BUFDG Briefing

HEIs and Tax

This guide is written by Harriet Latham, ACA CTA, Tax Manager at the Open University, and formerly the Technical Director at BUFDG. Having extensive experience of tax in a Big 4 firm, the commercial world, and then 6 years of experience in the HE sector, Harriet is well placed to write this guide – however the views expressed are personal views, and not those of The Open University or BUFDG.

The aim of this guide is to dispel any myths that universities, as charities and/or public bodies, do not pay tax, and so tax is not an issue! The main message of this guide is that anyone transacting business on behalf of a university should ask "The Tax Question", first of themselves and then of someone who can answer it. We hope that this accessible guide will be useful to:

- Senior finance staff and Directors of Finance, who are responsible for taxation within their university;
- Anyone thinking of applying for a senior role in a finance department of a university;
- Any other finance staff new to the HE sector;
- Governors, especially those on Finance or audit committees;
- HR Directors in universities;
- Estates Directors in universities;
- International Development Directors in universities;
- Registrars and Chief Operating Officers in universities;
- Heads of Administration in university departments and faculties;
- Research and Knowledge Transfer Managers in universities;
- Heads of Planning;
- Heads of Procurement;
- IT Directors;
- Senior academic colleagues involved in commercialisation, outreach activities and overseas activities.

BUFDG and the author of this guide accept no responsibility for any losses arising as a direct or indirect consequence of following this guidance and universities are advised to seek further professional tax and/or legal advice on any aspects covered in this guide.

"The hardest thing to understand in the world is the income tax."

Albert Einstein

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“Develop internal communications in your institution to raise awareness of tax issues amongst decision makers.”

“Ensure that you have adequate expertise on hand – whether through external advisers, an in-house tax manager, or a combination of the two.”

Executive Summary

Universities can benefit from a very favourable tax regime – but as always, good housekeeping and caution when undertaking new activities is essential to demonstrate compliance and avoid bear traps! In order to achieve this…

- Most importantly, develop internal communications in your institution to raise awareness of tax issues amongst decision makers and ensure that your finance staff understand the direction of travel for your business.
- Do not let “the tax tail wag the business dog” – you need to go with the substance of the activity but forgetting tax does have the ability to derail a project if you fail to incorporate it into your planning stage or forget to budget for it!
- Ensure that you have adequate expertise on hand – whether through external advisers, an in-house tax manager, or a combination of the two.
- Make sure you bring your tax expertise into the loop as early as possible in the development process – although sometimes tricky because of confidentiality, it is much easier to build tax into original decisions than to retrofit.
- Take particular care with property and overseas transactions.
- Have a policy for employees who are sent to work outside the UK – this should cover their compensation package, including tax equalisation, exit and arrival interviews with a professional, tax return assistance, and family travel policy – this should include the requirement for mobile workers to keep a travel diary.
- Ensure that your HR policy on homeworkers incorporates a policy on managing the income tax and social security implications on those workers who reside outside the UK.

Chapter 1:
Why take an interest? – A brief history

Around 15-20 years ago, *managing* your HEI's tax affairs meant an accountant was responsible for filing quarterly VAT returns. For the more ambitious, professional advisers were on hand to implement [complex] structures to save VAT on capital projects and maximise the VAT recovery on your day to day activities.

But now in 2014, I think we find ourselves in a very different place…

The first change is that the UK now has the longest tax legislation or "code" in the world[1], and with a now well established self-assessment regime, the onus to "get tax right" rests with taxpayer. HMRC see their resources reducing at a rapid rate, and so they are no longer able to offer the tailored advice and reassurance we have become accustomed to. And taxpayers must face the wrath of a robust penalty regime if they get it wrong.

Perhaps more worryingly, there has been an [unforeseen] surge in public interest in tax compliance, and the reputational risks of engaging in tax planning are [for most] unpalatable[2]. And in response to public opinion, the government has built tax [compliance] into its procurement framework[3].

To add to these external pressures, many HEIs are entering into new ventures – at home and abroad. With these new activities comes tax complexity. Whilst the tax regime for provision of traditional education and research is known and relatively benign, the tax regime for these new activities can be considerably more complex. The most striking problem is that the generous corporate income tax reliefs we see in the UK are rarely replicated overseas – bringing not only a real tax cost, but a heavy compliance burden which may be disproportionate to the scale of the operations. In my view, a failure to consider the tax implications of new activities or ventures could be crucial in the financial sustainability of such ventures and even the HEI, not to mention crucial in preserving the impeccable reputation of an institution.

Of course, as is demonstrated by our supersized tax code, it is a challenge to explain everything you need to know about HEI tax matters in just a few pages – but I hope that this guide will give you a flavour of where the risks lie, how they can be managed, and what questions you should be asking.

"A failure to consider the tax implications of new activities or ventures could be crucial in the financial sustainability of such ventures."

1 www.telegraph.co.uk/finance/newsbysector/banksandfinance/6146911/UK-has-longest-tax-code-handbook-in-the-world.html

2 www.itv.com/news/2013-06-27/nhs-trusts-in-england-accused-of-avoiding-tax/

3 www.gov.uk/government/uploads/system/uploads/attachment_data/file/175672/Tax_PPN_March-13_v07Final.pdf

> "As charities, HEIs can benefit from a range of very generous statutory exemptions from corporation tax on chargeable gains and various sources of income."

> "An HEI will need to consider whether to carry out that activity through a subsidiary company."

Chapter 2:
What's OK?

Direct Taxes

A direct tax is one that is levied on the income, property, or wealth of people or companies. A direct tax is borne entirely by the entity that pays it, and cannot be passed on to another entity. Examples include corporation tax, income tax, and social security contributions.

Key controls

The favourable tax position for HEIs as described in this guide derives from the charitable status of universities in the UK. Private universities or "alternative" HE providers can only benefit from this regime if they operate through a charitable organisation.

As charities, HEIs can benefit from a range of very generous statutory exemptions from corporation tax on chargeable gains and various sources of income[4]. It is important to note that these exemptions are only available where the profits arising are applied for charitable purposes. The key tax exemptions, in order of importance rather than as they appear in the legislation, cover:

- Profits of charitable trades (also known as **primary purpose trading income**)
- **Property income** (i.e. rent)
- **Investment income** (i.e. interest and dividends)
- **Chargeable gains** on disposal of capital assets (including gains on investments)
- Profits of **small-scale trades** with income not exceeding £50,000
- Profits from **fund-raising and lotteries**
- Income and gains arising from **Intellectual Property** and other such assets (including royalties).

So the vast majority of an HEI's income will be in the privileged position of being exempt from UK corporation tax.

Where an HEI enters into activities where the income does not fall within these exemptions, the HEI will need to consider whether to carry out that activity through a subsidiary company. Using a subsidiary can offer a more favourable tax position, but the main reason for use of a subsidiary is that as a charity, there are restrictions on non-charitable activity – these are neatly summarised in the Charity Commission Guidance note CC35[5] as follows:

"While charities may trade more or less freely in pursuit of their charitable objectives, there are restrictions on engaging in trades the objective of which is to generate funds for the charity. In particular, charities may not engage in such commercially-oriented trades where a significant risk to their assets would be involved.

[4] s256 TCGA 1992 and Part 11 of CTA 2010, ss478 et seq (formerly s505 ICTA 1988)
[5] www.charitycommission.gov.uk/Publications/cc35.aspx#2

Where trading (other than trading in pursuit of its charitable objects) involves significant risk to a charity's assets, it must be undertaken by a trading subsidiary. But even where it is not essential for the trading to be undertaken by a trading subsidiary, the use of trading subsidiaries may produce benefits, for example in reducing tax liabilities. In particular, trading subsidiaries may make donations to their parent charity as 'Gift Aid', so reducing or eliminating the profits of the subsidiary which are liable to tax."

Payroll Taxes

When HEIs pay their employees, they also operate as a tax collector as they are obliged to operate Pay As You Earn (PAYE) for Income Tax and National Insurance Contributions [like any other business] and report under Real Time Information (RTI). Payroll costs represent a large proportion of the overall expenditure for most HEIs – and so the amount of PAYE is significant. However the UK PAYE system is well established and for those employees who work solely in the UK, it works very well and so the risk of error occurring is generally small.

"Payroll costs represent a large proportion of the overall expenditure for most HEIs – and so the amount of PAYE is significant."

UK Universities are able to benefit from a very generous relief in connection with the issuance of shares to academic researchers in spin out companies (see HMRC's Guidance[6]). An award of shares to an employee would normally give rise to a benefit in kind. Relieving provisions in Chapter 4A, Part 7 of ITEPA 2003 prevents an Income Tax and NICs charge arising on researchers:

- On an increase in the value of the shares in the spin-out company that is caused by the transfer of designated intellectual property (IP) from the Research Institution and
- Where the researchers acquire shares after any IP transfer, the value of the IP will not be reflected in considering whether they have acquired the shares at undervalue

There are strict rules around who can qualify for the relief, in particular:

- The researchers must acquire shares in the Spin-out company either before the IP transfer agreement is made or within 183 days thereafter; and
- The researchers receiving the shares must be involved in research in relation to the IP that is the subject of the IP transfer.

Indirect Taxes

An Indirect Tax is a charge levied by a state on consumption. Customs duties levied on imports, excise duties on production, sales tax or value added tax (VAT) at some stage in production-distribution process, are examples of indirect taxes because they are not levied directly on the income on earnings, but are borne by the final consumer.

"As with corporation tax, UK HEIs are able to benefit from a generous VAT regime whereby the majority their income sources are exempt from VAT."

VAT

VAT rules are laid out by the EU, and then adopted into UK Tax Law. Fortunately, *as with corporation tax, UK HEIs are able to benefit from a generous VAT regime whereby the majority their income sources are exempt from VAT.*

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[6] www.hmrc.gov.uk/manuals/ersmmanual/ersm100060.htm

"Most UK HEIs are "Eligible Bodies" and so can "exempt" their supplies of education i.e. they do not need to add VAT to the price paid by students."

"Customs duties are calculated based upon the value of the goods, and there are a number of methods by which the value is calculated contained in HMRC's guidance."

This regime means that whereas most UK businesses have to charge VAT at a rate of 20% on most of their sales, most UK HEIs are "Eligible Bodies" and so can "exempt" their supplies of education i.e. they do not need to add VAT to the price paid by students. Note that there are a number of definitions of "Eligible Body" in the UK tax code. For this particular relief, UK Universities are separately identified as being Eligible Bodies.

This VAT exemption for education is currently limited to traditional not-for-profit providers but there are proposals to extend this to "alternative providers"[7].

Equally, much of the income received for publicly funded research is not regarded as being carried out in the course of business[8] i.e. it is in the form of grants or donations and so the HEI will not need to account for VAT on the amounts received, which are considered to be "outside the scope of VAT".

There are further VAT reliefs available to charities in relation to the purchase of some equipment used for medical research, advertising costs, and on some buildings.

Customs Duties

Customs duties levied on imports[9] are designed as a measure to protect UK industries and to control the types and volume of commodities entering the UK. Goods have to be classified using the Harmonised System of Commodity Codes ("HSCC" or The "Tariff"). The HSCC classification determines the duty rates applicable along with any preferences in place. Quota restrictions are imposed against specific commodities entering from particular countries and any other import requirements such as licensing. This also acts as a measure to control goods entering the UK.

Customs duties are calculated based upon the value of the goods, and there are a number of methods by which the value is calculated contained in HMRC's guidance[10]. The value for Import VAT is calculated on the value of the goods plus any Customs duties payable.

Import VAT and Customs duties are usually an additional cost element on goods or services. It is therefore important that HEIs *budget* for the correct amount of duty and VAT. There are a number of opportunities for HEIs to claim reliefs from import duty – from HEI specific provisions or reliefs available more generally.

The compliance aspects are generally handled by third party freight forwarders, however they rely on information provided by the HEIs and so it is important that this information is accurate and timely. Import VAT is often an actual cost for Universities so it is important that it is correctly treated to ensure correct VAT is paid and, where appropriate, recovered.

HMRC impose penalties for under declarations of duty and VAT – and these apply to HEIs as with any other taxpayer.

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[7] www.gov.uk/government/uploads/system/uploads/attachment_data/file/205767/130606HE_CONDOCresponse-Final.pdf

[8] Article 9, Directive 2006/112: 9(1) "Taxable person" shall mean any person who, independently, carries out in any place any economic activity, which in the UK is seen to be the same thing as "business".

[9] Customs duties only arise on imports coming from outside the EU. There is free movement of goods within the EU and so no Customs duties arise.

[10] http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&propertyType=document&resetCT=true&id=HMCE_PROD_008051

Chapter 3:
What's not OK?

Direct Taxes

Corporate Income Taxes – UK

Unlike in some countries where HEIs have a blanket exemption for their activities, UK HEIs claim the reliefs on their eligible income, and so some income may remain in the charge to corporation tax.

In practice, most HEIs' liability to corporation tax will be nil. However the compliance burden to demonstrate this is onerous. Fortunately, HMRC do not require all HEIs to submit a return annually – however, as the UK operates a system of self-assessment, HEIs should always undertake sufficient calculations to demonstrate that the liability is nil, even if they are not required by HMRC to submit a return.

"There are three key areas where caution is needed: land transactions, renewable energy "schemes", and making of investments."

In addition to managing the compliance requirements, HEIs also need to remember that some income could be subject to corporation tax – and so they need to take care to identify high risk transactions and take advice as soon as possible. In my view there are three key areas where caution is needed: land transactions, renewable energy "schemes", and making of investments.

Whenever entering into any negotiations for land transactions, HEIs should seek advice. The highest risk situation is where an HEI reaches agreement with a developer to share in the profits of development, sometimes known as an "overage" payment, this income is not covered by the charitable exemptions listed above, so will be subject to tax if it arises in the university itself. HEIs should always seek professional advice in such circumstances.

"If an HEI is entering into any such schemes, they should seek professional advice at the earliest possible date."

The second area is income from renewable energy schemes including (but not limited to) Feed in Tariffs[11] or sale of Carbon Credits on the open market. HMRC have taken legal advice and confirmed that this income is unlikely to be considered as trading income, but falls to be taxed as miscellaneous income. And so if this type of income arises in the university, it will be subject to corporation tax. As above, if an HEI is entering into any such schemes, they should seek professional advice at the earliest possible date.

The third area to consider is non-charitable expenditure – the charitable tax reliefs are all given on the proviso that the profits derived from those activities are applied for charitable purposes. Hence when a charity applies its funds for non-charitable purposes, this can create a corporation tax liability (as well as regulatory problems!)

The most common risk area for non-charitable expenditure is "non-charitable investments or loans". The legislation for "non-charitable investments or loans" is set out in s511 and s514 CTA2010 (formerly Sch20 of ICTA1988 – and so sometimes this will be referred to as Schedule 20).

[11] www.energysavingtrust.org.uk/Generating-energy/Getting-money-back/Feed-In-Tariffs-scheme-FITs

“HEI must be able to demonstrate that they have taken reasonable steps to ensure that the payment will be applied for charitable purposes.”

“The responsibility for determining the “employment status” for the engagement, and so liability for any deductions not made, falls with the employer.”

“The rules for determining employment status may well be different in an overseas territory – and so HEIs should consider whether engaging consultants in an overseas territory will expose them to foreign payroll taxes.”

The legislation lists out the types of investment that can be made by a charity with a view to generating additional resources. HEIs must be able to certify [and if required provide evidence] that their investments are qualifying i.e. will not give rise to any non-charitable expenditure and hence no corporation tax charge is due. Appendix III[12] of HMRC’s detailed guidance for charities summarises the 12 types of qualifying investments that are included in the legislation.

The other risk area for non-charitable expenditure is payments to overseas bodies where the UK HEI must be able to demonstrate that they have taken reasonable steps to ensure that the payment will be applied for charitable purposes. Without this, such payments will be non-charitable expenditure.

Payroll Taxes

The main area of difficulty for HEIs is the use of “consultants” – who can bring in specialist skills or help with the seasonal workload. Whilst many consultants consider themselves to be self-employed, and so not subject to PAYE and NIC deductions, the responsibility for determining the “employment status” for the engagement, and so liability for any deductions not made, falls with the employer. Unfortunately determining employment status is not an exact science, and is a popular topic for HMRC reviews.

Therefore all HEIs must have a procedure in place to ensure that they operate PAYE correctly on consultants. HMRC have confirmed that where an employer [correctly] uses their “Employment Status Indicator Tool” (ESI), and retains evidence of this, HMRC will not assess tax (or penalties) for prior periods, although they may direct an HEI to start operating PAYE for future periods. You can find the ESI and more detail on HMRC’s interpretation of employment status and the on the HMRC website[13].

It is accepted that where a consultant provides their services through a Limited [personal service] company, this will remove any PAYE risk for the employer, and if HMRC consider that the individual should be an employee, HMRC will pursue the appropriate tax under the provisions of IR35[14]. However, additional care is needed where a consultant is filling a senior position and could be considered to be an “office holder”. In this case the use of a personal service company is not necessarily effective, and the HEI could need to operate PAYE and NIC on payments to the individual in the normal way.

As expected, the use of consultants outside the UK is also a tricky area. The rules for determining employment status may well be different in an overseas territory – and so HEIs should consider whether engaging consultants in an overseas territory will expose them to foreign payroll taxes, pension liablilities, and/or create a permanent establishment in that country. Because of the complexity of the rules for consultants, and the potential for less control over the nature of the engagement with consultants, some HEIs may decide to avoid such arrangements altogether.

A related issue arises where an HEI’s academic employees undertake external consultancy work for third parties. Most academic employment contracts provide for a number of days of external consultancy work each

[12] www.hmrc.gov.uk/charities/guidance-notes/annex3/annex_iii.htm
[13] www.hmrc.gov.uk/calcs/esi.htm
[14] www.hmrc.gov.uk/ir35/

year. The academic can then choose whether to take payment for this work, or to waive their right to the income and donate it to the HEI. Just as with the use of external consultants, it is important that the HEI reviews these arrangements to ensure that they operate PAYE/NIC correctly. Whether the income is deemed to be employment income (subject to PAYE), or professional income (which can be paid gross), will depend upon the terms of the employment contract and the nature of the work done. It is also worth noting that NIC can sometimes arise on income donated to the HEI if the waiver is not made before the income is earned.

The final payroll tax difficulty arises with remote workers. There was a time when UK HEIs required their staff to live within a certain distance from the main site – but with changing working practices, improvements in travel connections, and remote connectivity, this is no longer the case. This brings a new problem for workers who are based in nearby EU countries or even further afield.

Where an employee resides, for some or all of their time, outside the UK, it will be necessary to determine whether to deduct UK income tax, and/or NI, or whether the UK HEI should operate income tax and social security in the country where the individual resides.

Although the basic rule for workers in the EU is that you pay income tax and make social security contributions where you work, if an employee resides in another state, they could be eligible to pay tax and make contributions in that country. Unfortunately this can require the employer (the HEI) to set up a payroll facility outside the UK, and budget for non-UK social security costs – which are often more expensive than in the UK.

The majority of problems arise where the payroll team are unaware that an employee resides outside the UK, and so they operate UK PAYE and NI on their salary. It is often some months (or even years) after the start of the contract that the employee contacts the payroll team to let them know there is a problem. An annual audit of employee home addresses is probably a good idea for all HEIs, although this is only one tool in the box for good tax compliance.

Indirect Taxes

VAT

Chris Tailby,when he was Director of the Anti-Avoidance Group at HM Revenue and Customs, remarked to the House of Commons Treasury Committee in 2004,

> *"If you have a big company which is making standard rated widgets then the VAT is pretty straightforward; if you have a company which makes taxable supplies and exempt supplies it does get more difficult."*

Unlike the standard rated widget maker (and the majority of regular businesses), VAT is complex in the university environment. Perhaps more importantly, it is also a cost in universities.

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"VAT is complex in the university environment. Perhaps more importantly, it is also a cost in universities."

"This "interruption" in the flow of VAT, increases the operating costs of HEIs compared to "regular" businesses and other organisations."

"Every time an HEI raises an invoice for income, they must decide whether to apply VAT, and then what is the appropriate rate."

"Even more complexity arises where a university sells services outside of the UK."

With a generous exemption, why is VAT a problem?

As noted above, with the exception of banks and insurance companies, most "regular" businesses add VAT to their sales – which unfortunately increases the price to the final consumer. However, because these "regular businesses" are charging VAT, they are given the right to reclaim any VAT incurred on expenditure and VAT "flows" through the business.

However, because the vast majority of a HEI's income sources are exempt from or outside the scope of VAT, any VAT incurred on associated expenditure is not reclaimable – thus the cost lies with the university as if they were a final consumer. This "interruption" in the flow of VAT, increases the operating costs of HEIs compared to "regular" businesses and other organisations [such as local authorities] which are able to reclaim VAT incurred.

Why is VAT so 'complex' for HEIs?

Income

HEIs undertake a wide range of activities and every time an HEI raises an invoice for income, they must decide whether to apply VAT, and then what is the appropriate rate. As noted above, these activities may not be in the course of business and so are outside the scope of VAT. Where they are within the scope of VAT, some activities fall within social exemptions, some are zero rated, and some standard rated.

The exemptions available to HEIs cover education, health, sport, land, fund raising events, cultural services or supplies of items on which the original VAT recovery was "blocked". Each of these exemptions has its own peculiarities, exclusions from exemption and differing definitions of the same terms.

If exemption does not apply, perhaps zero rating does as a supply of food, books or various supplies by charities. The following provides some insight into the difficulties faced:

- food is generally zero rated, unless it is catering in which case it is subject to VAT;
- unless it is catering provided to a student in which case it is exempt under the education exemption as a closely related supply;
- unless it is provided to a student who does not pay a fee in which case it is non-business provided it is supplied at or below cost;
- unless the student comes from another institution where no fee is paid in which case it is subject to VAT.

Even more complexity arises where a university sells services outside of the UK. The "place of supply" rules work well for services which fall clearly within the "general" rule or a specific exemption. The nature of many supplies bought or sold by a university is that they are complex. This means it is not entirely clear whether they fall into the "general" rule, the exceptions, or exceptions to exceptions. One example of this would be where:

- An executive training subsidiary company provides training to overseas business customers and therefore needs to properly interpret 2011 changes to the place of supply rules.
- This is difficult because it is almost impossible to decide whether a fee for a training course is "admission to an educational event", or an "educational service"? What is the subtle difference between the two?

Further complexity will arise with the final suite of changes to the "place of supply" rules which will come into place on 1 January 2015 and will impact on the provision of distance learning.

Expenditure

If we consider expenditure, a university needs to consider whether it is paying the right amount of VAT – or whether they claim any relief from VAT by exemption, by zero rating, or by lower rating. Where relief is claimed, it is up to both the university and the supplier to decide if relief is available, which in itself can cause disputes and, as ever, the rules are not easily understood. For example:

- a video camera for use in medical research can be zero rated whereas a still camera cannot;
- electricity can be subject to the lower rate of VAT to the extent that it is used (and use of course has to be quantified) in non-business activities and if more than 60% is used in this way 100% can be lower rated;
- for disabled students, a bathroom, washroom or lavatory can be zero rated in a student residence, but only a washroom or lavatory in any other building.

Once a university has waded through the liability issues, it has to decide how much, if any, of the VAT it incurs can be reclaimed. For some purchases, all of the VAT can be reclaimed, for others none, and for most a proportion of the VAT is reclaimable. The proportion is reduced by how much non-business and exempt activity a university undertakes. Although tension and disputes with HMRC have reduced significantly following the adoption of the HE PE Framework Guidance, which is a practical framework agreed by BUFDG and HMRC around 8 years ago, and is subject to an annual review process, there will always remain some uncertainty as to what is a fair and reasonable proportion. In practice, many HEIs are only able to recover around 10% of VAT incurred.

It can be seen from the above that there is much scope for misinterpretation and confusion and there is a rationale for universities to seek to reduce their VAT cost. Consequently many universities employ specialist tax staff, and others rely on external advice, all of which is an additional cost (albeit less than the VAT cost which would be incurred without access to the social exemptions!). The EU has undertaken a series of consultations on the VAT problems faced by public bodes[15] [and BUFDG have contributed]. However any change will be difficult, and will take several years to evolve.

"A video camera for use in medical research can be zero rated whereas a still camera cannot."

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[15] http://ec.europa.eu/taxation_customs/common/consultations/tax/2013_vat_public_bodies_en.htm

"HEIs should always seek professional advice when entering into any overseas activities."

"The UK, and overseas, tax implications for the HEI will depend upon both the nature of the activities to be carried out."

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Chapter 4:
Venturing Overseas

Direct taxes – non-UK

International taxation is a huge topic – and cannot possibly be covered in a couple of pages – but this guide aims to alert the reader to the main risks and signpost sources of help.

The first key point is that unfortunately, the generous UK corporate income tax and VAT reliefs for charities are not always replicated in overseas territories. More importantly, if HEIs operate overseas this activity may require the HEI to register with the overseas tax authorities, and/or pay corporate income taxes, VAT, payroll taxes, and/or withholding taxes[16]. The rules for internationally mobile workers are notoriously complex, and so where HEIs are operating in multiple overseas locations, this will pose risk and almost certainly lead to [significant] tax risk and high compliance costs.

HEIs should always seek professional advice when entering into any overseas activities to ensure that they budget for, and comply with any overseas tax obligations which could well be very material – and failure to do so could jeopardise the success of any such project.

Foreign branches and non-UK resident subsidiaries

One of the first decisions to be made is whether the UK HEI, or one of its UK subsidiary companies, subject to local law, undertakes the activities directly in an overseas territory – or whether, again subject to local law, the HEI sets up a foreign [non-resident] subsidiary company through which they will operate.

The UK, and overseas, tax implications for the HEI will depend upon both the nature of the activities to be carried out, and whether the activities are carried out directly by the HEI, a UK subsidiary of the HEI, or through a non-UK resident subsidiary company.

In general, a non-UK resident subsidiary will be subject to taxes in the foreign territory by virtue of its place of incorporation.

Where UK HEIs, or their UK subsidiary companies, undertake their activities directly in an overseas territory, the nature of the activities and the contractual arrangements entered into will determine whether the HEI or UK subsidiary company has a foreign Permanent Establishment (PE) or branch, and so is subject to corporate income tax in that territory. This will be determined by local laws and where in existence, the Double Tax Treaty Agreement (DTA)[17].

It is important to note that the rules for VAT, also known as GST or sales tax, are generally different from the rules for corporate income taxes. Some countries operate a collection system where if an HEI makes a supply to a customer in an overseas territory, the customer will collect the VAT and pay it over to the local tax authorities. However in some circumstances, the overseas tax authorities will require the HEI or its subsidiary to register for VAT and submit returns.

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[16] *Withholding tax is where your customer deducts a proportion (say 10%) of the invoice value and remits the remaining proportion (90% in this example) to you. The customer will pay over the withholding tax deducted (10% in this example) to the local tax authorities. This is very similar to PAYE or when your bank deducts say 1p income tax at source from any interest, 5p in this example, earned on your current account.]

[17] You can access all the UK's Double Tax Treaty agreements on the HMRC website.The UK is fortunate to have one of the most extensive treaty networks. DTAs are joint agreements, whose purpose is to improve international trade. The agreements cover both personal and corporate income taxes. The terms of a DTA can only improve any local rules – and so are a good first starting point when investigating a territory – but must be consulted in conjunction with the local tax legislation.

In some cases, the activities of the HEI or its UK subsidiary will be such that they do not create a foreign PE or branch. In this case the profits arising from the activities should not be subject to corporate income tax in the overseas territory – although the income derived in the territory may well be subject to withholding taxes (and VAT or GST) – which generally means a lower administrative obligation, but could well still be a significant cost as they are generally calculated based on the income rather than profit. Typically withholding tax rates vary from 7% to 20% of income and VAT rates vary from 5-20%.

Because most UK HEIs do not have any UK corporation tax liability, any overseas withholding taxes or corporate income tax suffered will be an additional cost to operating in the overseas territory. It is therefore vital that UK HEIs budget for both tax cost, and the professional fees required complying with UK and overseas tax filing obligations when venturing overseas.

Most organisations will need to seek professional advice in order to evaluate the tax and compliance costs. At the early stage of budgeting, it would be prudent to ensure that all prices are stated as excluding VAT, GST and all sales taxes wherever arising, and make a provision of up to 30% of projected income as an estimate of the potential tax and administration costs.The precise value will depend on the size of the project and the type of activities.

One of the most difficult practical aspects of managing the tax implications of overseas activities is tracking an HEI's activities in each territory. In many cases more than one school, faculty or department will be operating in the same overseas territory. Entering into new arrangements in this same territory may well [adversely] affect any existing arrangements. It is also important to be able to provide full details of an HEI's activities to their advisers to ensure the integrity of the advice given. This is just one example of a situation where strong internal communications are essential.

Payroll Taxes – non-UK

The rules for tax and social security for internationally mobile employees are very complex – and are dealt with by specialist tax advisers. HEIs should seek country specific professional advice on any planned secondments to or from the UK.

The first key point to note is that the UK rules for income tax and social security (national insurance) are not aligned with most other territories – and so you need to consider both sets of rules and make sure that you budget accordingly.

In order to determine whether an employee is liable for tax and social security in the UK, the overseas territory or both, it is necessary to consider:

- Where he or she lives (is resident – note this could be different from the country of which they are a citizen)
- Where he or she works and how long they spend in each territory
- Where his or her employer is based and whether they have a PE or branch in the territory

The location of the payroll does not influence the liability for tax and social security– if this were the case then all employers would move their payrolls to

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"In many cases, internationally mobile employees are subject to tax in more than one territory i.e. they will remain in the UK PAYE regime, but also be liable for taxes in the overseas territory."

Hong Kong to take advantage of their low tax rates - this seems obvious to you now, but in many cases the default country for payment of income tax and social security will be the country where the employee is paid from.

In many cases, internationally mobile employees are subject to tax in more than one territory i.e. they will remain in the UK PAYE regime, but also be liable for taxes in the overseas territory.

Under the UK tax system, a UK resident will get credit for any overseas tax paid up to the amount of their UK tax liability i.e. he will suffer tax at the higher of the UK or overseas rate. Unfortunately, it is often necessary for an employee who becomes liable for taxes in more than one country, to pay tax in both countries. Often an employer will help the employee by paying their overseas tax, and the employee will then reimburse the employer once they have submitted their UK tax return, and received a refund of the overseas tax credit. However the administration burden filing UK tax returns in order to recover the overseas taxes, and then reimbursing the employer, can be frustrating and sometimes intrusive.

In many [but not all] countries, there is a withholding regime [like our own PAYE system] where the employer is responsible for collecting income tax and social security contributions on their employees' earnings. This will impose an administration burden on the HEI and also incur professional fees.

"When sending an employee overseas, the tax and social security consequences should be factored into the overall package."

When sending an employee overseas, the tax and social security consequences should be factored into the overall package, together with "cost of living adjustments" and other incentives, or equalisations which are offered to the employee. Ideally this should be negotiated before the secondment starts.

Some double tax treaties include provisions to offer tax exemption for teachers and/or researchers who are working in the overseas territory. Although these can be useful, they should be approached with caution. The conditions for claiming relief may be onerous – in terms of the type of activities being undertaken, and there is sometimes a requirement for the individual to be paying tax in one territory. Further, these exemptions are time limited (between 12 months and 3 years), and if the secondment continues beyond this time tax will be due for the entire time spent in territory (rather than from the end of the period of exemption).

"There is a general myth that if an employee spends less than 183 days in a country then they will not have to pay tax there. Sadly this is only sometimes true."

So what should you watch out for?

Where an HEI sends its employees abroad, or engages consultants in another country, this could create a Permanent Establishment for the HEI (as noted above). More importantly, the employees could become liable for payroll taxes overseas. In most cases, the UK employees will not break UK tax residence (this is quite tricky and set out in the statutory residence test rules (available on HMRC's website[18]) – largely an employee needs to work full time abroad for an entire UK tax year to cease to be UK resident).

There is a general myth that if an employee spends less than 183 days in a country then they will not have to pay tax there. Sadly this is only sometimes true – and so should not be used as a "safe harbour".

[18] *www.hmrc.gov.uk/international/rdr3.pdf

Chapter 5:

Sources of useful information

You can find the HE PE framework on HMRC's website[19].

You can find a copy of the Corporation Tax Guidelines on The BUFDG website. If you do not have access to the website then please send an email to: info@bufdg.ac.uk for a copy.

You can find a handy summary of overseas country rules on PwC's website – Worldwide tax Summaries[20], and Deloitte's International Tax Source[21] KPMG also publish a printed guide.

These guides are [of course] merely an overview and not a substitute for advice – but they can provide some useful information such as tax rates, withholding and PAYE regimes, and the conditions for tax residence.

You can find the double tax treaties on HMRC's website[22] – the most useful articles are 5 (permanent establishment), 12 (Royalties), 15 or 16 (Dependent Personal Services) and 20 or 21 (teachers and researchers).

And finally – you can always find out more at your regional BUFDG tax group and the resources on the BUFDG website– or if you prefer to do desktop research, Google will take you to a number of HEI tax policy guides – which will form a useful reference point for you or could help you to develop your own internal guidance.

BUFDG has recently published the first in a series of country guides – *Doing business in India*[23], which includes links to a wide range of free resources. Further country guides are planned throughout 2014 and beyond.

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[19] www.hmrc.gov.uk/menus/frame-hei.pdf
[20] http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/frmTerritory?ReadForm
[21] https://dits.deloitte.com/Administration/ManageHomePage/Popup.aspx?ChildPage=Country%20Guides%20and%20Highlights
[22] www.hmrc.gov.uk/taxtreaties/
[23] http://bufdg.ac.uk/resources/Documents?g=633850aa-3320-456d-978c-28dce0946a81