BDO International

Expatriate News

September 2005

As we move towards the last quarter of 2005, the authorities around the world have been particularly busy announcing changes that will impact expatriates and their employers.

Canada

Withholding on non-residents Canadian earnings

The Canadian Revenue Agency has recently released an updated version of its Information Circular 'Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada'. This has been followed by an audit initiative aimed primarily at non-resident employers who do not meet their Canadian payroll obligations.

Non-resident employers are required to withhold tax, compulsory Canada Pension Plan contributions (CPP) and Employment Insurance premiums (EI) in the same way as resident employers, unless a double tax treaty waiver has been obtained at least 30 days before the first payment date. Even where such a waiver is held, an employment income T4 slip must be filed.

Individual income tax returns which include employment income that has not been reported by the employer on a T4 slip are likely to be selected for audit. The employer could then be required to pay the CPP and EI, together with penalties for the withholding failure and the failure to file the T4. A follow-up payroll audit could also take place.

Denmark

Simplified taxation of non-residents

Proposal L 148 was passed by the Danish parliament on 31 May 2005 to modernise and simplify the provisions for the taxation of non-resident individuals and those governing individual investments in private companies. The main changes from 1 January 2005 are:

- Non-residents receiving income from Danish sources are taxable in Denmark under the current provisions, based on categorisation as Danish source in a list in the Source Tax Law Announcement or in the Law (Kildeskatteloven) itself. These categories of income will be divided into groups and incorporated into the Law. In particular, interest on the Danish savings of non-residents will not be taxed as Danish source income.
- The income tax liability of non-resident individuals carrying out independent business with a Danish permanent establishment will be extended to include sickness benefits from the Danish state. These rules only apply if the individual is subject to Danish social security contributions.
- The provisions in the Personal Income Tax Law (Personskatteloven or PSL) for income from renting immovable property or inventory (which is treated as capital income for tax purposes if the income is attributable to an activity falling within the scope of the Danish Private Company Law) where the contract is managed by a manager of contracts for more than 10 individuals, will be abolished. The limited tax deductions for passive investors in a property owned by more than ten individuals remain unchanged.

EC

Deductions for residents with foreign-source income

The European Commission announced on 15 July 2005 that it had sent a formal request (a 'reasoned opinion') to Finland regarding its discriminatory rules on the income tax deductions for Finnish resident individuals with foreign source income. If Finland does not reply satisfactorily to the reasoned opinion within two months, the Commission may refer the matter to the European Court of Justice (ECJ).

Some of the tax treaties between Finland and other EU or European Economic Area (EEA) Member States provide that the foreign source income of a Finnish resident may be exempt from tax in Finland, using the exemption with progression method. Section 6 of the Finnish Act on the Elimination of International Double Taxation only grants resident individuals limited personal deductions on a pro-rata basis.

Based on the ECJ decision in the de Groot case (see previous Newsletters), the Commission considers that the unavailability of full personal deductions may dissuade Finnish residents from pursuing their occupational activities as migrant workers in another EU or EAA Member State. Accordingly, the Commission is of the opinion that by not granting full personal deductions to resident individuals with foreign source income, which, under the relevant tax treaty, is exempt with progression in Finland, Finnish tax law is incompatible with Articles 39 and 43 of the EC Treaty (free movement of workers and self-employed persons) and the corresponding provisions of the EEA Agreement.

Although, in principle, the limitations to the personal deductions also apply to resident individuals who receive exempt foreign pension income, the treatment of foreign pension income is not considered to be discriminatory. A rule in Article 136(3) of the Finnish Income Tax Act ensures that Finland does not treat persons receiving foreign pensions less favourably than persons who only receive income from Finnish sources. The provision also provides that, if the global amount of income tax payable in Finland and abroad is greater than it would have been had the income only been derived from Finnish sources, the Finnish tax is reduced accordingly. However, this rule only applies to pension income.

Sweden: deferral of gains where the new property is outside Sweden

The European Commission also announced on 15 July 2005 that it had sent a reasoned opinion to Sweden regarding the rules governing sales of owner-occupied dwellings.

Swedish domestic law provides that resident individuals may, in certain circumstances, defer the taxation of capital gains attributable to a sale of an owner-occupied dwelling, provided that the seller has acquired, or has the intention to acquire, a replacement dwelling fulfilling the conditions for permanent residence. It is necessary that both the dwelling sold and the replacement dwelling are situated in Sweden. Swedish residents leaving Sweden are not allowed to defer the capital gains derived from the sale of a owner-occupied dwelling situated in Sweden if the replacement dwelling is situated abroad. In addition, individuals moving to Sweden and acquiring a replacement dwelling in Sweden on the sale of an owner-occupied dwelling situated abroad are not allowed to defer tax.

According to the Commission, these Swedish rules restrict the free movement of persons and the free movement of capital, as individuals selling or acquiring owner-occupied dwellings situated in another EU Member State or in another EEA Member State are treated differently for tax purposes.

Sweden is expected to reply on the reasoned opinion within two months to avoid referral to the ECJ.

Estonia

Reduction of income tax rates decelerated

The Ministry of Finance presented a draft law on 5 May 2005 to slow down the planned reduction of the income tax rates. This is a result of the change of Government in April 2005.

The current law foresees a gradual reduction of the flat rate of general income tax from 24 per cent in 2005 to 22 per cent in 2006, and to 20 per cent in 2007 and subsequent years. The proposed amendments would decelerate this reduction by one percentage point in each year i.e. the current 24 per cent rate would reduce to 23 per cent in 2006, 22 per cent in 2007, 21 per cent in 2008, and 20 per cent in 2009. Correspondingly, the reduction of the distribution tax rate on net dividends would also be decelerated to 24/76 in 2005 and to 20/80 in 2009 and subsequent years, compared to the current law proposal of a 20/80 tax rate (ie 20 per cent on the gross amount) in 2007.

Finland

EEA winnings exempt from income tax

On 20 May 2005 the president of Finland signed a law amending Section 85 of the Income Tax Law (Tuloverolaki) which exempts from income tax in Finland any amounts won in a game of chance held in another EEA Member State in accordance with that state's legislation. The new law came into force on 1 June 2005 and is effective retroactively for the tax year 2004 onwards. Similar winnings from Finnish domestic games of change are already exempt from income tax, but are subject to lottery tax under the Lottery Tax Law (Arpajaisverolaki) at rates of between 1.5 per cent and 30 per cent of the value, depending on the type of game. The person liable for the tax is the organiser of the game. Winnings derived from countries outside the EEA remain subject to income tax.

The amendment was introduced in response to the ECJ decision on 13 November 2003 in the case of Diana Elisabeth Lindman (C-42/02), which held that Article 49 of the EC Treaty prohibits legislation in a Member State under which winnings from games of chance organized in other Member States are treated as the winner's income for income tax purposes, whereas winnings from games of chance conducted in that particular State are not subject to income tax.

France

Individual income tax reforms

The French Prime Minister announced new tax measures on 1 September 2005, which are part of a plan to improve the growth of the French economy. The measures are aimed at increasing the purchasing power of the lower and middle classes by reforming individual income tax. If approved, the measures will generally apply from 2007 (in respect of assessment tax year 2006):

- The individual income tax rate brackets would be reduced to four from seven, however the actual rates and thresholds have not yet been determined. In addition, the supplementary 20 per cent deduction for the first EUR 117,900 (in 2005) of taxable income would be directly integrated into the progressive income tax rates so that, for example, a marginal rate of 48 per cent would be reduced to 40 per cent. In contrast, the maximum amount of tax deductions and allowances available would be limited.

- At the end of the tax year 2005 companies would be allowed to grant their employees a tax-free salary bonus not exceeding EUR 1,000. This measure would be included in the 2006 Finance Bill.
- The employment bonus (which is effectively a tax credit for low-income employees) would be paid by the tax authorities on a monthly basis (currently, it is paid after 12-18 months). It would also be increased by 50 per cent for part-time employees receiving minimum wages.
- Other measures announced include a commitment that the aggregate of the individual income tax, net wealth tax and local taxes would be limited to a certain percentage (for example, two thirds) of the taxpayer's annual gross income. If this percentage is exceeded, the net wealth tax would be reduced accordingly

Germany

Salary splits in intra-group secondments

In a recently published decision the German Federal Tax Court (Bundesfinanzhof) decided the treatment under the tax treaty between Germany and Spain of the employee of a German multinational enterprise who was seconded to a Spanish subsidiary. The judgment clarifies the tax treatment of a salary split structure in the case of an intra-company employee secondment.

The facts

A German-resident employee (E) received income from a German multinational enterprise (G), of which he was a member of the board of management and he also worked for 124 days in the calendar year in various functions for a Spanish subsidiary (S). Initially, E acted as a member of S's supervisory board, subsequently as the representative of the group management, and finally as a member of S's permanent commission which was in charge of S's reorganization. According to E's estimation about 40 per cent of his total work time was attributable to his activities for S.

E received his full remuneration as a member of the management board from the German parent company and no separate remuneration was agreed in respect of the activities in Spain. Nevertheless, G was duly reimbursed by S for the secondment. No German wage tax was withheld by G in respect of the remuneration attributable to E's activities in Spain. However, S withheld Spanish withholding tax and in his German tax return E treated that part of the remuneration as exempt from German tax under the tax treaty. The tax office, however, treated the total remuneration as subject to German tax, and gave credit for the Spanish tax due.

Main issues

Primarily, the Court had to decide whether, under the Germany/Spain tax treaty the remuneration attributable to E's activities for S is exempt from taxation in Germany or taxable in Germany (with Spanish tax credit). In addition, it had to decide whether Spain has the right to tax that income under the directors' fees or employment income provisions of the treaty, in view of the fact that E was seconded to the Spanish subsidiary of a German parent.

Decision

The Court ruled that the treaty Article 16 for directors' fees (which would give Spain the taxing rights) did not apply. According to the Court, this provision only applies to remuneration paid specifically in respect of participation in the different bodies and if uniform remuneration is paid in respect of the individual's various activities, such remuneration cannot be split up and attributed proportionately to treaty Article 16. To achieve German tax exemption according to Article 23(1)(a) of the treaty for the Spanish source income, E would have required separately stipulated remuneration.

The Court also considered the treaty term 'economic employer' and indicated that a foreign subsidiary can only be considered as the economic employer if the secondment is exclusively or predominantly in the interests, and at the instigation, of the subsidiary. In addition, the employee must be integrated into the subsidiary's operational procedures and subject to its instructions. Where the employee stands outside the hierarchy of the subsidiary and exclusively acts as the parent company's representative, the country of residence should refuse to exempt the foreign country income from taxation.

It should be noted that the Federal Tax Court felt unable to decide on the above issues on the basis of the facts at hand, therefore although it reversed the local tax court's judgment, the case was referred back to the local court for clarification of the underlying facts. If the local tax court decides that the part of E's

remuneration attributable to his Spanish activities in Spain is exempt from German tax under the tax treaty, the Court stated that the exempt amount can be determined pro rata on a time basis. However, another apportionment method might have to be used if the time-based remuneration would be higher than the amount S would pay to an employee who was not seconded to it by G. Otherwise, the non-arm's-length part of the remuneration would not be employment income paid by G 'on behalf of' S, but a hidden profit distribution by S to G.

Conclusion

The case provides useful clarification for the arrangements in salary split cases. Early and adequate preparation of the employee's integration into the operational procedures of the subsidiary, as well as a proper description and documentation of the situation will be of special importance in intra-company employee secondments involving directors.

Tax treaty exemption

The German Federal Ministry of Finance has published a letter on the application of the domestic rules limiting the availability of the treaty exemption for foreign employment income derived by a German-resident individual. The letter contains the following details:

- As from 2004, exemption from German tax with progression for the foreign employment income derived of a taxpayer who is a German-resident taxpayer under a tax treaty is only available if the taxpayer can prove that either the tax assessed by the other country has either effectively been paid, or that country has renounced its taxing right. The provision only applies for assessment purposes and not for the wage tax withholding procedure.
- The letter provides a threshold for foreign employment income of up to EUR 10,000 for the application of the letter ruling.
- The letter states that the amount of the foreign employment income must generally be determined in accordance with German tax provisions, in particular payment of the assessed foreign tax must normally be demonstrated by submitting the foreign tax assessment notice and a payment document. In the case of a net salary agreement, or where the tax withheld by the employer is the final amount, an employer's certificate showing the amount of income accrued in a given assessment period, the amount of tax withheld and the period of employment abroad, is sufficient.

The letter also addresses the requirements in special cases, such as development co-operation, or where the employment was exercised in countries like Kuwait or the United Arab Emirates which do not levy individual income tax, and for ships operated under a foreign flag or under the Liberian flag.

- If the taxpayer is unable to provide the required proof of payment of foreign tax, the foreign employment income is assessed to German income tax regardless of the treaty provisions. If the taxpayer provides the required proof at a later date, the German tax assessment notice has to be amended. If the German tax office has doubts whether the requirements have been met, it will include the foreign employment income in the German taxable income and send an information request to the foreign tax authorities.

South Africa

Expatriate incentives

The new draft Revenue Laws Amendment Bill 2005 has been published and includes major changes regarding the taxation of non-residents and withholding taxes.

The Budget speech in March 2005 promised to make South Africa more attractive for expatriates and the proposed changes are a major step forward in that regard.

Firstly, the definition of a resident by reference to the physical presence test would be changed. The current test which allows a 91-day period in South Africa in the preceding three tax years before the individual becomes resident would be increased to the preceding five tax years. A further proposal would increase the maximum aggregate days that can be spent in South Africa during those three tax years (to be increased to five) from the current maximum of 549 days to a maximum of 915 days. In summary, this means that an expatriate may have five years before becoming resident in South Africa.

Secondly, it is also proposed that visiting non-resident entertainers and sportspersons will only pay a 15 per cent final withholding tax and the relevant income will therefore be exempt from normal tax in South Africa.

Sweden

Regional development incentives

On 15 August 2005 a report on regional tax incentive measures was presented to the Government, which aimed to promote regional development in 'Development Area A', which includes certain municipalities in Dalarna, Gävleborg, Jämtland, Norrbotten, Värmland, Västerbotten and Västernorrland.

The report investigated whether an increased basic allowance for individuals living in the area should be introduced with effect from income year 2005 and whether other incentives should be introduced to promote development in this area, or other areas, where individuals or companies incur high costs as a result of long transport distances or cold climate.

According to the report, an increased basic allowance will not be the most appropriate incentive to promote development and an expansion of the current rules on the deductibility of social security contributions will be more appropriate. To stimulate regional growth and development, it is important to promote small and medium-sized enterprises and therefore it is proposed to increase the tax deduction for social security contributions from the current 10 per cent to 16 per cent. This would mean that the maximum deduction for social security contributions paid by employers (arbetsgivaravgifter) would be SEK 136,320 per year.

2006 Budget

The 2006 Budget proposals presented to parliament on 20 September 2005 included the following changes that would affect expatriates and their employers:

- Individual income tax would be reduced by SEK 126 per month for individuals earning SEK 20,000 or more per month.
- The Government will complete the review of the rules which treat part of the income of the owner of a small or medium-sized company as capital (taxed at 30 per cent) and part as employment income (taxed at up to 57 per cent).
- The social security contributions payable by sole proprietors in respect of their employees would be reduced to 10.21 per cent for one year (either 2006 or 2007).

Taiwan

Stock options

The Ministry of Finance in Taipei recently issued rulings relating to individual income tax returns and the corporate tax deduction position for stock options granted by foreign companies. The rulings clarify the tax treatment of employees and their employers (the local subsidiaries or branches) when the employees receive and exercise stock options offered by foreign parent companies or headquarters. Previously, there were no clear regulations to require expatriate employees to include stock options benefits in their individual tax returns.

The content of the tax rulings may be summarised as follows:

- In general, there is no requirement on the employer to withhold income tax in respect of the stock option gains.
- Employees who are Taiwan resident at the date of exercise of stock options on or after 17 May 2005 are liable to tax at the normal progressive income tax rates at the date that options are exercised (and not at the date of grant).
- The difference between the market value at the date of exercise and the exercise price paid will be treated as a taxable benefit in the employee's income tax returns.
- Where the employee is not resident in Taiwan, the taxable benefit (which is considered to be Taiwanese source income) is calculated pro rata by reference to the number of the employee's days in Taiwan divided by the number of days in the period from the date of grant to the date on which the options vest. Tax is charged on the benefit at a 20 per cent flat rate.
- Regardless of whether the costs of the stock options are cross-charged to the subsidiary or branch in Taiwan, the employer is required to provide information regarding the stock option scheme to the tax authorities. If the local subsidiary or branch is cross-charged with the cost of the stock options by the foreign company, that cost must be treated as a salary expense in the years in which the employees exercise the options and the Taiwanese subsidiary or branch should withhold payroll tax and report and pay it to the tax authorities.
- Where options were exercised before 17 May 2005, there is no tax liability and no reporting obligation,

provided there is no cross-charge of option costs to the Taiwanese entity. However, if costs have been cross-charged and the option gain at exercise has not been reported, the employer should have reported this to the tax authorities by issuing a non-withholding statement to the employee by 15 August 2005.

In addition, employees who have exercised pre-17 May 2005 options are required to amend their tax returns for the each exercise year to declare the income and they should have paid the additional tax on the option income before 16 September 2005.

A penalty of up to 5 per cent of the taxable income will be imposed if the Taiwanese employer fails to comply with the reporting rules by the relevant date and an employee who missed the 16 September 2005 deadline faces a penalty of up to three times the unpaid tax.

Thailand

Stock options

The Revenue Department has ruled on the taxation of US stock options granted to employees of a subsidiary in Thailand.

Background

Options were granted at no cost to the employees of the Thai subsidiary of a New York Stock Exchange quoted company. The options were not transferable, and had to be exercised within ten years of grant at a price calculated as the average of the maximum and minimum prices of the shares on the date the options were issued. There was no recharge of costs to the Thai company.

The ruling indicated that in this situation:

- There was no assessable income at the date on which the options were issued.
- The difference between the market value of the shares at the exercise date and the exercise price paid is a taxable benefit from employment.
- The market value of the shares at the date of exercise is the price at which the shares would be sold to the general public on the exercise date or (where there is no such price), the average stock market price in the month of exercise.
- As the options were issued at no cost by a US company and there was no recharge to the Thai company, there was no obligation for either the US company or the Thai company to deduct personal income tax on the gain on exercise of the options. However, each employees must include the gains on their personal income tax return for the tax year of exercise and the associated tax must be paid when the return is filed.

USA

New guidance on tax reporting obligations of US expatriates

The Internal Revenue Service (IRS) has issued new guidance on the tax reporting obligations of US citizens and long-term permanent residents who expatriate from the United States. The IRS has also released a revised Form 8854 (Initial and Annual Expatriation Information Statement) to address the changes made by the American Jobs Creation Act of 2004 (AJCA) for individuals who lose US citizenship or long-term resident status after 3 June 2004. The AJCA provides for expatriating citizens and permanent residents to continue to be subject to US taxation where the individual either:

a) has net worth at the expatriation date of at least $2m or;

b) has an average net annual income tax liability for the five preceding tax years in excess of $124,000 (as adjusted for annual inflation) or;

c) has failed to certify that all federal tax obligations for the five preceding tax years have been met.

In addition to enacting new information reporting requirements for former citizens and long-term residents, the AJCA provides that all former citizens and long-term residents will continue to be taxed as US citizens or residents (on a worldwide income basis) until they (i) notify the Department of State of loss of citizenship or the Department of Homeland Security of termination of permanent resident status and (ii) file an initial expatriation information statement with the IRS.

The IRS guidance states that Form 8854 was revised to permit individuals to meet the new notification and information reporting requirements of the AJCA. In addition, Form 8854 was expanded so that it may be used as both the initial and the annual expatriation information statement required by the

AJCA. Revised Form 8854 and its instructions also address how individuals should certify that they have met their US federal tax obligations for the five preceding taxable years, as required by the AJCA, and what constitutes notification to the Department of State or the Department of Homeland Security. Revised Form 8854 and the related instructions can be downloaded from the IRS web site at www.irs.gov.

In Notice 2005-36 the IRS provides special rules for individuals who lost US citizenship or terminated long-term resident status after 3 June 2004 and before the new notification and information reporting requirements were enacted by the AJCA. Where any such individual filed the revised Form 8854 with the IRS by 15 June 2005, they will be treated as having met their reporting obligations on the date on which they provided the required notice to the Department of State or the Department of Homeland Security.

US/Japan social security agreement

Background

The new US/Japan social security agreement comes into force on 1 October 2005. The agreement was signed on 19 February 2004 and one of its purposes is to ensure that employees who move between the USA and Japan, and their employers, are not subject to social security contributions in both countries. The other purpose is to ensure that the eventual social security pensions earned by the employees are maximised, by recognizing the years of employment service in the other country in computing the total years of service for the calculation of the pension.

Agreement provisions

The general default rule is that both employed and self-employed individuals will be subject to social security contributions in the country in which they are working. The exception to this rule, as in most such agreements, relates to the 'detached worker'. This provides that where an employee is temporarily seconded by the home country employer to work in the other country, the employee can remain in the home country social security system. Self-employed individuals are also covered by the detached worker provisions.

The detached worker provisions apply to an initial temporary secondment period of up to five years, but an extension can be requested.

Transition rules

Where a temporary assignment between the USA and Japan is already underway on 1 October 2005, the period of temporarily detachment is considered to commence at that date.

US and Japanese employers who have employees on temporary secondment to the other country must apply for Certificates of Coverage for these individuals, however the relevant procedures are understood to be in development.

Immigration

The US immigration law and regulations require all foreign nationals (including lawful permanent residents, 'Green Card' holders) to report every change of personal address to the Immigration and Naturalization Service (INS) on Form AR-11 within 10 days of moving.

In the case of employees assigned to the US, the form is the obligation of the individual (not the employer) and it must be submitted once permanent accommodation has been obtained. Failure to follow the Form AR-11 filing requirements incurs a fine of up to $200 and thirty days imprisonment. In addition, the foreign national can be removed from the US unless it can be shown that the failure was reasonable, excusable, or was not wilful.

Form AR-11 requires an Alien Card number, but it should be noted that this only applies to Green Card holders (other foreign nationals should leave this part of the form blank). The form can be downloaded from www.bcis.gov/graphics/formsfee/forms/ar-11.htm.

More information

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