



**BDO Seidman, LLP**  
Accountants and Consultants

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# Global Expatriate News

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This issue of *BDO Global Expatriate News* will examine new legislation and upcoming changes around the world, which impact expatriate employees and their employers. Further information can be obtained from your BDO member firm contact at the end of the newsletter.

## USA

On October 22, 2004, the President signed into law the "American Jobs Creation Act of 2004." The Act contains a myriad of tax changes, the most significant of which for expatriates are discussed below.

### Foreign Tax Credit Carryforward and Carryback

#### Old Law

*Under the old law, the amount of creditable taxes paid or accrued (or deemed paid) in any tax year which exceeds the foreign tax*

*credit limitation could be carried back to the two immediately preceding tax years applied first to the earliest tax year; and any carryforward amount generated that was not carried back could be carried forward five years in chronological order.*

#### New Law

Under the new law, the amount of creditable taxes paid or accrued (or deemed paid) in any tax year that exceeds the foreign tax credit limitation can only be carried back to the immediately preceding tax year; and any carryforward amount generated that is not carried back can be carried forward ten years in chronological order.

**Effective Date  
Comments & Observations**

**The ten-year carryforward period for excess foreign taxes is effective for any tax year ending after October 22, 2004. Thus, the extension of the carryforward period will apply to any carryforward amounts that extends into tax years ending after October 22, 2004, but that do not expire in the current tax year.**

The one-year carryback period of excess foreign taxes will be effective for tax years beginning after October 22, 2004.

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**Reduction of Foreign Tax Credit Baskets**

**Old Law**

*The foreign tax credit limitation is calculated separately for the nine different baskets of foreign source income listed below:*

- *Passive income*
- *High withholding tax interest*
- *Financial services income*
- *Shipping Income*
- *Certain dividends from noncontrolled section 902 corporations*
- *Certain dividends from a DISC or former DISC*
- *Taxable Income attributable to foreign trade income*
- *Certain distributions from a FSC or former FSC*
- *Income other than described above (general category income)*

**New Law**

The number of baskets will be reduced to the following two:

- *Passive category income*
- *General category income*

The new passive category income includes the old passive basket, as well as dividends from a DISC, distributions from a FSC and taxable income attributable to foreign trade income. Income from financial services also are included in the passive category unless earned by a member of a financial services group or any other person that is predominately engaged in the active conduct of a banking, insurance, financing or similar business. All other income is included in the new general category.

**Effective Date  
Comments & Observations**

**The new baskets apply for tax years beginning after December 31, 2006.**

Foreign taxes carried forward to a tax yearending on or after December 31, 2006 will be assigned to one of the two new basket as if the new rules were in effect when the foreign taxes were paid or accrued. Treasury is authorized to issue new regulations to allocate taxes carried back from a post-effective year to a pre-effective year.

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**Foreign Tax Credits Under Alternative Minimum Tax (AMT)**

**Old Law**

*Under the old law taxpayers were subject to an alternative minimum tax (AMT), which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax liability. Taxpayers are permitted to reduce their AMT liability by an AMT foreign tax credit. The AMT foreign tax credit for a taxable year*

*is determined under principles similar to those used in computing the regular tax foreign tax credit. The AMT foreign tax credit for any taxable year generally could not offset a taxpayer's entire pre-credit AMT. Rather, the AMT foreign tax credit was limited to 90 percent of AMT computed without any AMT net operating loss deduction and the AMT foreign tax credit.*

**New Law**

Under the new law the AMT foreign tax credit is no longer limited to 90 percent.

**Effective Date  
Comments & Observations**

**Tax years beginning after December 31, 2004.**

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**Expatriation of Individuals**

**Old Law**

*Expatriating U.S. citizens or long term green card Holders (namely, citizens who relinquish their US citizenship, or residents who surrender their green cards), who have or are presumed to have a primary purpose of tax avoidance, are subject to an alternative tax regime under Section 877, for the ten tax years immediately following the year of expatriation. Under this regime, the individuals are subject to U.S. tax on an expanded category of U.S. source income, generally at tax rates applicable to U.S. citizens.*

*A tax avoidance motive is presumed for individuals with an average federal tax liability of \$124,000 for the 5 preceding years, or whose net worth is \$622,000 or more. Certain individuals who fall within these rules can submit a ruling request to the Internal Revenue Service regarding*

*whether tax avoidance motivated the expatriation.*

*Under the gift tax rules, an expatriating individual with an actual/presumed motive of tax avoidance, who makes gifts within 10 years of expatriation, is subject to gift tax on gifts of U.S. situated intangibles. Furthermore, under the estate tax rules, if an expatriating individual dies within the 10 year period, he must include certain closely held foreign corporation stock in his gross estate.*

*Expatriating individuals must provide the Internal Revenue Service with information about their assets at the date of expatriation.*

### New Law

Under the new law, the rules applicable to expatriating individuals are revised as follows;

- Expatriating U.S. citizens or long term green card holders are subject to the alternative tax regime under Section 877, UNLESS;
  - (a) Their average annual income tax liability for the prior five years is \$124,000 or less (adjusted for cost of living); AND
  - (b) Their net worth is less than \$2 million.

In addition, expatriating individuals must certify under penalties of perjury that they have complied with U.S. tax laws for the prior five years, and be able to provide evidence upon request.

- Expatriating U.S. citizens or long term green card holders will be treated as U.S. citizens/residents until they give notice of the act of expatriation/termination of residency to the Secretary of State or the Secretary of Homeland Security, together with a statement containing personal and financial

information required under Section 6039G. Section 6039G is amended as follows;

- The scope of information required to be disclosed is expanded
- The same information is also required for any subsequent year in which the individual is subject to tax under this alternative regime
- The Penalty for failure to provide this information is increased to \$10,000.
- An expatriated individual who is subject to tax under this regime will be subject to full U.S. federal tax for any tax year during the ten year period in which he is present in the U.S. for more than 30 days. Therefore, he would be taxable in the U.S. on his worldwide income, subject to gift tax in respect of any transfers by gift, and estate tax on worldwide assets should he die during that year. For certain individuals who are present in the U.S. by virtue of performing services for an unrelated employer, up to 30 days of U.S. presence is disregarded, provided that they can show strong ties to a foreign country by virtue of birth or marriage, or, provided that they have minimal prior physical presence in the US.
- An expatriated individual subject to tax under this regime, who within the ten year period, makes a gift of certain closely held foreign corporation stock, will be subject to gift tax, based on the proportion of the corporation's assets that are situated in the US. Likewise, individuals who die while subject to tax under this

regime, must include in their U.S. taxable estate interests in certain foreign corporations that they control, to the extent that the corporation holds assets situated in the US.

- Expatriated individuals subject to tax under this alternative regime are required to file an annual tax return for each applicable year, even if no U.S. federal tax is due.

### Effective Date Comments & Observations

**These provisions apply to individuals who relinquish their U.S. citizenship or terminate their long term residency after June 3, 2004.**

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### Deduction of State and Local Sales Taxes

#### Old Law

*No itemized deduction is permitted for any State and/or local sales taxes.*

#### New Law

Taxpayers that itemize their deductions may elect to deduct either State and/or local income taxes or State and/or local sales and use taxes. Taxpayers may use either actual sales tax records or sales tax tables the IRS will provide increased by the sales tax on large purchases, such as a car.

### Effective Date Comments & Observations

**Effective for taxable years beginning on or after January 1, 2004 and before January 1, 2006**

*This election is especially significant to taxpayers who reside in Florida,*

Alaska, Nevada, South Dakota, Texas, Washington and Wyoming, which do not have an income tax.

### **Certification of US Tax Residence**

A certificate of US tax residence is normally required where an individual needs to prove their US residence by a US Residency Certification Letter (Form 6166) in order to support a claim under a US tax treaty.

The IRS has announced that, with effect from July 5, 2004 any certification of US tax residence must be obtained by submitting Form 8802. Previously, it was necessary to make a written petition to the US Treasury to obtain Form 6166.

The use of Form 8802 provides a uniform application method for the future and ensures that the additional residence qualifications of certain countries (such as Spain and the UK) are addressed. Proof of US tax status can be required for other purposes, for example reclaiming the Value Added Tax (VAT) imposed by a foreign country, and Form 8802 can also be used for this purpose.

### **New US/Mexico Social Security Agreement**

A Social Security Agreement between the USA and Mexico was signed on June 29, 2004. The agreement seeks to eliminate the double social security charges on the same income that currently occur, for example in the situation where the US Citizen employee of a US

employer is working in Mexico. In addition, the benefits coverage of individuals who work in both the US and Mexico during their careers will be consolidated. Around 3,000 US Citizens and 10,000 Mexicans are expected to benefit from the new agreement.

An employee who qualifies as a "detached worker" under the new agreement will continue to pay home country social security contributions and should obtain a Certificate of Coverage from the home country social security authorities, which will provide exemption from social security contributions in the host country.

The new social security agreement must be reviewed by US Congress and approved by the Mexican Senate before it can come into force. It is anticipated that the agreement will come into effect in late 2005. ■

## Australia

Amendments to the Australian tax rules, which received Royal Assent on June 25, 2004, mean that taxpayers transferring their retirement savings from a foreign superannuation scheme or pension fund to an Australian one from July 1, 2004 onwards may choose to have the Australian fund pay any Australian tax arising on the transfer. The tax is calculated on the increase in the pension account balance from the date that the individual becomes a tax resident of Australia. Previously,

the individual had to pay the Australian tax on the transfer, which caused cash-flow problems as the individual was unable to access the pension fund. It is still open to the Australian Tax Office to tax transfers, which took place before July 1, 2004 on this basis. ■

## European Court

### **Access to the EC Treaty**

The European Court of Justice (ECJ) has ruled in the Pusa case, which revolves around Mr. Pusa, a Finnish national. He left Finland and went to Spain to retire. As he had debts in Finland, the Finnish collector seized part of his Finnish old age pension. Finnish regulations indicate that the collector should take into account the Finnish withholding tax that Pusa was liable for on the pension. However, as Pusa was a resident of Spain, the pension was subject to tax in Spain by virtue of the Spain/Finland tax treaty.

Pusa felt that as a Spanish resident he was prevented from enjoying the freedoms guaranteed by the EC treaty because the collector could only take into account Finnish withholding tax on the pension, and not the Spanish income tax that Pusa had to pay.

The ECJ ruled that as an EU Citizen Pusa was allowed to remain and travel throughout the EU member states without being discriminated against or being hindered. In principle he was hindered from enjoying

the freedoms the EC treaty provides and guarantees.

We believe that this is the first case in which the ECJ has ruled in a tax-related case that EU Citizenship and the freedom to remain and travel throughout the EU member states grants an individual the protection of the EC treaty. Previously, it was understood that the protection of the EC treaty only applied where there was a cross-border situation within the EU or the European Economic Area and that cross-border activity had to be economic.

The ECJ also ruled that the Finnish regulations are not in conformity with EU legislation, as they do not take into consideration the tax paid or payable in another EU member state. If the Finnish regulations took into account the tax paid or payable in another EU member state, the Finnish regulations would in principle be in accordance with EU legislation, even if the Finnish authorities demand proof of payment in that other state.

### **Entitlement to the Swedish Tax-Free Amount and Other Personal Deductions**

The European Court of Justice has also ruled in the Wallentin case, which concerned Mr. Wallentin, a German national who lived and studied in Germany, but had no taxable income in Germany. Wallentin did a traineeship in Sweden, for which he received remuneration.

Wallentin filed a request with the Swedish tax authorities to be exempt from Swedish taxation on the remuneration, but his request was denied. According to Swedish tax regulations, foreign employees who temporarily reside in Sweden for less than 6 months are taxable at a standard rate of 25 percent and cannot claim the tax-free amount and deductions based on personal and family circumstances.

The ECJ ruled that, based on case law, the position of resident and non-resident taxpayers in principle is not equal. EU member states are entitled to tax residents and non-residents in a different way. However, non-residents who do not have substantial taxable income in the state of residence should be treated as resident taxpayers, as otherwise neither the state of residence nor the state of activity will take into consideration the personal and family situation of the taxpayer. Consequently, Sweden should allow Wallentin to claim the tax-free amount as well as the deductions based on his personal and family circumstances.

### **The De Lasteyrie Case**

In the press release dated April 29, 2004 the European Commission confirmed its request that Germany abolish its exit tax regulations in the situation where a substantial shareholder emigrates from Germany to another EU member state. On the basis that Germany was not able to justify its exit tax regulations within two months after the request was filed, the European Commission

may file a lawsuit against Germany for maintaining legislation that allegedly is not in conformity with European legislation.

The press release also indicated that more jurisdictions would be challenged because their exit charges do not conform with European legislation. We will report further developments in a future issue. ■

## **Netherlands**

### **Taxation of Severance Payments**

The Dutch Supreme Court has ruled in two cases involving Dutch nationals, which look at which country is entitled to tax severance payments.

The first case revolves around a taxpayer who was employed by a Dutch employer for the period May 1976 to August 1998, and who lived in the Netherlands from 1976 to March 1996. In the period from April 1996 to August 1998 the taxpayer resided in the UK. As the employee did not meet his employer's expectations, his employment contract was terminated and a severance payment was agreed. The question then arose whether the severance payment was taxable in the Netherlands. The Dutch Supreme Court ruled that, if the severance payment has no extraordinary character and in general is connected to the employment rendered, then the state or states of activity are entitled to tax the part of the severance payment that can be allocated to the

employment carried out in that state. The relevant period for this purpose is the period January 1 of the year in which the labour agreement is terminated up to the date of termination, plus the four previous calendar years. The Netherlands is entitled to tax the part of the severance payment that is allocated to the period of the Dutch employment activity, provided that part is paid by or on behalf of the Dutch employer.

The second case concerns a taxpayer who lived in the Netherlands from October 1985 up to December 31, 1997. During that period the employee worked for a Dutch employer and its affiliates in the Netherlands, Belgium and Luxembourg. Again, the question was whether the Netherlands was entitled to tax the severance payment agreed on termination of the employment contract. The Dutch Supreme Court again ruled that the severance payment was taxable in the state of activity, the relevant period was January 1 of the year in which the labour agreement is terminated up to the termination date, plus the previous four calendar years, and the Netherlands can tax on the part of the severance payment allocated to the Dutch employment activity if it is paid by or on behalf of the employer concerned.

These two ECJ rulings establish the principles that severance payments relate to the employment agreement, and that for tax purposes a payment is allocated to the countries in which the employment activities were actually rendered in the year of termination and the four

preceding years. In addition, in order for the Dutch tax authorities to provide double tax relief, the severance payment should be charged to the employing company that is resident outside the Netherlands.

### Personal Deductions

Mr. De Groot was a Dutch resident taxpayer in 1994 and in that tax year he had income from employment for duties performed in the Netherlands, Germany, France and the United Kingdom. On the basis of the tax treaties concluded with those countries, the income from employment allocated to Germany, France and the United Kingdom was subject to tax in those countries. De Groot also paid alimony in 1994.

According to Dutch tax regulations, in this situation the double tax relief was calculated as:

#### Foreign income

Worldwide income x the Dutch income tax payable on worldwide income

As a result, De Groot's non-employment deductions (such as alimony) were allocated to both the Dutch-taxable income and to the income taxable abroad. De Groot was of the opinion that under EC law, the calculation should be:

#### Foreign income

Worldwide **taxable** income x the Dutch income tax payable on worldwide income

This would mean that the non-employment deductions would be deductible wholly from the Dutch taxable income.

De Groot filed a complaint with the ECJ, stating that he was discriminated against by comparison to other Dutch taxpayers who were in the same position, but did not have income that was taxable abroad. The EC Court of Justice ruled in December 2002 that the way in which the Dutch double tax relief was calculated did not conform with European legislation, as the taxpayer lost part of the tax-free amount and personal deductions if he had income from other EU member states and those states did not take into account the taxpayer's personal deductions.

The Dutch Supreme Court ruled in May 2004, in accordance with the ECJ ruling, that in relation to the German, French and British income the Dutch double tax relief should be calculated by reference to worldwide taxable income.

In February 2004, the Dutch State Secretary of Finance issued a decree that the calculation upheld in the ECJ should apply where:

- (a) the double tax relief relates to sources of income that are exempt from Dutch taxation and;
- (b) the income derives from countries that are EU member states, states that belong to the European Economic Area (Norway, Liechtenstein and Iceland), or by virtue of an association agreement should act in accordance with the EC Court of Justice ruling and the Netherlands has not concluded a double tax agreement under

which the Dutch resident taxpayer is entitled to claim personal deductions in that country and;

- (c) the taxpayer is not entitled to deduct the personal deductions in the state of activity and;
- (d) the tax payer does not earn a substantial part of his income in the state of activity, on the basis of which he should be treated as a resident taxpayer and therefore entitled to claim personal deductions following the Schumacker ECJ case of February 1995 (in the Netherlands the “substantial part” test is met if the Dutch non-resident taxpayer earns at least 90 percent of his taxable income in the Netherlands).

As regards to (c) above, a Dutch resident taxpayer is entitled to deduct personal deductions to the extent that the state of activity does not take them into account. Where tax deductions have been granted by the foreign tax authorities, the taxpayer is not entitled to deduct them from his Dutch taxable income, even if the foreign tax relief is lower than the relief that would have applied in the Netherlands. ■

## United Kingdom

### Non-UK Pension Schemes from April 6, 2006

The UK tax rules for approved pensions have been completely re-written with effect from April 6, 2006,

which will impact both inbound and outbound expatriates. In particular, “migrant member relief” will replace the “corresponding” tax relief for employer and employee contributions to certain non-UK pension schemes where an individual comes to work in the UK as an existing member of a non-UK scheme. UK tax relief for non-UK pension contributions, which is allowed under a tax treaty, will also be affected by the new rules, although the details have not yet been announced.

In some ways the new rules from April 6, 2006 are more flexible than the current arrangements, in particular:

- (a) Currently pension relief can only be claimed by individuals who are not domiciled in the UK and are employed by a non-UK resident. The rules from April 6, 2006 do not take the individual’s domicile into account, instead the individual must be UK-resident or have UK-taxable earnings, have joined the non-UK scheme while not resident in the UK and have been eligible for tax relief on contributions in the country in which he was resident immediately before coming to the UK.
- (b) At present a non-UK scheme must normally be established either in a country in which the employee was either working or resident immediately before coming to the UK, or in a country in which the employer has an operating presence. There will be no restriction on where

the scheme has to be established from April 6, 2006 impose. Instead, the scheme must be regulated as a pension scheme in the country in which it is established and the manager of the scheme must undertake to provide certain information to the UK Revenue authorities.

These changes should make UK income tax relief more accessible to all types of employees who transfer to the UK as existing members of a non-UK pension scheme, by enabling them to continue to participate in the non-UK scheme when UK-resident, without incurring a tax charge on the employer’s contributions and allowing them to claim UK income tax relief on their own contributions to the scheme.

Further details on non-UK pension schemes will be published in draft UK Revenue regulations in due course.

### UK Revenue Expatriate Tax Teams and Other News

Five UK Revenue specialist teams now handle substantially all work in relation to expatriate employees. Where the employer has a separate, dedicated UK tax Pay-As-You-Earn (PAYE) withholding arrangement for expatriate employees, one of the specialist teams will deal with all the individuals covered by it. Where a multi-national employer, which does not have a separate PAYE arrangement for expatriates, advises the Revenue that it regards an individual as on secondment to the UK,

that individual's tax affairs will be handled by a specialist team.

The Revenue will identify other individuals who are working in the UK for multi-nationals, or who have employment conditions or arrangements that are different to those which apply to employees recruited in the UK by a UK-based employer; their affairs will be dealt with by a specialist team. The Revenue have already written to certain employers who have employees in this category, but they have also invited employers to contact them if they think that this applies to their employees.

The UK Revenue have recently confirmed the following issues:

- The use of a modified PAYE scheme (which allows withholding tax and any social security contributions to be paid quarterly, rather than monthly) only applies to expatriates who are tax equalised. The UK Revenue are considering whether the arrangements might be applied in the

future to certain non-equalised individuals.

- There is no minimum for the operation of tax withholding via PAYE for employees working in the UK. The UK employer or host employer is must operate PAYE from Day One. The Revenue are considering whether the PAYE requirement might be waived for short UK business trips, but in the meantime only expatriates who are likely to be exempt from UK income tax under a double tax agreement can avoid PAYE if the UK employer enters into a special agreement with the UK Revenue.
- Where a payment for termination of the employment is made after an employee has left the UK and a No Tax PAYE code is in operation, if the payment pre-dates the issue of the P45 (final pay and tax certificate), the employer can make the payment gross. If the payment is made after the P45 has been issued, basic rate tax deduction (currently 22 percent) will apply. ■

For further information on any of the topics covered in this Newsletter, please contact your local BDO Member Firm, or the international BDO Centre of Excellence Expatriate Services, whose representatives are:

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