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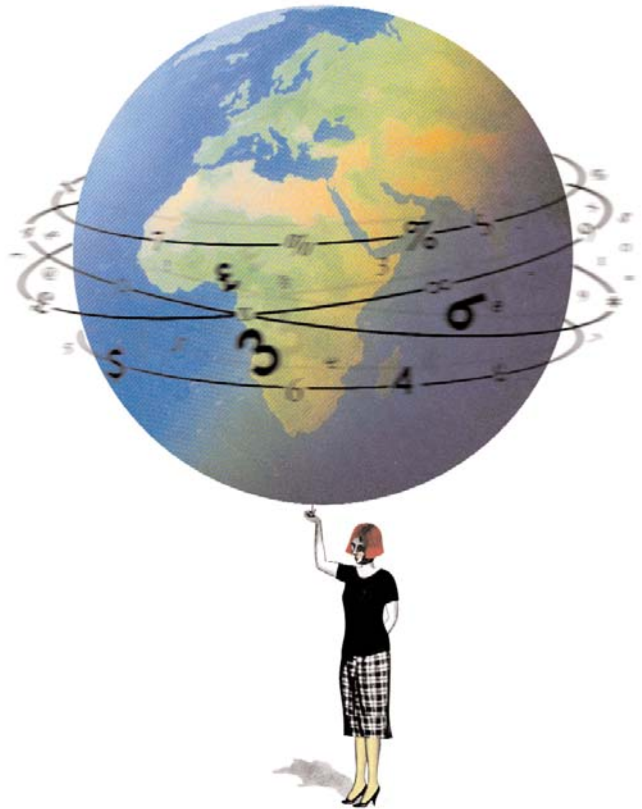
BDO

BDO International

Expatriate News

This time last year, the BDO International global Expatriate Services team held their annual conference in Orlando in the eye of a hurricane. This year, the less dramatic location of London has been chosen. Readers can be sure that, whatever the venue, the team will use this gathering to evolve new solutions and ideas to meet the ever-increasing pressures on employers and their expatriates.



NEW BDO INTERNATIONAL PUBLICATION

BDO International has produced a new publication, International Employee Payroll, in conjunction with Gee Publishing and this will be an essential resource for tax, payroll and HR professionals.

The book is aimed at companies of all sizes, whether a large multinational, a smaller firm within EU or global networks, or a business with its first expatriate employee.

The book outlines the UK tax and social security aspects of international employments, including the employer's compliance obligations and provides practical case studies. All situations are covered, from local hires, directors and dual employments, to long and short secondments.

In addition to the UK coverage, separate chapters cover the regulations in key non-UK locations, and the issues surrounding international payroll management (including outsourcing).

Newsletter readers can order a copy of International Employee Payroll: A Practical Guide (second edition) and save 20 per cent off the standard price, either by calling +44 (0)1264 388560 or by emailing sweetandmaxwell.customerservices@thomson.com and should quote code: REG1576A.

EUROPEAN COURT:

Germany: Non-deductibility of foreign school fees incompatible with EC Treaty

The July 2005 issue of Expatriate News indicated that the local tax court of Cologne had requested a preliminary ruling from the European Court of Justice (ECJ) regarding the non-deductibility in Germany of fees for attending certain foreign private schools and supplementary schools. This ruling (C-76/05) has now been issued and at the same time the European Commission has brought an action against Germany to the ECJ under the EC Treaty infringement procedure (C-318/05).

Both cases concerned the compatibility with the EC Treaty of the German income tax legislation for the deduction of school fees. The disputed provision in the German tax rules says that taxpayers may deduct 30 per cent of the fees which they pay to certain private and supplementary schools. However, a deduction is not permitted for fees paid to foreign private schools.

The Advocate General's opinion in regard to both cases was that such a provision contradicts the basic freedoms of the EU, because it differentiates for tax purposes between domestic schools and foreign ones. Ultimately, the provision infringes both the individual's right to move and reside freely within the European Community and the rule of free movement of

workers in the situation in which parents move to, or commute to, Germany to work there while their children stay and attend a school abroad. In her conclusion, the Advocate General also stated that national legislators remain free to limit the tax benefits granted to private schools, or to establish objective criteria for these schools regarding benefiting from these tax advantages.

Netherlands: Dutch conservatory assessment in accordance with EU legislation

In the case of N v Inspecteur van de Belastingdienst Oost/kantoor Almelo (case C-470/04) the taxpayer moved from the Netherlands to the UK on 22 January 1997, at which time he owned all the shares in three Dutch limited liability companies (BVs). On the date of emigration the effective seats of the BVs were transferred to Curacao.

Dutch income tax regulations result in a deemed disposal where a shareholder owning more than 5 per cent of a company's capital emigrates from the Netherlands, although this can be cancelled if the taxpayer returns to the Netherlands within 10 years (and the tax can be deferred where financial guarantees are given to the Dutch tax authorities). However, as the result of the Lasteyrie case (case C-9/02, see Expatriate News July 2005) the Dutch State Secretary of Finance removed the requirement for a financial guarantee for emigrations within the EU/EEA with effect from 11 March 2004. In addition, from the same date any reduction of the taxpayer's interest in the company after emigration and any foreign income tax paid are taken into consideration.

As N emigrated to the UK before 11 March 2004, he was assessed and the Dutch tax authorities did not take into account the fact that his interest in each company decreased in value after the date of emigration. A financial guarantee needed to be provided by him for an extension of the tax payment on the deemed disposal and he had to file a Dutch income tax return. Although the Dutch authorities released him from his financial guarantee in 2004, the taxpayer asserted that this did not eliminate the restriction on his freedom that was imposed by the tax on the notional disposal.

In the preliminary hearing the ECJ decided that this part of the Dutch tax system was not in line with the EU treaty.

In the preliminary hearing the ECJ decided that this part of the Dutch tax system was not in line with the EU treaty, as it limits the freedom of establishment. The ECJ questioned whether the breach of the EU treaty could be justified and decided that the demand to file an annual income tax return in the Netherlands was not a disproportionate requirement compared to the goal of the regulations. However, the requirement to provide a financial guarantee was considered to be disproportionate. The Court also decided that only a system that takes into account any reduction in the taxpayer's shareholding after the date of emigration could be regarded as an adequate system, unless the reduction had already been taken into account by the host country (the state of residence) of the taxpayer.

The ECJ also decided that a taxpayer can claim damages for falsely required financial guarantees and the resulting losses, provided that such damages could be claimed in domestic situations under national tax regulations.

Considering that the Dutch conservatory assessment system, as it applies as from 11 March 2004 onwards, is in line with what the ECJ has called a balanced system, it appears that the new-style Dutch tax regulations are not in conflict with the EU treaty in this respect.

UK: Social security contributions not in breach of Human Rights Convention

The case of Walker v United Kingdom [2006] All ER (D) 102, which was heard in the European Court of Human Rights in August 2006, considered whether the UK social security contributions legislation was discriminatory under the European Conven-tion on Human Rights.

The age at which men are paid a UK state pension is 65. The UK state pension age for a woman varies between 60 and 65, depending on her date of birth. This is because the state pension age for women will be gradually equalised with the pension age for men during the years 2010 to 2020 (so that all women will receive their pension at age 65 from 2020 onwards).

Up to state retirement age, working men and women are required to pay UK social security contributions (national insurance contributions or NICs) if their earnings exceed a threshold. Mr Walker was over 60 years, but under 65 and therefore he was required to pay NICs on his earnings until he reached the age of 65. However, a woman of the same age who continued to work would not be required to pay NICs on her earnings. Mr Walker complained to the European Court of Human Rights that this fact was discriminatory and contravened his rights under article 14 of the European Conven-tion on Human Rights, taken in conjunction with article 1 of the First Protocol.

The Court accepted that the contracting states enjoyed a certain margin of appreciation in assessing whether or not, and to what extent, differences in otherwise similar situations justified a different treatment. However, very weighty reasons were required before the Court would regard a difference of treatment which was based exclusively on the ground of sex as compatible with the Convention. Against that had to be balanced the proposition that the margin of appreciation available to the legislature in implementing social and economic policies should be a wide one. This applies to systems of taxation or contributions, which inevitably differentiate between groups of taxpayers, and the implementa-tion of which unavoidably creates marginal situations. It was stated that the national authorities were in a better position than the Court to assess the needs and requirements of different groups and the Court would generally respect the national legislature's policy choice (unless it was manifestly unreasonable).

In Mr Walker's case, the Court indicated that there was clearly a factual link between work and contributions. The use of the state pension age as a cut-off point for contributions was a decision which related to administrative coherence and economy, and was thus a matter generally falling within the UK's margin of appreciation. Ceasing to pay NICs at the notional end of the individual's working life or from his state pension age had to be regarded as pursuing a legitimate aim and as being reasonable and objectively justified. Therefore, the Court found that it followed that there had been no violation of article 14 of the Convention, taken in conjunction with article 1 of the First Protocol.

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NETHERLANDS:

Budget 2007

The Dutch Budget and Tax Plan includes changes which impact employers and employees, as outlined below. It was also announced that the Dutch tax authorities would increase their focus on tax inspections.

2007 tax and social security contributions rates

The income tax rate on the first two income brackets will increase for 2007, but the social security contribution rate will decrease, so that the overall rate will be lower for these income brackets, as follows:

Taxable income	Tax rate %	Social security contributions %	Total contributions %
0-17,319	2.5	31.15	33.65
17,320-31,122	10.25	31.15	41.40
31,123-53,064	42	0	42
53,065 and over	52	0	52

Employer contribution to childcare costs

All employers will have to make a compul-sory contribution to the cost of childcare from 2007 and the current compensation scheme for employees and the self-employed who receive little, if any, contribution from their employers will be abolished from 1 January 2007. Employees will be able to apply to the Dutch Tax and Customs Administration to receive a childcare allowance.

The new contribution will apply to all employers whether or not their employees actually incur childcare costs, so that this will be an additional cost for many employers.

Artists and professional sportsmen

As outlined in the last issue of Expatriate News, the artists and professional sportsmen scheme for tax withholding at source has been abolished in respect of both professional sportsmen resident in the Netherlands and for non-resident professional sportsmen, artists and theatre compa-nies that reside in a country with which the Netherlands has concluded a tax treaty. This means that there will be no Dutch tax liability and a reduced compliance requirement for many such individuals who are resident in a Dutch tax treaty country.

UK:

Non-residents capital gains tax

The UK capital gains tax legislation includes a rule which matches the disposal of shares with a share purchase which takes place within 30 days after the disposal date.

This 30-day rule was designed to prevent 'bed and breakfast' transactions, in which shares were sold and then bought back on the following day, either to use the individual's capital gains exemption (£8,800 for 2006/07) or to produce losses to reduce chargeable gains. Married couples (or civil partners) could, however, arrange for the spouse to repurchase the shares on the market without triggering this rule (but not where the shares were purchased directly from their spouse).

In the case of Davies v Hicks (2005) the 30-day rule was successfully used by a trust which was about to become non-resident in the UK. The trustees sold the trust shareholding shortly before it ceased to be UK resident, in order to avoid an exit charge. When the trust had become non-resident (and within 30 days of the original disposal), the shares were re-purchased by the non-resident trustees. The shares which were sold were then matched with the shares subsequently re-purchased and a large capital gain was eliminated.

This scheme was blocked with effect from 22 March 2006 by the 2006 Finance Act, which provides that the 30-day rule does not apply in respect of any acquisition by a person who is not UK resident or ordinarily resident in the UK. In this connection, resident means resident either under the UK domestic legislation, or under the provisions of a tax treaty.

Non-UK pension plans

At a joint meeting between senior representatives from the UK Revenue authorities (HMRC), from business and from the major accounting firms, HMRC provided the following information regarding the procedures and rules relating to UK tax relief for contributions to non-UK pension plans:

Corresponding pension plans: As outlined in the May 2006 issue of Expatriate News, a new system of tax-approved pensions came into effect in the UK on 6 April 2006. Up to 5 April 2006 a non-UK domiciled employee working in the UK for a non-UK employer could normally obtain UK tax approval for a non-UK pension plan which was broadly comparable ('corresponding') to a UK approved pension plan. On the introduction of the new pension rules, transitional relief continues to be given for contributions paid in any tax year after 2005/2006, if corresponding relief was received on contributions made to that plan in the year ended 5 April 2006.

HMRC has now confirmed that, in order for an individual to qualify for this transitional relief, the contributions that the individual made to the scheme in 2005/06 must have been actually allowed as deductions for income tax purposes. This means that it is not sufficient for the individual to have some earnings for UK duties in 2005/06 that were exempt under the employment income article of a tax treaty. Therefore, a tax-equalised expatriate in a Short Term Business Visitor tax arrangement for 2005/06 could not qualify for transitional corresponding relief (because this special employer tax compliance arrangement only applies to employees who would be able to make a claim for exemption from UK income tax on their earnings under a tax treaty).

> All that is required is an entry on the individual's tax return stating that relief is claimed under Article 18 of the UK/US treaty.

A new UK migrant member tax relief applies to certain non-UK pension plans after 5 April 2006, where the employee comes to the UK as an existing member of a non-UK plan. However, even where a non-UK scheme is a qualifying overseas pension scheme for this UK relief, the employee must also meet specific conditions. In particular, the individual must be tax-resident in the UK in order for income tax relief to be available on the pension contributions. This means that non-resident expatriates who make short business trips to the UK (and who are not exempt from UK income tax on their UK earnings under a tax treaty) will not only fail to qualify for UK tax relief for their own pension contributions, but will also be taxed on pension contributions made by their employer.

US pension plans: Procedural guidance on US pension contributions will be published by HMRC by the end of 2006. If all of the conditions of US/UK treaty Article 18 are met and the US scheme falls under the comments relating to Article 3 paragraph 1 in the Exchange of Notes, no documentation needs to be submitted to HMRC and a claim form PS3008 is not required. All that is required is an entry on the individual's tax return stating that relief is claimed under Article 18 of the UK/US treaty and confirming that the US scheme is of a type specified in the Exchange of Notes as within the definition of a pension scheme.

A claim may be made for the tax relief on an individual's US pension contributions to be given during the tax year through the UK Pay as You Earn (PAYE) system. In this situation, in the first year of claim the information that is required in the tax return claim should be sent to HMRC with details of the contributions made, or to be made, during the tax year. The contributions will then be included in the individual's PAYE Tax Code. When the individual's tax return is submitted to HMRC, a claim should be made as indicated in the previous paragraph, or alternatively reference can be made to the original claim letter. It should be noted that this Tax Code procedure does not apply to tax-equalised expatriates who are covered by a modified PAYE arrangement (because tax relief for deductible employee contributions to non-UK pension plans is included in the calculation of the monthly or quarterly tax paid over to HMRC by the employer).

Where HMRC decides to make a formal enquiry (under TMA 1970 s 9A) into the non-UK pension aspects of the individual's tax return, in order to review the validity of the claim HMRC will want to see either:

- a copy of the pension plan's legal documentation
- confirmation by a competent person (the scheme manager or the regulatory body in the US) that the scheme is one which falls under the Exchange of Notes as within the definition of a pension scheme
- a copy of the HMRC Audit and Pension Schemes Services letter confirming that the scheme is accepted as corresponding to a UK pension scheme (see above).

In addition, a copy of the pension scheme rules may be requested on occasion.

EC social security Regulation 883/2004

HMRC has provided the following update on the status of the new EC social security Regulation 883/2004 (which will replace Regulation 1408/71 when it enters into force):

Various issues are currently being resolved and the implementation regulations are being drafted.

In view of the time which the implementation process takes, it is believed to be almost impossible for the regulations to come into force for 2007. Although 2008 could be a possible start-date, 2009 appears the most likely introduction date.

There is no truth in the rumour that Regulation 883/2004 will present particular problems for the employers of mariners, by treating a company as resident for UK social security purposes (on the basis that the company has a place of business on board a UK ship by reason of its employees on that ship).

The electronic transfer of information throughout Europe (which will apply in particular to forms E101) will take some time. However, once implemented this should improve the accuracy of records and improve access to benefits, as well as helping to counter fraud.

USA:

Form 8898 and Form 8840 revisions

The Internal Revenue Service (IRS) has announced interim revisions to Form 8898 (Statement for Individuals Who Begin or End Bona Fide Residence in a US Possession) and Form 8840 (Closer Connection Exception Statement for Aliens). Form 8898 facilitates reporting to the IRS the cessation of bona fide residency by individuals resident in certain US possessions (American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the US Virgin Islands). Form 8840 facilitates an explanation of the basis for an individual's claim of a significant closer connection to a foreign country that overrides the substantial presence test for US residence purposes.

The IRS has advised that taxpayers who are required to file these forms should disregard the indicated line items until new Forms are available.

These revisions reduce the reporting burden and modify the information required on lines 17 and 29 of Form 8898 and lines 20 and 31 of Form 8840, which generally request information about the individual's social, cultural, religious, professional and political ties to a particular location, and about any charitable organizations to which the individual makes contributions. The closer connection tests of sections 937(a) and 7701(b) are facts and circumstances tests, therefore all of the factors described in Forms 8898 and 8840 are material in determining whether an individual is considered to be either a bona fide resident of a US possession or a resident of the United States.

The IRS has advised that taxpayers who are required to file these forms should disregard the indicated line items until new Forms are available. Filers are required to retain the information previously required by these lines on the forms, together any other relevant information, so that this is available for inspection in the event of an IRS examination.

Pension Protection Act 2006

The Pension Protection Act 2006 has made permanent the pension and Individual Retirement Account (IRA) provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) 2001. This has been described as the most sweeping reform of the US pension laws in 30 years.

EGTRRA included provisions that substantially increased pension and IRA contribution limits and the indexed income limits for traditional, spousal and Roth IRAs for a fixed time period, which was scheduled to expire in 2010. The Pension Protection Act 2006 makes these provisions permanent, which will significantly improve the vesting and portability of pensions and retirement savings plans. In addition, the indexed income limits will ensure that the benefits afforded by these plans are not eroded by inflation.

The EGTRRA legislation:

- Requires companies that under-fund their pension plans to pay additional premiums.
- Extends the requirement that companies that terminate their pension plans must provide extra funding for the pension insurance system.
- Requires companies to measure the obligations of their pension plans more accurately.
- Closes loopholes that allowed under-funded plans to miss pension payments.
- Raises the limits on the amount that employers can put into their pension plans, so they can add more money during good times and build a cushion to keep their pension plans solvent in lean times.
- Prevents companies with under-funded pension plans from making the position worse by promising extra benefits to their workers without paying for those promises up front.

In addition, the Pension Protection Act 2001:

- Removes barriers that prevent companies from automatically enrolling their employees in defined contribution plans.
- Ensures that workers have more information about the performance of their pension accounts.
- Provides greater access to professional advice about investing for retirement.
- Gives workers greater control over how their accounts are invested.
- Makes permanent the higher IRA and 401(k) pension contribution limits which were introduced in 2001, enabling workers to build up larger retirement savings.

ZIMBABWE:

2006 Finance Bill

The Zimbabwe 2006 Finance Bill changes were set against the background of sweeping currency reforms in which the Zimbabwe dollar was re-valued on 1 August 2006 by three decimal places.

2006 Income tax rates

New income tax rates have been introduced for employment income, which will apply by splitting 2006 into two tax years. The first tax year runs from 1 January to 31 August 2006 and the second tax year runs from 1 September to 31 December 2006. The monthly PAYE tables for the period up to 31 December 2006 calculate the cumulative tax that is payable (including the 3 per cent AIDS levy, see below).

Tax rates 1 January to 31 August 2006:

Re-valued $	Band	Tax Rate %
1-56,000	56,000	NIL
56,001-128,000	72,000	20
128,001-224,000	96,000	25
224,001-320,000	96,000	30
320,001 and above		35

Tax rates 1 September to 31 December 2006:

Re-valued $	Band	Tax Rate %
1-80,000	80,000	NIL
80,001-120,000	40,000	20
120,001-168,000	48,000	25
168,001-216,000	48,000	30
216,001 and above		35

A 3 per cent AIDS levy also applies to both years' income.

Employee purchase of company vehicle

The benefit in kind calculation for the sale of a company vehicle to an employee was changed from 1 September 2006.

The benefit is now based on the market value of the vehicle on the date of disposal to the employee, less the original cost as increased by an inflation allowance. The inflation allowance is calculated as the increase in the Transport and Consumer Price index from the date the vehicle was purchased by the employer up to the date of sale to the employee.

Tax exemptions for older taxpayers

The first $144,000 of the following types of income is exempt from tax with effect from 1 January 2006 for taxpayers aged 55 years or over:

- Rental income.
- Interest on bankers acceptances and other discounted instruments.
- Interest on deposits with a financial institution.

Pension fund contributions

The maximum pension fund contributions that can be paid in 2006 will be aggregated as follows:

Period ended	Maximum contributions (re-valued $)
31 August 2006	48,000
31 December 2006	24,000

Therefore, a total maximum of $72,000 in pension contributions can be paid in 2006.

Legislation will be enacted so that it will be a criminal offence where an employer deducts employee pension contributions and fails to remit them to the pension fund within the 25-day period after the deductions are made.

Quarterly tax payments

Provisional taxpayers are required to submit Quarterly Tax Return Forms with their quarterly tax payments with effect from 1 September 2006.

The quarterly return must be in the form prescribed by the Commissioner General and taxpayers must disclose an estimate of their total taxable income for the year for which the provisional tax is (or may be) payable. A consultation process will examine the most appropriate method of estimating the taxable income for this purpose.

Capital Gains Tax

The Capital Gains Tax Withholding Tax rate is increased as follows with effect from 17 October 2005:

- Listed shares: 5 per cent.
- Unlisted shares: 10 per cent.

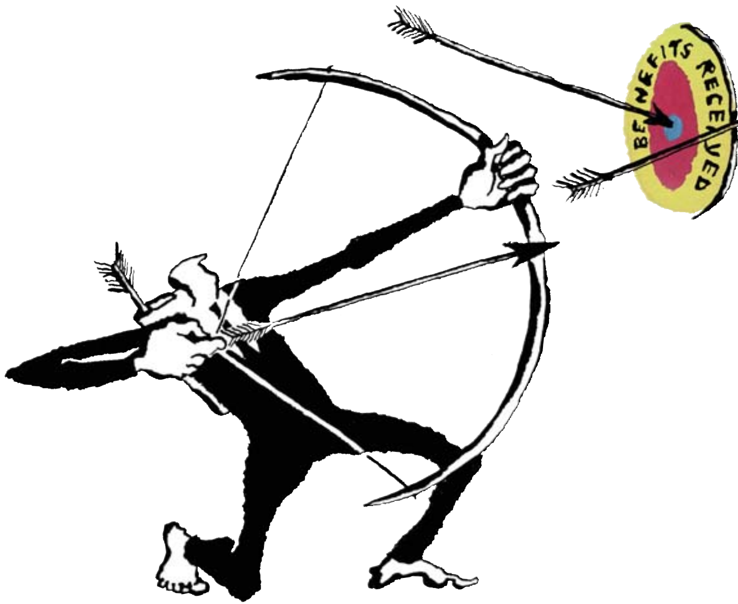
Where a company, or a group of companies, donates immovable property to an approved employee-housing trust on or after 1 September 2006, any gain on the donation is exempt from Capital Gains Tax.

Employee share schemes

A regulatory framework will be established by December 2006 to safeguard employees' interests in, and to facilitate the approval of, employee share participation schemes.

Revenue investigations

The Zimbabwe Revenue Authority (ZIMRA) has increased its revenue raising activities. In particular, it should be noted that investigations are targeting share option schemes, employee benefits and withholding taxes.



The first tax year runs from 1 January to 31 August 2006 and the second tax year runs from 1 September to 31 December 2006.

ITALY:

Tax and social security contributions on stock options

Following the changes which were outlined in the last issue of Expatriate News, further changes to the treatment of stock options have been published unofficially in a Decreto Legge that will become effective upon official publication. This official publication is expected within the next few days (and must be converted into law within 60 days).

This provision supersedes the changes previously announced by adding further conditions for the beneficial tax and social security treatment of stock options.

The benefit derived from the exercise of a non-transferable stock option is excluded from the employment income basis and therefore not subject to ordinary taxation (at a marginal rate of 43 per cent) or to social security contributions (approximately 9.89 per cent payable by the employee and 30.86 per cent by the employer) if the following five conditions are satisfied:

- The exercise price paid by the employees must be at least equal to the 'normal value' at grant (an approximation of fair market value).
- The employee's total holding cannot exceed 10 per cent of the voting power in the general assembly or of the issued share capital.
- The option vesting period must be at least three years.
- At the time of exercise, the company that issued the options must be listed on a stock exchange.
- The individual must maintain an investment in the shares obtained through the option exercise for at least five years after exercise and this investment must be at least equal to the value of the shares when acquired less the option price paid.

More information

For more information, please contact your local expatriate contact or one of the Expatriate Services Centre of Excellence contacts below.

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'Employer of the Year' 2004 and 2005
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