GMS Flash Alert

Global Compensation Edition

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United Kingdom – What HMRC's "Know Your Customer" Program Means for U.S. Companies

This GMS *Flash Alert* focuses on the U.K. tax authority's approach to employer compliance through the "Know Your Customer" (KYC) program, specifically, HM Revenue and Custom's (HMRC) move away from traditional employer compliance reviews to a wider and more holistic review of the compensation and benefits, HR and payroll processes, and the underlying controls and policies in place at an organization.

KYC is now being filtered down to mid-sized and small-sized employers, which will mean more and more branches and subsidiaries of U.S. companies will be included. Proactive preparation can be particularly important where the U.K. payroll and employment tax is managed outside of the U.K. as part of a global payroll operations platform.

WHY THIS MATTERS

For a business of any size, maintaining employer payroll compliance is becoming ever more challenging in today's increasingly complex regulatory and global tax environment. Some of the challenges impacting global payroll compliance include processing and reporting complex forms of compensation and benefits and delivering compensation and benefits across international borders to assignees and business travelers.

Over the past few years HMRC has undertaken numerous KYC visits, with greater consistency of approach and shared knowledge developing over this period. HMRC believes that it now has a more targeted approach to carrying out KYC reviews, and that more follow-up visits are taking place following the initial KYC meeting. In light of the KYC program, the challenge for U.S. employers with U.K. operations is to make sure they are prepared and "audit-ready" for a possible KYC meeting.

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Background on HMRC's KYC Program

HMRC's KYC program was launched several years ago in response to the U.K. government's commitment to reducing the increasing tax gap relating to employment taxes. KYC builds upon HMRC's Business Risk Review process and Senior Accounting Officer (SAO) regime[1], and is a "top-down" approach to HMRC understanding the business environment and assessing employment tax risks within a business.

As part of the KYC initiative, HMRC recruited a number of "Employer Compliance Champions" from outside of the U.K. civil service who have previous experience of working within different industries and are familiar with the policies and practices occurring in those industries. Most Employer Compliance Champions have since moved on from HMRC; however, KYC is still very much embedded within HMRC as "business as usual" and is here to stay.

What Does KYC Mean for Branches and Subsidiaries of U.S. Companies?

KYC started out as an initiative focused on large business[2] employers only – approximately 2,000 of the largest employers operating in the United Kingdom. KYC focused on the size of the employer, regardless of headquarter location, and therefore even in its early stages the effort picked up some U.K. subsidiaries of U.S. companies. KYC's scope has now broadened to include mid-sized and small-sized employers and has become the standard operating procedure for employer compliance risk assessment.

What Should Be Expected as Part of the KYC Process?

As part of the KYC initiative, an employer will receive a letter from HMRC inviting it to attend a meeting to enable HMRC to establish a clear and consistent understanding of how the employer manages its compliance obligations. The letter is usually sent to an individual within the business whom HMRC normally liaises with on employment tax matters (i.e., head of tax, employment tax manager). The KYC meeting is usually attended by the HMRC Customer Relationship Manager ("CRM")[3] and may be attended by as many as eight additional representatives from HMRC.

HMRC will expect relevant stakeholders from the business who have an understanding of the employment tax operations to attend the meeting, potentially including individuals from HR, compensation and benefits, global mobility, payroll, finance, and tax.

KPMG NOTE

HMRC does understand that companies may not necessarily have dedicated employment tax specialists within the business and instead use external professional advisers. Therefore, it is possible for the business' professional tax advisers to attend the meeting and actively engage in the meeting on behalf of a client. Alternatively, it is also acceptable for the company to follow up with their professional tax advisers following the meeting regarding any questions or issues raised in the meeting.

KYC meetings are extensive and wide-ranging in their scope, covering all employee-related policies and practices – these typically include:

- The business' reward structure – salary, bonus, pensions, equity compensation, expenses, and benefits, etc.
- The composition of the workforce – directors, full-time/part-time workers, and independent contractors.

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- The location of the workforce – globally mobile employees and business travelers.
- Employee tax governance and documentation – tax strategy, policy documents, equity plan rules, process documentation, and other similar documents.
- Who does what, where, when, and how? – establishing an understanding of the processes and systems to foster effective oversight of all areas of employment tax risk, as well as the interaction between the different stakeholders within the business.

KPMG NOTE

Employers should not underestimate the amount of time that can be involved in preparing for a KYC meeting. Our experience has shown that preparation for the KYC meeting is key and can reduce the amount of potential follow-up from HMRC.

What Are the Potential Outcomes from a KYC Meeting?

Following the KYC meeting, HMRC will usually let the business know if there are any areas of concern, which may be responded to by the relevant stakeholders at the meeting or at a later date after discussing internally or with professional advisers. HMRC will usually report back to the business in writing if any further information or documentation (e.g., written policies and processes on particular areas) is required or if there are areas that require improvement. Most importantly, the KYC meeting will be used by HMRC to establish the business' overall risk rating. Where the KYC meeting adversely impacts an employer's risk rating, HMRC is more likely to increase its scrutiny of the business from all other tax aspects.

KPMG NOTE

A key concern many employers have is the effect that a KYC meeting could have on any planned disclosure of employment tax errors. HMRC confirmed that any voluntary disclosure submitted after the business has been notified of an intention to hold a KYC meeting will *prima facie* be considered as "prompted" rather than "unprompted" by HMRC. The latter can see penalties reduced to zero, but for prompted disclosures penalties can only be reduced to a minimum of 15 percent of potential lost revenue (i.e., the tax which would have gone unpaid if the error had not been disclosed). HMRC may be prepared to consider any evidence a business can provide to demonstrate that a disclosure was imminent and therefore should be treated as "unprompted." However, this would depend entirely on the circumstances.

Maintaining a good dialogue with HMRC, and flagging potential disclosures promptly, will go a long way to help to manage risks and mitigate exposure to penalties and any adverse impact on the business' overall risk rating.

HMRC's Vision for the Future

KYC is just one example of how global tax authorities are scrutinizing U.S. employers with U.K. operations more and more. Moving forward, an increased level of inspection of an employer's documentation, a heightened focus on targeting specific areas based on review of payroll data and other data sources, and a greater use of data analytics to prioritize the program of KYC visits, are expected.

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Further, now that the U.K. government has triggered Article 50 of the Treaty on European Union, the next two years of Brexit negotiations will bring a period of uncertainty and change, in particular with regard to employee migration, social security, and global mobility. HMRC has not revealed any immediate changes in its approach to KYC; nonetheless, over the next two years it is anticipated that Brexit will have an impact on companies' workforces, this being one of the key areas of focus in the KYC meeting.

KPMG NOTE

If a company has a CRM or is subject to SAO certification, then the business will get a KYC letter if it has not already. Upon receiving a letter, companies should consult with their professional tax advisers to determine next steps and how the company can be properly prepared when going into its KYC meeting.

Learn more about the GMS practice's Compensation and Benefits group and Employment Tax group.

FOOTNOTES:

1 The SAO legislation is aimed at reducing the U.K. tax gap through improvements in businesses' tax governance and systems. It requires a qualifying company to identify who its SAO is and for this person (typically the CFO or finance director) to certify annually that the company for which he or she is responsible had appropriate tax accounting arrangements in place throughout the year.

2 For HMRC purposes, a large business is defined as having any of the following:

- Turnover – annualized, aggregated, attributable, and worldwide of £30 million or more;
- More than 250 employees (100 employees where the business is foreign owned).

HMRC also treats as a large business, partnerships which have any of the following:

- Ten or more partners;
- Five or more partners and a turnover of £5 million or above – a turnover exceeding £15 million.

3 The primary role of the CRM is to manage the relationship between the business and HMRC across all taxes and duties.

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The KPMG Compensation and Benefits and Employment Tax teams have a wealth of experience in transactional, advisory, and compliance services. We will be able to advise your business in relation to practical considerations in light of the above changes, taking into account your unique operational models and total reward packages.

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