



**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.

## 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.

### **Update on the De Lasteyrie Case**

The last issue of Global Expatriate News (June 2004) covered the De Lasteyrie ECJ case (which held that France could not tax an emigrating individual on his unrealised capital gains) and reported that the ECJ had formally asked Germany to abolish its "exit tax" provisions.

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 activ-

ities 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 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.

## USA

### New Threat to Foreign Earned Income and Housing Exclusions

Section 632(c) of the Jumpstart Our Business Strength (JOBS) Act, which was passed by the Senate on May

11, 2004, would limit the foreign earned income and housing exclusions permitted to US Citizens and Resident Aliens working abroad to a combined \$80,000 total for both the housing and earned income amounts. Since almost all Americans working overseas have foreign earned income in excess of \$80,000, the practical effect of the new rules would be to preclude *any* housing cost from being excluded from gross income under section 911 of the US Internal Revenue Code.

Existing rules enable US Citizens and Resident Aliens working abroad to exclude from gross income the cost of housing provided by their employers to the extent that the housing costs are reasonable and in excess of a certain threshold amount. A modification of the exclusion as set out in the JOBS Act would raise taxes on American workers abroad, as well as on their employers who frequently pay all or part of the individual's taxes because they maintain tax equalisation programs for their expatriate workforce. Given that it is likely that the US Senate and House of Representatives Bills are likely to go to conference, it is hoped that taxpayers may once again win the day.

### **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.

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Material Discussed in this newsletter is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.