

March 27, 2014
2014-035

flash International Executive Alert

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

United Kingdom – Amended Legislation to Prevent Tax Avoidance Using Dual Contracts

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The U.K. Finance Bill 2014¹, published today, includes provisions aimed at preventing the avoidance of income tax by a small number of non-U.K. domiciled individuals who work under arrangements commonly known as “dual contracts,” as had been previously announced in the Autumn Statement 2013 and the 2014 Budget Statement.²

Why This Matters

Although these so-called “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 and not with a primary aim of minimizing the U.K. tax liability.

The initial draft of the legislation was too widely drawn. It unintentionally caught some genuine commercial arrangements and following representations from KPMG LLP (U.K.) and others the scope of the legislation was narrowed.

Employers and U.K. resident but non-U.K. domiciled employees who have more than one employment (an employment for this purposes includes a directorship) should check whether they are caught by these new rules which will be introduced from 6 April 2014. Employers will also need to consider whether they are required to withhold tax and/or social security on the earnings under the offshore contract.

Where a dual contract arrangement meets the conditions stipulated by the legislation and is, therefore, brought into the charge to U.K. tax, foreign tax credit relief will be available against any U.K. tax charge.

Background

The government believes that U.K. tax is being avoided with the creation of “an artificial division of the duties of one employment between contracts in both the U.K. and overseas.” Where these contractual arrangements are in place, non-U.K. domiciled individuals are then able to take advantage of the remittance basis of taxation relating to that overseas contract; as such, the income is not subject to U.K. income tax unless remitted to the United Kingdom.

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 65 percent of the U.K. additional rate which is currently 45 percent (65 percent of 45 percent rate is 29.25 percent).

This last condition is an amendment from the original proposal of 75 percent of the additional rate (45 percent) equivalent to 33.75 percent. This will make it easier for certain individuals including American citizens to determine whether they are caught by the new rules.

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 workday 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 (for example by not claiming reliefs) in order to meet the “65 percent of 45 percent” test. The legislation contains provisions that “all reasonable steps have to be taken to minimise any amounts of tax payable.” The foreign tax also has to be paid in respect of duties performed in the overseas country to be considered for the 65-percent test. Foreign tax paid on the basis of domicile on duties performed in another territory would not be creditable.

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 who holds more than 5 percent of the ordinary share capital of the company, 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.

A new condition has been added to the initial draft legislation. The new legislation does NOT apply when the following apply:

- (a) were the duties of the relevant employment to be duties of the U.K. employment instead, all or substantially all of them could not lawfully be performed in the relevant territory (whether on the meeting of any condition or otherwise) by virtue of any regulatory requirements imposed by or under the law of that territory, and
- (b) were the U.K. duties of the U.K. employment to be duties of the relevant employment instead, all or substantially all of them could not lawfully be performed in the part of the United Kingdom in which they are performed (whether on the meeting of any condition or otherwise) by virtue of any regulatory requirements imposed by or under the law of that part of the United Kingdom.

KPMG LLP (U.K.) Note

The original draft legislation caught individuals with multiple Directorships. HMRC received feedback from KPMG LLP (U.K.) and others that Directorships were not an artificial division of duties but had many commercial reasons, as well as regulatory and legal reasons. The amended legislative provisions in the bill include a new measure that stops the new rules applying when both contracts are for regulatory or legal purposes or the Director has a 5 percent or less ordinary capital shareholding in the company.

Deferred Compensation

Under the draft legislation, it was not clear whether deferred compensation paid after 5 April 2014, but earned in respect of a period before 6 April 2014, would be caught. The legislation included in the bill clarifies that such remuneration will not be caught. This is achieved by stating that the new legislation "has effect in relation to general earnings which are general earnings from an employment for the tax year 2014-15 or any subsequent tax year."

KPMG LLP (U.K.) Note

Our view is that the majority of the arrangements that HMRC wishes to target could indeed be caught by the new arrangements. Individuals who will not be caught include individuals who qualify for OWR under the new rules. We are pleased that HMRC has listened to representations made during the consultation and introduced the carve-out for directorships.

Next Steps

The legislation is intended to be effective from 6 April 2014. Employers will need to consider whether any of the arrangements they use will be caught by the new rules and whether they will have an obligation to withhold tax and U.K. social security on any contracts, employments, and directorships caught by the new rules.

If clients have any questions regarding this legislation, they should contact their usual KPMG professional. .

Footnotes:

- 1 See: <http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0190/14190.pdf> .
- 2 For prior coverage, see [*Flash International Executive Alert 2014-032*](#), 20 March 2014.
- 3 For example, see [*Flash International Executive Alert 2013-057*](#), 28 March 2013.

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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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