rules, it is common for executives to come to the UK for no fixed period at first. This means that they are neither resident nor ordinarily resident, immediately, which may have certain favourable tax implications, as explained in further detail below.

UK tax implications of residence/domicile status

The foregoing rules in relation to residence and domicile need to be reviewed in the context of their tax impact. Those individuals not ordinarily resident in the UK, regardless of their domicile, are eligible to use what is known as the remittance basis of tax on foreign income, including certain employment income. This means that, on items of income that are not UK source income, they are only subject to UK tax to the extent such income is brought into or remitted to the UK. Those individuals who are not domiciled in the UK are entitled to use the remittance basis on items of both income and gain which are not UK-source. There are very complicated rules regarding what constitutes a 'remittance', which are beyond the scope of this article but, very broadly, an item of income is regarded as being remitted to the UK if it is brought into the UK. For the purposes of this article, the basic tax implications of residence and domicile are important to identify in the context of the internationally mobile executive.

60 *Ibid* paragraph 7.2.

61 *Ibid* paragraph 7.5.

UK tax implications on employment income of residence, ordinary residence and domicile

This section provides a summary of the treatment of employment income for those of differing UK residence and domicile status and with differing locations of work and residence of employer.⁶² In some cases, more than one of these situations may apply to an executive in a given tax year.⁶³

WORKING WHOLLY OUTSIDE THE UK FOR A UK EMPLOYER

- If an executive is resident and ordinarily resident, he will pay tax on all of his earnings.
- If an executive is resident but not ordinarily resident, he will only pay tax on earnings remitted to the UK.

It makes no difference whether the executive is domiciled in the UK.

WORKING PARTLY IN AND PARTLY OUTSIDE THE UK FOR A UK EMPLOYER

- If an executive is resident and ordinarily resident, he will pay tax on all of his earnings.
- If an executive is resident but not ordinarily resident:
 - for work he does in the UK, he will pay tax on all of his earnings; or
 - for work he does overseas, he will only pay tax on any earnings remitted to the UK.

It makes no difference whether the executive is domiciled in the UK.

WORKING PARTLY IN AND PARTLY OUTSIDE THE UK FOR AN OVERSEAS EMPLOYER

- If an executive is resident and ordinarily resident, he will pay tax on all of his earnings.
- If an executive is resident but not ordinarily resident:
 - for work he does in the UK, he will pay tax on all his earnings; or
 - for work he does overseas, he will only pay tax on any earnings remitted to the UK.

It makes no difference whether the executive is domiciled in the UK.

62 The relevant provisions are found in the Income Tax (Earnings and Pensions) Act 2003.

63 It should be noted that the summary below does not deal with minor exceptional cases, such as the Seafarers' Earnings Deduction.

WORKING WHOLLY OUTSIDE THE UK FOR AN OVERSEAS EMPLOYER

- If an executive is resident but not domiciled he will only pay tax on earnings remitted to the UK – it makes no difference whether he is ordinarily resident.
- If an executive is resident and domiciled:
 - he will pay tax on all his earnings if he is ordinarily resident; or
 - he will only pay tax on earnings remitted to the UK if he is not ordinarily resident.

It can be seen from the above summary that residence, ordinary residence and domicile can make a significant difference in terms of an individual's liability to UK tax on employment income. Of most importance in the context of the above summary is the shift in position between a non-domiciled individual who works partly in and partly outside the UK for an overseas employer and one who works wholly outside the UK for an overseas employer. In the former circumstances, the individual concerned may use the remittance basis of taxation for work done overseas, provided that he is not ordinarily resident in the UK. Once he becomes ordinarily resident, the right to use the remittance basis is lost. However, the remittance basis is available to an individual who works wholly outside the UK for an overseas employer as long as such individual is non-domiciled. This results in the potential for 'dual contracts' for non-domiciled individuals.

Domicile and dual contracts

Most executives who live and work in the UK are likely to become UK resident and, if they remain in the UK for more than three years, they will also become ordinarily resident for the reasons described above. As stated above, this may occur at an earlier date. However, typically foreign executives will take the position that they continue to be non-domiciled for UK tax purposes since they do not intend to remain in the UK permanently.

As stated above, executives who have two separate employments – one with a UK employer and one with a foreign employer – can continue to use the remittance basis of taxation on their earnings from foreign employment where the work for that foreign employment is carried out wholly overseas. Thus, a popular proposal is that a non-domiciled executive works for employer A in the UK and employer B, a foreign employer, outside the UK. The conclusion from the above rules is that only the earnings from employer A are subject to UK tax (unless earnings from employer B are remitted to the UK, which would be unlikely to occur if correctly addressed).

HMRC have extremely strict rules in relation to such dual contracts. They have made it very clear that they will not accept dual income arrangements unless there is a commercial rationale for two separate roles undertaken in both the UK and overseas; an artificial division of essentially one job will not be accepted. Specifically, if the job was originally a single role and the dual contract proposal only arose because an executive was non-domiciled, the arrangements will automatically be regarded as a single job. This can be important when executives request a change in their arrangements on becoming ordinarily resident in the UK but remaining non-domiciled. HMRC have also, as recently as March 2012, made it clear that they will closely review records to determine exactly where employment is being performed, including electronic records. There must be evidence that the overseas role is genuinely being performed wholly overseas. It needs to be acknowledged that compliance with this is likely to be difficult in an era of electronic communications where e-mail, etc related to the overseas employment may well be sent (or even merely opened) while the executive involved is in the UK. This might result in the position being taken by HMRC that the employment is not being performed wholly outside the UK and any planning is thus no longer effective.

From a UK tax perspective, dual contract arrangements should be approached with extreme caution. It is rare to encounter circumstances in which they can operate effectively and it must always be assumed that such arrangements will be closely scrutinised by HMRC and must be robust to withstand such scrutiny.

Employment income tax: rates and compliance

Executives performing their employment activity in the UK will be liable for UK income tax on related employment income. Employment income is widely defined and will include certain benefits in kind provided by an employer. Income tax is imposed at graduated rates with the highest rate of 50 per cent being applicable to income in excess of £150,000 per year.⁶⁴ As can be seen from the above summary in relation to residence and liability to tax, there is no specific *de minimis* on the amount of work which needs to be performed in the UK for the liability to tax to arise. Accordingly, in theory, any employment activity in the UK will give rise to UK tax. Thus, again in theory, a business trip by an executive working for a foreign employer will result in UK tax issues. However, practice does not reflect this. HMRC show some flexibility as to when UK tax needs to be accounted for – this is highly unlikely to be necessary if the executive is present in the UK for less than a

64 The 50 per cent rate will fall to 45 per cent in April 2013.

month. There are also some links to visa status in this field – an executive present in the UK on a standard visitor's visa is unlikely to attract attention. Equally, this area is often covered by the 'employment income' Article of a typical double tax treaty so that short-term postings to the UK of executives working for foreign employers are likely to be protected by the relevant treaty. Analysis of each and every potentially applicable treaty is beyond the scope of this article but, in relation to the US, this is addressed to some extent below in the discussion on reliefs and protection.

The UK operates a system known as 'pay-as-you-earn' (PAYE), in which UK employers withhold income taxes due on employment income and duly remit the relevant amounts to HMRC.⁶⁵ Nearly all employers are legally obliged to operate this system.

In the context of the internationally mobile executive, this is fairly straightforward if the executive concerned will be working in the UK for a UK company, since PAYE will automatically be set up and will address the necessary compliance. The issue becomes more difficult if the executive is working in the UK for a foreign employer and there are certain rules in this area to deal with the need for compliance.

If the executive is providing services through a UK company, then that company can be deemed to be the employer for PAYE purposes and thus be obliged to account for PAYE. This circumstance can arise if, for example, the executive remains technically employed by an affiliated foreign company but works for a while, for example on secondment for a UK company in the same affiliated group. That UK affiliated company would, for PAYE purposes, be regarded as the executive's employer and withholding for PAYE would be accounted for through the company's payroll.

If the executive is not providing his services through a UK company, but the overseas employer nevertheless has a permanent establishment in the UK, and the executive is working for them in the UK, then the foreign employer will be obliged to register for PAYE and withhold and remit the relevant amount from the executive concerned. The term 'permanent establishment' is subjective and may depend on the terms of any applicable double tax treaty. Under the US/UK Tax Treaty (at Article 5, also discussed in the section on 'independent personal services' above), which is not atypical in this area, a 'permanent establishment' includes a branch or an office but can also include an individual entitled to conclude contracts in the name of the overseas company. Thus, in some circumstances, even the presence in the UK of a single executive can amount to a permanent establishment, depending on the authority of that executive. In terms of PAYE compliance, local PAYE service companies in the

65 These rules are found in a body of PAYE regulations issued by HMRC.

UK can assist overseas employers who have a permanent establishment in the UK but who are not of sufficient size to warrant a separate payroll department. Potentially affected companies should always seek specialist advice on whether they have a UK permanent establishment.

If the overseas employer has no permanent establishment in the UK, then the executive will need to comply through self-assessment for his own income tax.

As discussed above, if the executive is not ordinarily resident or not domiciled in the UK, he may elect to use the remittance basis of tax where possible. This brings with it compliance through the UK's self-assessment system. There may also be a charge for non-domiciles for use of the remittance basis, the amount depending on the amount of time the executive has lived in the UK. Executives should be encouraged to seek advice in this area since, as discussed above, what constitutes a remittance is a complicated matter. There is no obligation for employers to provide assistance to UK executives in this area and employers should ensure that any assertions made by executives as to their residence or domicile status are supported by professional advice.

Employment income tax: reliefs and protection

Treaty relief

The UK has entered into a large number of double tax treaties, the vast majority of which contain provisions relating to employment income. The actual terms of the treaties do vary but they generally give relief for short-term postings. Once an executive has remained in the UK for a certain period of time, he is unlikely to be eligible for treaty relief and the right to tax employment income will be that of the UK, where he is living and working.

The terms of the US/UK Tax Treaty in the area of employment income tax are described in part one (US tax issues) above. As can be seen, these give clear relief for short-term postings for US individuals working temporarily in the UK and vice versa. This, and similar treaties, would thus address 'short-term' postings to the UK and the technical issue of exposure to UK income tax.

Unilateral relief

In addition to possible treaty relief, the UK operates⁶⁶ a system of foreign tax credit reliefs so that UK taxpayers are not subject to double taxation. The

66 See Taxation (International & Other Provisions) Act 2010.

amount of relief is, generally speaking, the lower of the amount of foreign tax paid and the amount of the UK tax chargeable on that item of income. Relief is restricted to the amount available under the treaty, where such a treaty is in place. These provisions are primarily of benefit to UK residents who are sent to work abroad for short periods in which they remain a UK resident.

Tax equalisation clauses

Although not legally mandated under UK or other laws, tax equalisation clauses are commonplace in employment contracts involving internationally mobile executives, to ensure, in the event that other possible reliefs fail, that they are not subject to an amount of tax greater than they would expect to pay in their home country. Such clauses are common in relation to inbound and outbound arrangements involving the UK. Specifically, they are commonplace in contracts in which an individual is sent from the US to work for a period of time in the UK. Generally speaking, US personal income tax rates are lower than those imposed in the UK, so US executives will frequently want to protect their position in this regard.

National Insurance contributions

The UK's social security contributions are known as National Insurance contributions or, more colloquially, NICs. NICs are payable by both employers (employer NICs) and employees (employee NICs). Above certain thresholds, these are imposed at rates of two per cent (employee) and 13.8 per cent (employer). Since tax and NICs are dealt with separately, it is entirely possible for an internationally mobile executive to be paying UK tax but to not be subject to UK NICs.

Rules in relation to internationally mobile executives

The general rule and default position is that employees (and accordingly their employers) are required to pay NICs from the outset.

However, NICs are not payable for the first 52 weeks, starting from the first Sunday after the employee arrives in the UK, for an employee:

- who is not normally living or working in the UK;
- who has been sent to work in the UK temporarily by an overseas employer;
- if the employer has a place of business outside the UK even if the employer also has a place of business in the UK; and
- who continues to work for the overseas employer.

Thus, for many executives, there is at least a 52-week period in which NICs are not payable, assuming they fulfil the criteria above. In considering the above criteria, special notice should be taken of the need for the employee to continue to work for the overseas employer. Even if, under the PAYE system described above, the executive's income tax is accounted for by his employer's UK subsidiary or similar, the fact that the executive continues to work for his overseas employer would mean that he would fall out of the NIC regime for 52 weeks under the above rules.

International agreements and NICs

EUROPEAN ECONOMIC AREA COUNTRIES AND SWITZERLAND

On 1 May 2010, new rules were introduced for internationally mobile executives moving within the European Union (EU) for professional reasons.⁶⁷ These modify some of the rules relating to UK NICs for people moving around the European Economic Area (EEA) and their employers. The rules largely replace similar regulations.⁶⁸ The new rules were extended to Switzerland from 1 April 2012 and to Iceland, Liechtenstein and Norway from 1 June 2012. Prior to this, the UK continued to apply the existing rules contained in Regulation (EC) No 1408/71 to these countries.

Broadly speaking, these rules mean that an executive who is a national of an EEA country or Liechtenstein/Switzerland but is sent to work in another such country for a period of up to two years may continue to contribute to the social security system in his home country. This is a change from the previously applicable period of one year with extension after that.

Where it is intended that an assignment in another Member State will last longer than two years, it is possible to apply for contributions to be paid in the home Member State if that is in the interests of the employee. The circumstances in which Member States should agree to contributions being payable in the employee's home Member State are set out in the recommendations of the EU Administrative Commission. These are where one of the following applies:

- the employee has specialist knowledge or skills;
- the employee has specific objectives in the host Member State for which the employee's services are required; or
- it is in the employee's interest to remain within the home Member State social security regime.

67 Regulation (EC) No 883/2004 (as amended by Regulation (EC) No 988/2009) and Implementing Regulation (EC) No 987/2009.

68 Regulation (EC) Nos 1408/71 and 574/72.

Although it cannot be entirely assumed, it is not generally difficult to argue that it is in an employee's interests to continue to contribute to the social security system in their home country.

Treaty arrangements

Despite its extensive tax treaty network, there are relatively few jurisdictions with which the UK has a treaty in relation to social security contributions. The jurisdictions with which the UK does have such a treaty are Barbados, Bermuda, Canada, Guernsey, Israel, Jamaica, Japan, Jersey, Mauritius, the Philippines, South Korea, Turkey, the US and the former Yugoslavia (not including Slovenia).

The terms of the treaties vary. However, in accordance with the focus of this article, the arrangements with the US are discussed in more detail below.

US/UK Social Security Treaty

Article 4(2) of the US/UK Social Security Treaty⁶⁹ states that, where the employee of a US or UK employer normally covered under his domestic social security system is sent to the other country to work for his employer for a period of five years or less, he can continue to contribute to his domestic social security system. He needs to obtain a certificate of coverage from his home jurisdiction to do this. This is more generous than the UK domestic law described above.

If the period of five years is extended or it becomes apparent that it will be extended, then there is scope for an executive to apply to continue contributing to the social security system in his home jurisdiction. This can be obtained by writing to the tax authorities in the overseas jurisdiction and explaining the circumstances. It should be noted in this regard that while the initial certificate of coverage is obtained from an executive's home jurisdiction, the application for extension is made to the foreign jurisdiction. An extension may then be granted on an annual basis and there is the potential for a year's extension to be reviewed in further years on further application.

However, it must be borne in mind that the circumstances according to which such extension is granted are limited. There is no formal guidance in the UK, but the US social security website makes this point in its guidance on social security agreements and the general rule of five years. While applications for a year's extension are typically granted, an executive should not assume this and, beyond the initial five-year period, the application is less likely to be granted.

69 Agreement on Social Security between the United States of America and the United Kingdom of Great Britain and Northern Ireland signed in February 1984.

Equity incentive arrangements

As stated above, a detailed discussion of the UK tax implications of equity incentive arrangements for internationally mobile executives is beyond the scope of this article and would demand separate consideration. In terms of equity incentive arrangements, the UK has some complicated rules and care needs to be taken in implementing 'cross-border' equity incentive plans. An individual's existing equity incentive arrangements also need to be considered before he enters or leaves the UK to work. Further complications arise with the use of the remittance basis of taxation described above and with interaction with any applicable double tax treaty. Individuals coming to the UK to work having acquired equity incentives will need to consider the UK tax implications of vesting, exercise or disposal of those incentives once they are regarded as resident in the UK.

Self-employment

The focus of this article has been on executives who are regarded as employees for tax purposes. However, some executives may be regarded as self-employed whether in the UK or in the relevant foreign jurisdiction or both. If this is the case, then in the UK there are certain key differences between the tax treatment of those who are employees and those who are regarded as self-employed. Importantly, different rules on NICs will apply – self-employed UK residents are subject to a more favourable regime. Both residents and non-residents will need to consider the fact that profits arising from a UK trade or business are subject to UK tax. This can be especially important for non-resident partners in UK partnerships or non-resident members of UK limited liability partnerships. Such individuals will be subject to UK tax on their partnership profits if that partnership carries on a UK trade or business. Those who are resident in the UK but not ordinarily resident or not domiciled will also need to consider the rules regarding remittance. Foreign source income will be subject to the usual tax rules on remittance but it may be difficult for an individual to distinguish between profits attributable to a UK trade and those that are genuinely foreign source. Specialist advice should be sought in this area and detailed analysis of the position of self-employed individuals is beyond the scope of this article.

Anti-avoidance

The UK government has recently focused on anti-avoidance in relation to employment income and NICs. This has been alluded to above in the context

of dual contracts, which were relatively common ten years ago but that are now rare given the increasing difficulty of falling within the parameters that render them acceptable to HMRC. However, the UK government has also released guidance and draft legislation on employment through ‘personal service companies’ where a company, rather than an individual, is engaged to perform services and thus lower corporation tax rates as opposed to individual tax rates are payable on the consideration for the services, with no NICs being due. The new legislation seeks to counteract this type of scheme, which had been popular in recent years including, somewhat embarrassingly, among senior figures in the UK government. Going forward, assuming the draft legislation is enacted, individuals who control such companies will be regarded as employees for tax purposes. Additionally, the UK has certain rules relating to services provided through intermediaries – the recipient of such services may be considered the employer for tax purposes.

The UK also has certain tax rules applicable to those returning to the UK after a period of absence. Although these apply more specifically to gains and less to employment income, they could have an impact on executives who leave the UK and then return there within a certain period of time – for income, one year and for gains, five years. The time when this legislation is potentially of most significant application to internationally mobile executives is in circumstances in which an employee acquires shares pursuant to an equity incentive plan while a UK resident, disposes of those shares once no longer a UK resident but then returns to the UK within five tax years of departing. Such executives will pay local capital gains tax on disposal of their shares while a non-UK resident (the UK does not typically tax non-residents on capital gains) but would also potentially be subject to UK capital gains tax on their return. Furthermore, the wording of the legislation means that treaty relief is typically unavailable to such individuals so that there is a genuine risk of double tax. Considerable care needs to be taken in this area.

Conclusion

The UK and US tax issues relating to internationally mobile executives are complicated and are unlikely to become any less complicated even with the proposed UK changes to the definition of residence and the modification of rules in relation to ordinary residence. Because of this complexity, and the frequent changes in the applicable rules and guidance, specialist advice should always be sought in relation to the tax position of those who work internationally. Tax authorities, including HMRC and the IRS, are becoming increasingly aware of the issues involved and are keen to ensure that their jurisdiction receives any appropriate amount of tax due to it. This heightened attention to compliance and enforcement can result in substantial costs and penalties for those employers and executive who fail to comply with relevant rules and procedures.



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