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January 21, 2014
2014-006

flash International Executive Alert

A Publication for Global Mobility and Tax Professionals by KPMG's International Executive Services Practice

United Kingdom – Details Published on Preventing Use of Dual Contract Arrangements

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The United Kingdom is implementing new rules that will make it more difficult to use "dual contract" arrangements to lower the U.K. income tax liability of certain foreign nationals. Last week, HM Treasury and HM Revenue & Customs (HMRC) published draft legislation and a paper summarizing the changes to existing legislation in this area[1].

Background

An announcement in the Autumn Statement 2013[2] indicated that the government believed that U.K. tax was being avoided "by creating an artificial division of the duties of one employment between contracts in both the UK and overseas." Where these contractual arrangements, commonly known as "dual contracts", are in place, non-U.K.-domiciled individuals are able to take advantage of the remittance basis of taxation relating to that overseas contract whereby income is not subject to U.K. income tax unless remitted to the United Kingdom.

Why This Matters

Although these dual contract arrangements are not routine, they are in use in the United Kingdom. In some cases the arrangements are in place for genuine business reasons rather than the primary aim of minimizing the U.K. tax liability. On first examination of the draft legislation, KPMG LLP's (U.K.) view is that a considerable number of current dual contract arrangements may be caught by the new rules. It is important, therefore, that all employers with these arrangements in place review their specific arrangements and seek advice on the implications of the new legislation before it is introduced with effect from 6 April 2014.

Legislation in Detail

The new legislation brings the offshore contract into charge in the U.K. when certain conditions are met. This is achieved by charging the remuneration from the offshore contract on the arising basis rather than the remittance basis. For the dual contract arrangement to be caught by the new rules, the following conditions have to be met:

- The U.K. employer and the offshore employer are either the same entity or are "associated" entities;
- The U.K. employment and the offshore employment must be "related"; and
- The foreign tax rate that applies to the remuneration from the offshore employment is less than 75 percent of the U.K. additional rate (currently this is 45 percent, and 75 percent of this rate is 33.75 percent).

Where a dual contract arrangement meets the conditions above and is, therefore, brought into the charge to U.K. tax, foreign tax credit relief will be available against any U.K. tax charge. The new measures will not apply where the income qualifies for overseas workdays relief (OWR) under the new rules which were introduced with effect from 6 April 2013 and which have been the subject of previous issues of *Flash International Executive Alert*[3].

It will not be possible just to pay a higher level of non-U.K. tax in order to meet the "75 percent of 45 percent" test. The draft legislation contains provisions that "all reasonable steps have to be taken to minimise any amounts of tax payable."[4]

Associated Employers

It appears from the draft legislation that the definition of "associated employers" which already exists within U.K. tax legislation is intended to apply in these circumstances. Generally, a company is associated with another if one company controls the other or if both companies are under the control of a third entity or person(s).

Related Employments

The new legislation also introduces tests to determine whether employments are related and therefore meet the second condition outlined above. In broad terms, employments will be related if it can be assumed that the second employment would not exist if the employee did not hold the first employment, if the employments would cease at the same time, or if one employment would cease as a consequence of the other employment ending.

Employments will be considered to be related in the following circumstances:

- Where one employment operates by reference to the other employment;
- If the duties performed in both employments are essentially the same (irrespective of the location in which those duties are performed) or are for the same clients;
- If the performance of the duties for one employment is dependent in any way on the performance of duties of the other employment;
- The employee is a Director of either employer, or is otherwise a senior employee or one of the highest earning employees of either employer.

It is important to note that even if the above tests are not met, then that does not mean that the employments will not be considered to be related. The specific circumstances outlined are set out without prejudice to the general condition that the U.K. employment and the relevant employment are related to each other.

KPMG Note

As stated above, our initial view is that the majority of current arrangements will be caught with the possible exception of individuals who are liable to U.S. tax on worldwide income and individuals who qualify for OWR under the new rules. It is therefore important to review your employees to see if anyone will potentially be caught by the new rules.

KPMG Note (*cont'd*)

There are several areas on which we are seeking clarification from HMRC. Firstly, in relation to OWR, it is clear that these new provisions do not apply where the individual qualifies for OWR under the new rules (S26A ITEPA 2003). The position is not clear if an individual qualifies for relief under the transitional rules, and we have asked HMRC to clarify the intention of the legislation in this respect.

It is also difficult to know how significant the "without prejudice" clause will be when looking at related employments. Most dual contract cases seen in practice would be caught by the specific tests. Again, we are seeking clarification on the intention of the legislation and how this will work in practice.

Next Steps

The legislation is intended to be effective from 6 April 2014. The legislation is **open for technical consultation until 13 February 2014**, and if you have anything you would like KPMG LLP (U.K.) to include in submissions to HMRC, please contact your usual KPMG professional. Further newsletters will be issued as required once the consultation period has ended.

Footnotes:

1 See: https://www.gov.uk/government/publications/finance-bill-2014-january-2014-draft-legislation .

2 For prior coverage of the Autumn Statement, see *Flash International Executive Alert* 2013-161 (December 6, 2013).

3 See the following issues of *Flash International Executive Alert*: 2013-057 (28 March 2013); 2012-231 (18 December 2012); 2012-185 (12 October 2012).

4 See: https://www.gov.uk/government/publications/finance-bill-2014-january-2014-draft-legislation .

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The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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