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BDO International

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Expatriate News

BDO Spencer Steward hosted the annual BDO Expatriate Conference in South Africa. Attended by a strong BDO contingent from all parts of the world, together with current and prospective clients, the presentations covered tax policies and the HR challenges of keeping an expatriate programme cost-effective and in step with the business's expansion plans, and of ensuring global corporate compliance. The global BDO Expatriate team sends good wishes for 2008 to all of its clients and contacts.

BELGIUM:

Salary withholding tax exemption

A general 0.25% reduction in the Belgian professional (salary) withholding tax (*précompte professionel*) came into effect on 1 October 2007. The intention is to make Belgian business more competitive and to improve the employer's position on salary costs relative to neighbouring countries.

Belgian salary withholding tax applies to earnings, allowances, pensions and other employment income taxable in Belgium. The reduction will be achieved by deducting 0.25% of the gross employment income (before the deduction of individual social security contributions) of all the relevant employees from the normal employment income withholding tax for the relevant period. Relevant employees are the employees employed by the employer who pays their professional withholding tax as of 1 October 2007.

The reduction applies to all employers who pay earnings that are liable to salary withholding tax, provided that they fall within the scope of the collective bargaining agreements and Joint Industrial Committees Law of 5 December 1968. The measure also applies to registered temporary employment agencies that supply

temporary workers to these businesses. The measure will only benefit the employer and it will not increase the individual employee's net income.

Operation

Each month the employer must deduct the total amount of withholding tax from the remuneration that it pay,s but the employer is exempted from paying part of this tax over to the Belgian Treasury.

In addition to the normal monthly or quarterly salary withholding tax return, the employer must file a second return in which the amount of the salary withholding tax exemption is declared. The employer must also have available for the tax authorities a list showing each employee's full name, national number, and the amount of the employee's gross remuneration before deduction of social security contributions. In most cases, the employer's payroll office will fulfil these requirements.

EUROPE:

Portugal: capital gains on non-residents' immovable property

The European Court of Justice (ECJ) has held in the case of *Erika Waltraud Ilse Hollmann v Fazenda Pública* (Case C-443/06) that Portugal's method of taxing non-residents' gains on property more highly than residents' gains is in breach of the EC Treaty.

The case related to a dispute between Mrs Hollmann and the Portuguese tax authorities regarding her income tax assessment for 2003. The Portuguese Personal Income Tax Code provides that individuals who are resident in Portugal are taxed on all their income and gains (including income arising outside Portugal), but non-residents are taxed only on income and gains which arise in Portugal. A 50 per cent reduction applies to the net capital gains or losses of Portuguese residents. Residents' income tax liabilities are calculated at progressive income tax rates (of up to 42 per cent in 2003), but a special 25 per cent tax rate applies to non-residents' capital gains on immovable property.

Mrs Hollmann was resident in Germany. Following the death of her husband, she inherited a property in Portugal, which she sold at a gain in 2003. The entire capital gain was taxed by the Portuguese authorities, but Mrs Hollman claimed that she was entitled to a 50 per cent reduction in the gain because she was resident in another EU Member State.

The ECJ considered whether it is contrary to the EC Treaty for national legislation to subject the capital gains on immovable property in a Member State owned by a resident of another Member State to higher taxation than the tax applicable to a resident of the first State. Article 39 (freedom of movement of workers) and Article 43 (free movement of capital) did not apply to Mrs Hollmann's situation and there was no evidence that she sold the property with a view to exercising her right under Article 18 to move and live freely in the EU.

The ECJ then looked at the non-discrimination rule in relation to the free movement of capital in Article 56. It

concluded that the system of Portuguese taxation that taxes all of a non-resident's capital gains at 25% but gives a 50% reduction before taxing a resident's gains at progressive rates, enables residents systematically to benefit from lower taxes. The effect of the national legislation was to make the transfer of capital less attractive for non-residents, by deterring them from investing in immovable property in Portugal and from selling such property. Therefore, this was a restriction on the movement of capital, as prohibited by Article 56.

The Court considered whether the restriction could be justified on any of the grounds provided in Article 58 and commented that it is clear that EC Member States can distinguish in their national legislation between resident and non-resident taxpayers, provided that this is not arbitrary or a disguised restriction on the free movement of capital. However, the Court held that Article 56 must be interpreted as precluding national legislation that subjects the capital gains on the immovable property of a resident of another State, to a greater tax burden than that applicable to a resident of the State in which that property is situated.

A change to the Portuguese tax rules is to be expected as a result of this decision.

GERMANY:

Tax exemption for US employment income from dual-resident employer

According to a German Federal Finance Court (*Bundesfinanzhof*) decision, the US employment income of a German-resident employee performing duties in the US for his German/US dual-resident employer is exempt from German income tax, but is included for the purposes of calculating the tax rates that apply to other income (exemption with progression).

The taxpayer was the employee of a US company that had an establishment in Germany. As the legal seat and the main office of the company were situated in the US, the company was US-resident and therefore liable to corporate income tax in the US. Due to the fact that the place of management was moved from the US to Germany, the company was also resident for corporate income tax purposes in Germany and had an unlimited German corporate income tax liability. In connection with his employment, the taxpayer performed minimal duties in the US (less than 183 days in a calendar year). The German tax authorities and the Finance Court of Munich denied a claim for the US earnings to be exempt with progression, therefore the taxpayer filed an appeal before the *Bundesfinanzhof*. In its decision, the Court concentrated on the interpretation of the Germany-US Double Tax Treaty (DTT). The treaty

allows employment income for services performed in the US to be taxed in the US. However, the US right to tax the earnings in any tax (calendar) year is given up in favour of Germany if the employee is resident in Germany for the purposes of the treaty and certain tests are met. The requirements of this '183-day rule' are:

- The taxpayer's presence in the US does not exceed 183 days in the calendar year; and
- The earnings are paid by, or on behalf of, an employer that is not resident in the US; and
- The earnings are not borne by the employer's permanent establishment or fixed base in the US.

The *Bundesfinanzhof* came to the conclusion that the employer was resident for the purposes of the treaty both in Germany and in the US. Thus, the second requirement of the 183-day rule was not met. The consequence is that the US retained the right to tax the earnings for the US duties and Germany must exempt this income with progression.

UK:

2007 Pre-Budget Report residence & domicile changes

The UK Government first announced its intention to review the UK tax rules relating to residence and domicile in 2002. On 9 October 2007, as part of the annual Pre-Budget Report (PBR), outline proposals for changes to the rules were finally announced. It is anticipated that the new rules will come into effect at the earliest on 6 April 2008.

A consultation document on possible new rules for individuals who are UK-resident for ten or more years has been issued. Full details of the other changes will be in draft legislation which will be released in January 2008.

UK residence

Historically, days of UK arrival and departure have been ignored in determining an individual's UK residence status, under a non-statutory practice of the UK Revenue authorities (HMRC). In the future, UK arrival and departure days will be included when applying the tests that determine residence and ordinary residence for UK tax purposes.

This change will have a significant impact on the UK tax position of employees who make regular, short visits to the UK. They are more likely to become resident and ordinarily resident in the UK under the rule for UK days averaging more than 90 days per year. Combined with the other changes (see below), the result is likely to be that all of a regular visitor's earnings will be UK-taxable (regardless of where the duties are performed).

The new day-counting rule will also affect the position of employees leaving the UK for full-time employment abroad. Recent court cases have supported the strict approach to counting UK days when considering whether individuals who were previously ordinarily resident remain UK-taxable on all of their income during a period of 'occasional residence' outside the UK. The non-statutory conditions for non-residence in the UK throughout a period of full-time employment abroad include a limit on the days that the individual spends in the UK in each tax year, and in future this test will be more difficult to meet.

Individuals not domiciled or not ordinarily resident

The most significant change proposed in the PBR will affect certain individuals who are either not domiciled or not ordinarily resident in the UK, and who are taxed on the remittance basis of assessment. An employee who is not ordinarily resident in the UK can restrict the UK tax liability on earnings for non-UK duties to the sums that are remitted to the UK. Certain non-UK domiciled individuals who are employed by non-UK companies are also taxed on their non-UK earnings on the remittance basis.

The PBR proposals will impose an additional annual charge of £30,000 on individuals who have been resident in the UK in seven out of ten tax years and who wish to continue claiming the remittance basis of assessment. The Government is considering further changes for individuals who have been resident in the UK for more than ten years (which will shortly be outlined in a consultation document).

The period for counting the seven tax years of residence is retrospective, so that an individual who has already been UK-resident for seven years at 5 April 2008 must either pay the additional tax charge from 6 April 2008 or lose the benefit of the remittance basis.

Where the individual decides not to pay the £30,000 tax charge, he or she will be liable to UK tax on worldwide income on an arising basis. However, it appears that even if the £30 000 charge is paid, any later remittances of the income or gains for the relevant year will still be taxable in the normal way. This complicates the decision regarding whether to pay the charge.

A further change will mean that, subject to a *de minimis* limit for unremitted foreign income of less than £1000 for the tax year, non-domiciled or not ordinarily resident individuals who use the remittance basis of assessment will forfeit their UK personal tax allowances.

Irish-resident employers

In the PBR the UK Government took the opportunity to announce a change from 6 April 2008 to the discriminatory legislation that currently prevents the non-domiciled employees of businesses resident in the Republic of Ireland from using the remittance basis of assessment for their earnings for non-UK duties. This legislation had already attracted the attention of the EC and it was expected that the UK would be required to change it, if it did not take action unilaterally. Although the new £30 000 remittance basis charge (above) means that this change is unlikely to benefit employees who are long-term UK residents, it will be welcomed by Irish-resident businesses assigning employees to work in the UK for periods of seven tax years or less.

Social security contributions

Where an employee's earnings are subject to UK social security contributions (National Insurance Contributions or NICs), any increase in the taxable earnings is likely to also attract additional NICs, increasing the employer's costs.

Employer contributions for 2008/09 will be payable at the rate of 11% on an unlimited amount of earnings. Employees will pay contributions of £2888 on the first £40 040 of their earnings for 2008/09 and an additional 1 per cent on their earnings above £40 040 (without limit).

The proposed PBR changes have attracted a great deal of criticism, both from the international business community due to the potential additional costs for its long-term UK residents and from representatives of UK industry (who feel that this will make the UK a less competitive location for inward investment). Further details of the changes should be known during the period leading up to 6 April 2008, when they will take effect.

HMRC guidance on share schemes

The share scheme sub-group of the HMRC Expatriate Forum (in which BDO actively participates) meets to discuss various issues and the following guidance has been issued by HMRC:

Tax treaty relief

The UK's domestic legislation generally looks at the residence status of the individual at the date of grant of an option, to determine the legislation that may apply to any gain derived from that option. The existence of a tax treaty does not alter the operation of the UK domestic charge, but may provide relief from that charge (in terms of either a reduction in the amount charged to tax, or foreign tax credit relief).

Although the UK domestic charge depends on residence status at the date of grant, it is not imposed until the option is exercised. In the treaty context, this means that when an individual is UK-resident and ordinarily resident at the date of grant, but is resident in a treaty-partner state at the date of exercise, the UK tax charge is not imposed by reference to the individual's state of residence. Instead, the UK charge is applied by reference to the state of the source of the income, so that any employment duties in the UK to which the option gain relates are taken into account and tax is charged accordingly.

Restricted shares

HMRC has previously stated that if an employee is UK-resident and ordinarily resident on the date when forfeitable restricted stock (with no performance criteria in the vesting period) is awarded, the income realised at vesting is fully UK-source and does not relate to the period between award and vesting of the stock.

In reply to the question whether stock awarded as part of a prior-year performance award is sourced to that performance period, HMRC has indicated that it would regard the tax charge as arising for the tax year in which the award occurs. The forfeiture condition is interpreted so that, although the award is for a particular year, entitlement has been withheld and the default position is to assess the value in the year in which the condition lifts.

HMRC has confirmed that there may be limited circumstances in which it might accept that a non-forfeitable restricted security received as part of a formal Long Term Incentive Plan (LTIP) was partly earned during an earlier period. This would include the situation in which the security was received after UK arrival in a part-year of UK residence.

Social security contributions on option gains

HMRC has commented on the UK social security contribution (NICs) treatment of share-option gains in certain assignment situations. This is where the employee is subject to the social security system of another EEA state or of the USA at the date of grant, but at the time of exercise the employee's earnings are chargeable to both income tax and NICs in the UK.

HMRC has confirmed that for an NIC liability to arise on an option, an employee must meet the UK domestic conditions of residence and presence for NIC purposes at grant. Where an employee is subject to contributions in another EEA state or the USA when granted an option, but is within the UK social security legislation when the option is exercised, the option gains should not be subject to UK NICs.

In order for a UK social security contribution liability to arise, the option gain must be taxable in the UK. If an option is granted when the employee is not resident in the UK and it is not in respect of UK employment duties, there is no income tax charge.

In general, where an employee of a non-UK company moves between group companies to the UK and, after a period of UK work, moves to work elsewhere for the same group, HMRC regard this as one continuous period of group employment. There would have to be at the time of grant a reasonable certainty or intention for the individual to return to the UK during the vesting period for HMRC to conclude that an option was granted partly in respect of prospective

UK employment duties. Where an option exists solely by virtue of a non-UK employment and the new UK employment activities have no impact on it, it is likely that HMRC would conclude that the option was granted in respect of the non-UK duties (and that it was not UK-taxable).

HMRC's view is that a change of employment between group companies may be one of the factors that determine the period of the duties for which an option is granted, but it may not be decisive. If, for example, continued employment by a new UK employing company is a requirement for the vesting of an option granted by a former non-UK employer, provided that there is sufficient certainty about the move at the time of the option is granted, HMRC's assumption would be that the grant is wholly or partly in respect of UK duties.

If an option is granted when an employee is UK-resident and then exercised after the individual leaves the UK for a new group employment, there will normally be a UK tax charge in the year of exercise (unless it takes place in a complete UK tax year of non-residence, in which there are no UK duties). If HMRC decides that the change of employing company within the group is a cessation of the UK employment, the gains on the share exercise would be assessed for the UK tax year in which the UK employment ended.

It should be noted that the UK taxation of employment-related share and share-option gains is extremely complex. Therefore, the general guidance above should not be relied on and specific advice should be taken in every case.

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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