The Language Of Payroll

When dealing with international assignees invariably a myriad of international payroll compliance issues also arise alongside the personal tax and social security issues, regardless of the size of businesses involved. There is no such thing as a typical international payroll and this could range from a relatively small business, which is employing an overseas resident for the first time, through to large multi-nationals who have acquired new employees through a recent acquisition and also the more traditional expatriate scenario with companies who are seconding employees to work overseas on a short or longer-term basis.

In recent years the range of countries we have been asked about has also changed significantly with expansion beyond our European neighbours and familiar destinations such as USA and Australia, into the BRICS countries and destinations anywhere from Canada to the Ascension Islands on to Cambodia and everything in between.

It is not surprising therefore that the language of payroll can vary dramatically from country to country and whilst we are very lucky that English tends to be the common international language used around the world, it is none the less necessary to test the understanding of the terminology we use on a regular basis.

More than one contact has confessed to us in the past that they didn't understand the practical application of a particular word or phrase but that they had sat through so many conversations where it was taken for granted that they knew what the words meant that it was rather difficult now to put their hand up and ask the question.

Hopefully this article can provide a useful crib sheet for some of the payroll terminology which we use on a regular basis and can easily take for granted.

NATIONAL INSURANCE CONTRIBUTIONS (NICs) is simply the UK name for social security contributions. When corresponding with those in overseas locations we typically revert to using the term social security but for businesses with a UK liability it is helpful if they are familiar with the way in which NICs are paid and the different categories which apply to earnings. Primary Class 1 NIC is an employee contribution, Secondary Class 1 is an employer contribution and we also have Class 1A for employer contributions on non-cash benefits, together with Class 1B which is collected when an employer meets an employee liability via a PAYE Settlement Agreement (PSA).

Typically in the UK we will pay NICs at the same time as we pay employment taxes in one joint payment to HM Revenue & Customs (HMRC). Although practices vary from country to country, some locations such as Spain will not only pay the taxes and social security in separate payments but also at different intervals with the former being paid on a quarterly basis whilst the latter is paid monthly.

SOCIAL SECURITY conversely is the name most countries use when talking about what we more commonly and usually refer to national insurance (NICs). Typically with social security or NIC's when advising employers and assignees most focus and advice is on the contributions payable and not on potential benefits from any social security system as a result of the payment of such contributions. The challenge in seeking to advise on social security benefits, notably pensions, is that generally the rules (will) change significantly over time and the life of the assignee and you also are touching on investment decisions and personal planning for which most are not authorised or qualified.

TAXES you may think are more straightforward although, whilst in the UK we think of social security payments/ NIC's as a liability which is separate and distinct from tax, in some countries they will refer to social taxes. It is important to clarify whether the country in question has a personal tax withholding obligation for employees, rather than taxes being collected direct from the employee on a personal reporting basis.

Another issue which should be clarified at an early stage when setting up a payroll in a new country is the question of who will be responsible for paying over the taxes and can they be paid from an overseas bank account. Whilst HMRC will accept overseas payments they do provide an alternative account number to which payments should be directed, but many countries such as Turkey will insist on payments being made from a local bank account.

In the UK you will find that an additional charge will arise if a payroll business is able to offer payment solutions such as:

BACS – Bankers Automated Clearing Services for making payments direct from one UK bank account to another.

CHAPS – Clearing House Automated Payment which is a UK system for same day payments, and other countries might recognise this as an **RTGS** – Real Time Gross Settlement system another example of which would be Canada's **LVTS** – Large Value Transfer System.

We think we are all familiar with the terms **GROSS** and **NET** pay but it is easy to become confused when people start talking about **GROSS TO NET** or **NET TO GROSS.**

The majority of employees are paid based on a gross salary. That is the amount they will receive before the deduction of taxes and social security contributions. A job role is therefore generally advertised based on a gross salary but the net that the employee will receive will reflect their personal circumstances and the tax and social security/NIC rates applying.

Typically we carry out a **GROSS TO NET** forecast based on a standard amount of tax free allowances to help an international employer understand what the likely net figure will be that is delivered to an employee.

Often though, in an international payroll scenario, an employer will have a pre-defined net salary that they want to deliver to an employee and then a calculation to give the estimated gross salary will be necessary to achieve the desired result - a **NET TO GROSS** calculation. This is frequently the case for tax equalised individuals.

The most frequent misconception we come across from an employer who is taking on an overseas employee for the first time, be it a secondment or a local hire is "It's ok we are going to pay them through the UK payroll so don't need to worry about local tax withholding". Whilst occasionally a country will operate on a self-assessment basis for the employee, particularly if the company has no other presence in the country, it is rarely that matters are that simple!

Whilst it is perfectly acceptable to pay an employee through the UK payroll whilst they are working abroad, it is by no means certain that this will be the end of your obligations, as many countries will require you to register locally as an employer, operate a 'local payroll' and withhold taxes and/or social security contributions in that country.

This brings us to the confusing world of **SHADOW, GHOST, MIRROR** and **SPLIT** payrolls.

A **SHADOW** payroll is a key component in maintaining compliance for an expatriate employee. Typically an employee may be paid from their home country payroll but will need a shadow payroll to be run in the host country to ensure payroll compliance obligations are met.

In addition to **SHADOW** payrolls you may also come across references to either a **GHOST** or **MIRROR** payroll. In essence though, these terms are all used to denote that it is a secondary payroll, run in the background, it is not the payroll which delivers the actual net salary to the employee. Instead, this secondary payroll may reflect the salary paid in the home country, but with deductions for tax and social security based on host country regulations.

Alternatively, these terms may also be used where the employee is paid via the host country payroll but a secondary payroll is required in the home country, perhaps to ensure continued contributions in the home country social security scheme or to maintain participation in a company pension scheme.

To complicate matters you may find that these terms are used differently around the globe and whilst in some countries they are interchangeable, in others they will define which type of secondary payroll is being run. So for instance looking at Sweden, a Ghost payroll may be maintained for local compliance and reporting purposes, whilst a home country Shadow payroll would be utilised for an employee who was being paid via the host country payroll but needed to remain in the home country social security system. Not to be confused of course with the phrase GHOST Employee which has a different meaning altogether, and typically relates to a situation where a fraud is being committed through the use of fictitious employees.

A **SPLIT** payroll arrangement is similarly used to maintain compliance in home and host countries for an expatriate employee, but in this scenario, both of the payrolls will be used to deliver part of the net salary to the employee.

As well as the issues covered above in relation to other secondary payroll arrangements, a split payroll solution may be preferred because an employee needs to maintain accommodation in both locations perhaps because a posting is unaccompanied, and therefore the employee needs to receive funds in both locations to assist with meeting their liabilities, or it can be utilised to help with fluctuations due to currency exchange rates.

Another term widely used is the phrase **BENEFITS IN KIND** which in the UK refers primarily to the non-cash elements of a remuneration package, the most popular being private medical insurance and company cars. Other countries might refer to these items as **FRINGE BENEFITS** or **PERKS**.

Australia and New Zealand for instance have FBT or Fringe Benefits Tax which is paid on certain benefits provided by employers.

In the UK in particular, it is important to identify which items are effectively a cash reward, perhaps the reimbursement of an expense item which does not meet the qualifying standards for exemption as a wholly business expense. Such payments will be considered to be part of salary and should therefore be subject to tax and social security/NIC via the payroll.

Whereas a non-cash item such as medical insurance which is provided under a company's group insurance scheme is generally reported post tax year end, and whilst the employee is taxed on the value of the benefit, under current rules only the employer will pay social security contributions on the value of a non-cash benefit, there are no employee social security contributions.

We should add that it is now possible for employers to opt to payroll such non-cash benefits on a voluntary basis and we have a new phrase **PAYROLLING BENEFITS IN KIND** to denote this arrangement.

In the UK we also have the concept of a **SHORT-TERM BUSINESS VISITOR,** and whilst again the terminology might vary from country to country, many jurisdictions now have separate rules which apply to **BUSINESS VISITORS** or **BUSINESS TRAVELLERS**.

Rather than an employee who is seconded to work abroad, the business visitor we have in mind will be an employee of an international company who makes short trips to countries on business and most likely will visit several countries a year, if not several a month. Whilst the visits may only be of a day or two in length, in some countries such as the UK or Canada, this will be sufficient to trigger withholding obligations and or reporting obligations.

The obligations for business visitors may vary depending on the type of group entity which is present in the country visited, for instance whether this is a subsidiary company or, a branch office of the company which employs the individual in question. The purpose of the visit may also be important to determine the status of the visit for tax purposes. The taxation of business visitors is under increasing scrutiny by HMRC in the UK and international organisations which have a UK presence ignore the obligations at their peril.

We cannot finish a discussion on the language of international payroll without giving some consideration to some phrases which you might come across, that although not directly related to the payroll tax withholding process, none the less represent key issues which may arise in conjunction with an international employment situation but are all too often overlooked when planning assignments and business trips.

The concept of **PERMANENT ESTABLISHMENT** and consideration of **TRANSFER PRICING** are both Corporate Tax matters which fall outside the scope of payroll, but they are both complex areas which may be directly impacted by an international secondment or enhanced business presence due in the local jurisdiction.

Transfer Pricing looks at the pricing of transactions between two companies within the same business group and therefore the recharging of employment costs will fall within the scope of this.

Suffice to say that the rules for Permanent Establishments in particular are under close scrutiny due to the new BEPS action point which is set to tackle the artificial avoidance of Permanent Establishment Status so we will leave you with one final definition as follows:

BEPS – Base Erosion and Profit Shifting. These new rules will see greater alignment of costs and value creation going forward. As mentioned, the action points will make it harder for businesses to avoid the creation of a permanent establishment but also much harder for individuals to avoid tax in an overseas jurisdiction, as more business will have to recharge costs, which in turn will reduce the tax treaty exemptions available.

Summary

It is sometimes too easy to assume that all understand the payroll terminology used or indeed that the same terminology is used across the world. If you are not sure of the words being used by your tax or payroll adviser then do ask. A clear understanding at the outset is better for all.

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