Wolters Kluwer

GLOBAL TAX WEEKLY
a closer look

ISSUE 161 | DECEMBER 10, 2015

SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

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Internationally Mobile Employees – The New UK Tax Rules For Employment-Related Shares And Securities

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Introduction

With the increase in globalization comes change in the way multinational organizations manage their workforces. As new markets open up and as the brightest new talent demands the opportunity to gain international experience, the number of internationally mobile employees (**IMEs**) continues to increase.

While commentators are predicting 50 percent growth in mobile employees by 2020,[1] the type of assignee is changing with 56 percent of multinationals surveyed[2] expecting an increase in short-term assignments while only 44 percent predict an increase in the more traditional long-term assignments.

What this means in practice is a great deal more complexity in the way in which such employees are taxed and a potential minefield for employers trying to keep up with changing tax legislation and regulation in a variety of different jurisdictions.

In the UK, the law relating to the taxation of employment-related securities (**ERS**)[3] is complicated, and income tax and potentially National Insurance Contributions (**NIC**) (UK social security) may arise on gains arising from the acquisition, holding or disposal of ERS or on the exercise of certain options to acquire ERS (securities options, most typically being employee share or stock options). The relevant charging provisions for UK resident employees are found in section 62 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA) or Part 7 ITEPA.

Historically, the tax treatment of such awards in the hands of IMEs had been governed by sections 423E and 474 of Part 7 ITEPA. The interaction of this legislation with the UK tax rules relating to residence and domicile, as well as the application of international tax treaties, led to a potentially convoluted route to the correct answer.

In recognition of this, new rules were introduced in the Finance Act 2014, and now form Chapter 5B Part 2 ITEPA which aims to simplify the taxation of ERS for IMEs. The aim of the new legislation is to tax the gains in the jurisdiction where the IME

was resident at the relevant time. This article considers these new rules and how they apply.

The rules apply from April 6, 2015, and due to the impact that an individual's particular circumstances may have on their tax treatment each arrangement should be considered on a case-by-case basis.

In determining the amount subject to tax in the hands of an IME, a four-step process should be followed:

1. Does section 62 ITEPA or Part 7 ITEPA apply?
2. Is the individual an IME (Chapter 5B Part 2 ITEPA)?
3. What is the "relevant period" (Part 7 ITEPA)?
4. What is the "taxable specific income" (section 41F ITEPA)?

Where the relevant charge arises under section 62 ITEPA (for example, the acquisition at undervalue of a very "plain vanilla" security which is not subject to restrictions or a right to convert *etc.*) then the new rules on ERS will not apply and similar provisions to a cash bonus should be considered – this is beyond the scope of this article.

However, where the charge arises under Part 7 ITEPA, we then need to determine whether the individual is an IME and hence whether Chapter 5B ITEPA applies.

Does Chapter 5B Apply?

If the employee meets one of the "internationally mobile conditions" in any part of the "relevant period" (see below) then Chapter 5B will apply. These conditions are as follows:

1. The employee is taxable on the "remittance basis" or is not resident in the UK for tax purposes in the UK in a UK tax year[4] in the relevant period; or
2. The overseas part of a UK tax year which is a "split year" falls in the relevant period.

What Is The Relevant Period?

The relevant period is important as it is the basis of determining which portion of the securities income is subject to UK income tax. The relevant period is determined by which Part 7 ITEPA charging provision applies. However, it will be subject to a "just and reasonable" override if a different period would be a better basis for the charging provisions (*e.g.*, if an award was made wholly in respect of prior UK service then the entire period might be treated as being UK and the entire gain will be subject to UK tax). It is also important to consider the potential interaction between the charging provisions.

Part 7 ITEPA Charging Provision	The Relevant Period
Restricted securities (Chapter 2)	Period from acquisition to the Chargeable Event (CE).
Convertible securities (Chapter 3)	Period from acquisition to CE.
Securities with an artificially depressed market value (Chapter 3A)	Tax year of acquisition (where acquisition is the CE) or otherwise the start of UK tax year to CE (except where a charge arises under section 446E(1)(a) ITEPA where the restricted securities rules would apply).
Securities with an artificially enhanced market value (Chapter 3B)	Start of the UK tax year of the valuation to valuation date.
Acquisition for less than market value (Chapter 3C)	Securities option – period from grant to vesting. Notional loan – normally the UK tax year in which the loan is made or, if the CE is in the same year, the period from the start of the UK tax year to the CE.
Securities disposed of for greater than market value (Chapter 3D)	The UK tax year of the CE.
Post-acquisition benefits (Chapter 4)	The UK tax year of the CE.
Securities options (Chapter 5)	Period from grant of the option until the CE or vesting if earlier (where options vest in tranches, each tranche is considered separately).

What Is Subject To UK Income Tax?

The amount subject to UK income tax is the "taxable specific income" which is calculated as follows:

> securities income – foreign securities income + chargeable foreign securities income = taxable specific income

Securities income is employment income calculated in accordance with the provisions of Part 7 ITEPA (*e.g.*, the spread or gains on exercise of a stock option).

Foreign securities income is made up of chargeable and unchargeable foreign securities income.

Securities income less foreign securities income will generally be subject to income tax in the UK under PAYE (unless certain exemptions apply). The employer should operate PAYE (where relevant) on their best estimate of the taxable securities income less foreign securities income. This means that it is not necessary for the employer to consider how much if any of the securities income has been remitted to the UK – chargeable foreign securities income must be declared on the individual's self-assessment tax return and will be taxed accordingly.

Chargeable foreign securities income means securities income which falls in any part of the relevant period in a tax year where:

(a) The individual has claimed the remittance basis (section 809B, 809D or 809E of the Income Tax Act 2007);
(b) The individual does NOT meet the requirements of section 26A ITEPA;[5]

(c) The relevant employment is with a foreign employer; or
(d) The duties of the relevant employment were performed wholly outside the UK in that year,

EXCEPT where there are restrictions on the remittance basis (under section 24A ITEPA),

OR, where the individual has claimed the remittance basis and does meet the requirements of section 26A ITEPA (contrasted with (b) above), then where the duties of employment are performed:
(a) Wholly outside the UK – securities income in that part of the relevant period is chargeable foreign securities income; or
(b) Partly outside the UK – the proportion relating to overseas duties is chargeable foreign securities income,

EXCEPT in a split year when the proportion relating to overseas duties in the split year is treated as unchargeable foreign securities income.

Unchargeable foreign securities income means securities income which falls in any part of the relevant period in a tax year where:
(a) The individual is not UK resident for tax purposes;
(b) The employee performed his duties outside the UK; or
(c) Where the employee performed some of his duties outside the UK, that part which is attributable to non-UK duties (on a just and reasonable basis).

Unchargeable foreign securities income is not subject to UK income tax.

Double Taxation

While the new rules are intended to bring a more appropriate proportion of ERS gains into the UK, there is still a risk of double taxation. Relief and how it is obtained will depend on the residence status of the employee at the date of the chargeable event and whether there is a double tax treaty in place:

1. Where the employee is resident in the UK at the time of the chargeable event, the amount will be subject to UK tax and the employee will normally be given credit for the foreign tax suffered;
2. Where the employee is not UK resident at the time of the chargeable event but is resident in a territory which has a double tax treaty with the UK, the gain will be apportioned in accordance with the tax treaty; and
3. Where the employee is not UK resident at the time of the chargeable event and is not resident in a territory which has a double tax treaty with the UK, the gain will be charged as above and tax relief given by the jurisdiction where the employee is resident.

National Insurance Contributions

Unlike the tax treatment, time apportionment and double tax treaties do not apply to NIC for IMEs.

The securities income as defined above will be treated as "earnings" and therefore subject to NIC in the UK. Statutory Instrument 2001/2004 Schedule 3

(as amended from April 6, 2015) aims to avoid a double charge and securities income is thereby disregarded for NIC purposes where EU social security rules or an international social security agreement mean that due to the IME's residence status, he is not subject to earnings related NIC. The relevant period is calculated as for tax purposes and gains are deemed to accrue evenly, but there is no just and reasonable override.

Double charges can arise; where the other charging jurisdiction is not an EEA member state or where there is no reciprocal arrangement in place, it can be difficult to obtain relief.

Moving Forwards

Now more than ever, IMEs and their employers will need to ensure they have records of the IMEs' movements, particularly where awards were made prior to April 6, 2015, as the old rules no longer apply and grandfathering has not been applied. Tax planning may also be difficult as certain actions are not available – for example, entering into a "section 431 election," which can reduce some tax charges arising on restricted securities, which cannot take place within the necessary 14 days of acquisition if that acquisition did not take place in the UK or at a time when UK duties were envisaged.

In the Chancellor of the Exchequer's 2015 Autumn Statement on November 25, it was recognized that the new legislation remains complex and further simplification is needed. We await further details in the Budget on March 16, 2016.

Endnotes

1 PWC, *Talent mobility: 2020 and beyond*.

2 Mercer UK, *Global Employee Mobility – Increased diversification across types of international assignments used*, December 1, 2015.

3 ERS include shares and other securities (such as debentures, loan notes *etc.*) acquired by reason of employment. Where such securities are made available by an employer, or person connected with the employer, then they will be deemed to have been acquired by reason of employment unless the person making available the right is an individual and it is in the normal course of a domestic, family or personal relationship.

4 A UK tax year, for individual tax purposes, runs from April 6 each year.

5 These are broadly the conditions for overseas workdays relief (known as OWR) to apply.