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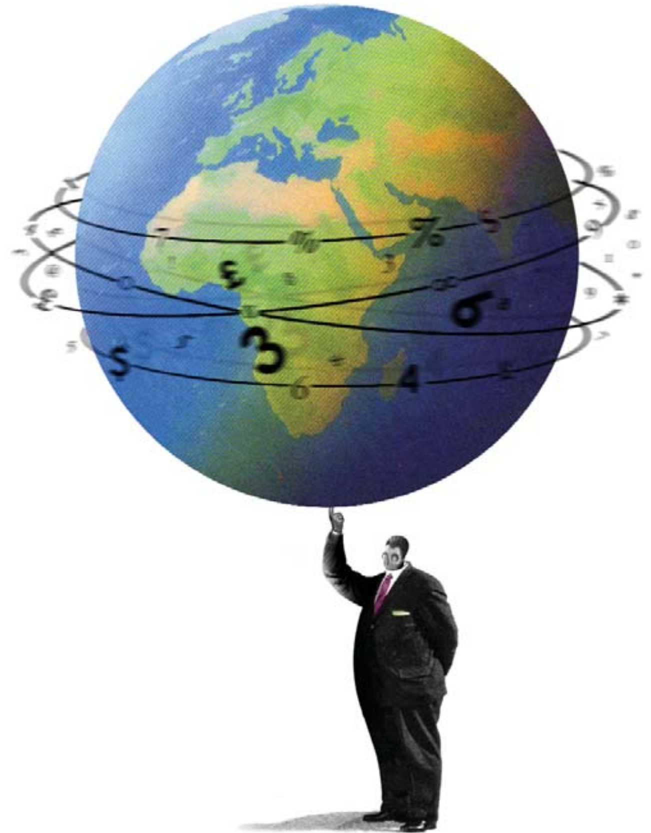
BDO International

Expatriate News

This edition of Expatriate News has numerous items to report. Changes which affect expatriates and their employers have emerged in early 2006 from the annual Budget process in a number of countries. Cases in the European and US Courts have examined specific cross-border employee issues and the authorities in the UK have announced important changes to the optional methods for payment of expatriates' income tax and social security contributions.



Africa

The latest changes impacting expatriates in Africa are outlined below.

Egypt:

A new Income Tax Law (Law 91 of 2005) was enacted on 9 June 2005 and became effective from 1 July 2005 for salaries and wages. The law applies retroactively for other types of income with effect from 1 January 2005.

Individual income tax

The development duty has been abolished and income tax is levied at 0 per cent and 20 per cent.

Withholding tax

Remuneration received by resident employees from a second employer and by non-resident employees is subject to a final 10 per cent withholding tax on the gross amount of salary without any deductions.

Ghana:

The Budget Statement and Economic Policy for the financial year 2006 was presented to parliament on 10 November 2005 and included the following proposals:

Corporate tax

An employment tax credit scheme will be established to encourage companies to employ new graduates from tertiary institutions.

Personal taxation

New rates and bands of personal income tax are proposed, varying between 0 per cent and 25 per cent. Taxes on overtime earnings will also be reduced.

Tax amnesty

A general one-off amnesty on penalties and sanctions for the self-disclosure of unreported and under-reported personal income tax, withholding and other taxes will be available from 1 January 2006 to 30 June 2006.

Tax treaties

The government intends to extend its present, very limited, network of tax treaties and negotiations with other countries will be initiated.

Namibia:

In the Budget for 2005/06 and the Medium Term Expenditure Framework (MTEF) for 2005/06 to 2007/08 presented by the Minister of Finance on 12 May 2005, the following tax measure was announced.

Personal taxation: Amendments will be introduced to prohibit taxpayers from offsetting losses from certain activities (including farming, rental of residential accommodation and vehicles) against employment income.

Seychelles:

The Budget for 2006 was presented to the National Assembly by the President and Minister of Finance on 30 November 2005. The most important features of the Budget (which generally applies from 1 January 2006) are as follows:

GST

The Goods and Services Tax (GST) on domestic air travel will be reduced from 15 per cent to 7 per cent.

Social security

The rate of employer's contribution to the Social Security Fund will be reduced from 35 per cent to 30 per cent for the salary range of 2,001 Seychelles Rupees (SCR) to SCR 10,000.

South Africa:

Personal tax: residence

The Revenue Laws Second Amendment Bill 41 of 2005 has been tabled and the original proposals changed, so that an individual will be resident if he or she is physically present in South Africa for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding that year of assessment, and for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment. The individual will be resident in South Africa from the first day of the relevant year of assessment.

The explanatory memorandum to the Bill makes it clear that the amendment will be phased in, so that the operation of the amendment does not result in a person who is a South African resident as a result of the previous three-year physical presence test becoming non-resident and avoiding capital gains tax on his or her assets (other than fixed property and assets attributable to a permanent establishment in South Africa).

Therefore, for individuals who were resident on 28 February 2005 as a result of the previous three-year physical presence test, the new provision comes into operation on 1 March 2006 and applies for years of assessment commencing on or after that date. In respect of any other person the new provision comes into operation on 1 March 2005 and applies in respect of years of assessment commencing on or after that date.

Withholding tax on sale of immovable property

Section 35A was introduced in 2004 to impose a withholding tax on foreign sellers of South African immovable property. This section will come into operation on a date to be fixed by the President by a proclamation in the Gazette.

It should be noted that the original section 35A does not allow a taxpayer to object and appeal against a decision by the Commissioner not to waive any penalty imposed under the section, if the tax was not paid within the prescribed period. The new Bill will allow an objection and appeal in this situation.

The 2006/2007 Budget

The Budget proposals were tabled in Parliament on 15 February 2006 by the Minister of Finance. The main proposals affecting expatriate employees are:

Personal Income Tax Rates

The minimum tax threshold increases from 35,000 Rands (R) to R40,000 for persons under age 65. For persons aged 65 and over, the tax threshold increases from R60,000 to R65,000.

The primary rebate increases from R6,300 to R7,200. The secondary rebate for individuals aged 65 and over remains at R4,500.

The maximum marginal tax rate of 40 per cent applies to taxable income above R400,000 (previously R300,000).

Medical expenses

A monetary cap was recently introduced for tax-free medical scheme contributions. In addition, with effect from 1 March 2006 the threshold for deduction of individual tax-deductible medical expenses increased from 5 per cent to 7.5 per cent of taxable income. Taxpayers aged 65 years and older continue to enjoy a full deduction for all medical expenses.

Motor Vehicle Allowance

As from 1 March 2006 the percentage of the monthly motor vehicle allowance which is subject to tax increased from 50 per cent to 60 per cent.

Learnership allowances

Learnership allowances (introduced in 2002) are due to expire in October 2006, but have now been extended to October 2011. The maximum initial allowances increase from R17,500 to R20,000 per annum for existing employees and from R25,000 to R30,000 for new employees. The allowance for completed learnerships increases from R25,000 to R30,000 for agreements entered into from 1 March 2006. The employment of a disabled person as a learner qualifies for an enhanced allowance from 1 July 2006.

Scholarships and bursaries

Scholarships for current and future employees will be tax exempt as long as the employer makes direct payment for the tutor and tuition rendered expenses. This proposal takes effect from 1 March 2007.

Capital Gains Tax (CGT)

The annual capital gain/loss exclusion is increased from R10,000 to R12,500 and the primary residence exclusion is increased

from R1m to R1.5m. The CGT exclusion on death is increased from R50,000 to R60,000.

Exchange control

The offshore individual investment allowance is increased from R750,000 to R2m.

Zimbabwe:

2006 Budget

The Minister of Finance presented the 2006 Budget to the House of Assembly on 1 December 2005. The following proposals are subject to approval by Parliament.

Tax rates: employment income

The following new rates of tax will be applied to taxable income from employment with effect from 1 January 2006:

Annual PAYE Table

1 JANUARY 2006 – 31 DECEMBER 2006				
Band of Income Zimbabwe $ (Z$)	Amount Z$	Tax Rate Per cent	Tax Z$	Cumulative Tax Z$
1 – 84,000,000	84,000,000	Nil	Nil	Nil
84,000,001 – 192,000,000	108,000,000	20	21,600,000	21,600,000
192,000,001 – 336,000,000	144,000,000	25	36,000,000	57,600,000
336,000,001 – 480,000,000	144,000,000	30	43,200,000	100,800,000
480,000,001 – and above		35 per cent		

A 3 per cent Aids levy is also payable

Monthly PAYE Table

1 JANUARY 2006 – 31 DECEMBER 2006				
Band of Taxable Income Zimbabwe $ (Z$)		Tax Rate Per cent		Cumulative Tax Z$
1 – 7,000,000	Multiply by	Nil	Nil	Nil
7,000,001 – 16,000,000	Multiply by	20	Less	1,400,000
16,000,001 – 28,000,000	Multiply by	25	Less	2,200,000
28,000,001 – 40,000,000	Multiply by	30	Less	3,600,000
40,000,001 – and above	Multiply by	35	Less	5,600,000

A 3 per cent Aids levy is also payable

Individuals, wherever resident, are subject to income tax on their remuneration for services rendered in Zimbabwe, regardless of where payment is made. Where expatriates are paid wholly or partly in foreign currency, their Pay As You Earn (PAYE) must also be paid in the foreign currency in which they receive their remuneration.

Every non-resident employer is required to appoint a local resident agent for PAYE purposes. Work permits for expatriate staff will only be granted on condition that the employer is registered for PAYE through a resident agent.

Rates of Tax: Employment Income

1 JANUARY 2005 – 31 AUGUST 2005				
Band of Income Zimbabwe $	Amount Z$	Tax Rate Per cent	Tax Z$	Cumulative Tax Z$
1 – 8,000,000	8,000,000	Nil	Nil	Nil
8,000,001 – 12,000,000	4,000,000	10	400,000	400,000
12,000,001 – 24,000,000	12,000,000	20	2,400,000	2,800,000
24,000,001 – 40,000,000	16,000,000	25	4,000,000	6,800,000
40,000,001 – 56,000,000	16,000,000	30	4,800,000	11,600,000
56,000,001 – 72,000,000	16,000,000	35	5,600,000	17,200,000
72,000,001 and above			40 per cent	

A 3 per cent Aids levy is also payable

1 SEPTEMBER 2005 – 31 DECEMBER 2005				
Band of Income Zimbabwe $	Amount Z$	Tax Rate Per cent	Tax Z$	Cumulative Tax Z$
1 – 6,000,000	6,000,000	Nil	Nil	Nil
6,000,001 – 12,000,000	6,000,000	20	1,200,000	1,200,000
12,000,001 – 20,000,000	8,000,000	25	2,000,000	3,200,000
20,000,001 – 28,000,000	8,000,000	30	2,400,000	5,600,000
28,000,001 – 36,000,000	8,000,000	35	2,800,000	8,400,000
36,000,001 and above			40	

A 3 per cent Aids levy is also payable

Tax-free bonus

The individual tax-free bonus amount increased from Z$5m to Z$20m with effect from 1 November 2005.

Pension contributions

The maximum amount allowable for employer and employee pension fund contributions increased from Z$1,440,000 per annum to Z$72,000,000 per annum with effect from 1 January 2006.

Passenger motor vehicles

The maximum amount allowable to the employer on the purchase of a passenger motor vehicle increased from Z$50m to Z$1bn with effect from 1 January 2006.

Staff housing

The ranking cost of a residential unit increased from Z$270m to Z$1.5bn with effect from 1 January 2006.

Benefits

Benefits enjoyed as a result of the employee's employment form part of the individual's gross income. The value of the benefit is the cost to the employer, except for the use of furniture or quarters (where the benefit is the value to the employee).

Motor vehicle benefits

The deemed motoring benefit is revised as follows with effect from 1 January 2006:

Engine Capacity	2005 Z$	2006 Z$
1,500cc or less	2,280,000	9,000,000
1,501cc to 2,000cc	4,200,000	15,000,000
2,000cc to 3,000cc	6,480,000	18,000,000
Above 3,000cc	7,200,000	24,000,000

In the case of a sale of a company motor vehicle to an employee, with effect from 1 January 2006 no taxable benefit arises on the sale of such a vehicle to an employee who is aged over 55 years. The benefit to an employee who is less than 55 years of age is reduced by an inflation allowance equivalent to the inflation figure and is calculated on the expenditure incurred on the purchase of the vehicle.

Loans

If an employer grants an interest-free or low-interest loan to an employee, or to his spouse or near relative, the deemed benefit to the employee is calculated using the following rates:

- Loan up to Z$35,000: 12.5 per cent
- Loan above Z$35,000: 16.0 per cent

Carbon tax

Individuals resident in Zimbabwe will no longer pay carbon tax based on the engine capacities of the vehicles that they own. Instead, with effect from 1 January 2006 the tax is paid at the rate of Z$1,000 per litre on the importation of petroleum products.

Visitors to Zimbabwe will pay carbon tax using the following annual rates:

Engine Capacity	US$
1,500cc or less	72
1,501cc to 2,000cc	132
2,000cc to 3,000cc	180
Above 3,000cc	360

Tax credits

Tax credits are increased from 1 January 2006 as follows:

	2005 Z$	2006 Z$
Mentally/physically disabled person	500,000	12,000,000
Blind Person	500,000	12,000,000
Elderly person's credit	500,000	12,000,000

Retirement pensions

A pension paid to a taxpayer who reaches 56 years of age in the year of assessment is exempt from tax with effect from 1 January 2006.

Rental & interest income of the elderly

The tax-exempt amount of rental income or interest from discounted instruments accruing to persons aged over 55 years is increased from Z$24m to Z$72m with effect from 1 January 2006.

Interest on late tax payments

The tax Commissioner will be empowered to charge interest with effect from 1 January 2006 where a defaulting taxpayer does not pay the penalty in full on the date that the default has ceased.

Capital gains tax

The rate of capital gains withholding tax on the sale of a marketable security has been confirmed to be 5 per cent with effect from 17 October 2005. In addition, with effect from 1 January 2006, the capital gains withholding tax will not be withheld on the sale of marketable securities by a unit trust, but will be paid on the redemption of any unit by an investor in the unit trust.

Duty on non-essential imports

A specific duty is levied on clothing, shoes, travel bags and beverages denominated in foreign currency with effect from 8 December 2005, and this is payable at the inter-bank exchange rate.

New African Tax Treaties:

The first income tax treaty between Botswana and Barbados came into force on 12 August 2005.

The first income tax treaty between Botswana and the Seychelles was signed on 22 June 2005. The provisions in the treaty came into force on 1 January 2006 in the Seychelles and on 1 July 2006 in Botswana.

The first income tax treaty between the Seychelles and Oman was signed on 1 January 2005 and the provisions came into force on 1 January 2006.

The first income tax treaty between the Seychelles and Mauritius was signed on 22 June 2005. The provisions in the treaty came into force on 1 July 2005 in Mauritius and on 1 January 2006 in the Seychelles.

Armenia and Egypt signed their first income and capital tax treaty on 6 December 2005.

The first income tax treaty between Tunisia and Ethiopia, which was signed on 23 January 2003, was approved by the Tunisian parliament on 1 November 2005.

Australia:

Foreign income exemption for temporary residents

The Tax Laws Amendment (2006 Measures No 1) Bill 2006 recently received Royal Assent on 6 April 2006. The Bill contains amendments to provide tax exemptions to temporary residents for certain non-Australian source income and for net capital gains from assets that do not have the necessary connection to Australia.

These amendments mean that temporary residents in Australia will only be subject to Australian tax on the following:

- Income relating to Australian employment, including foreign-sourced employment income.
- Gains on some employee shares or rights to the extent that they relate to employment in Australia.
- Australian investment income.
- Net capital gains on assets that have the necessary connection with Australia (including Australian real property, shares in private companies, and non-portfolio interests in Australian public companies).

In order to qualify for the exemptions, the individual taxpayer must be a temporary resident for Australian tax purposes, which means that he or she must hold a temporary visa granted under the Migration Act 1958 (for example: a 457 visa). However, an individual will not be entitled to the temporary resident exemption if his or her spouse is an Australian citizen, holder of a permanent visa, or a protected special category visa holder.

The Bill also exempts temporary residents from withholding tax obligations on interest paid to a foreign lender.

In this legislation, there is no time limit on how long the tax exemptions are available. Furthermore, it does not matter if the person has been a temporary resident before.

Similar amendments were previously introduced to Parliament on 30 May 2002 and 23 October 2002. However, on both occasions, the legislation did not pass the Senate.

The amendments will apply for income years that begin on or after 1 July 2006. The exception is the interest withholding tax exemption, which will apply from 6 April 2006.

Baby Bonus: child overseas in taxpayer's care

Where a child resides overseas, an Australian resident taxpayer may still be entitled to receive the First Child Tax Offset (Baby Bonus), according to Australian Tax Office Interpretative Decision (ATO ID) 2006/16.

Receipt of the Baby Bonus is contingent upon the satisfaction of a number of requirements. Section 61-355 of the Income Tax Assessment Act (ITAA) 1997 provides entitlement to Baby Bonus where certain conditions are met. These conditions include the requirements that the child is less than five years of age, the taxpayer is legally responsible for the child, the taxpayer is an Australian resident, and the child is in the taxpayer's care.

In ID 2006/16 the taxpayer was considered to be actively involved in the care of the child, notwithstanding the geographical distance between parent and child. This was evidenced by the taxpayer's involvement in making decisions concerning the child's day-to-day care, welfare and development. As such, the taxpayer was considered to care for the child, and thereby satisfied the appropriate conditions and was entitled to the Baby Bonus.

Germany:

German denial of negative tax progression for foreign losses

The European Court of Justice (ECJ) has held that the German income tax rules denying 'negative income tax progression' in respect of losses from foreign dwellings is incompatible with the free movement of workers within the EC.

A German married couple named Ritter-Coulais was jointly assessed for income tax purposes in Germany for the tax year 1987. Even though residing abroad in a house they owned in France, they were subject to unlimited German tax liability, because they were civil servants of German nationality and their non-German taxable income did not exceed 5,000 Deutschmarks (DEM) (extended unlimited tax liability). In 1987 their house in France gave rise to imputed income, which in this case was negative.

The Germany/France double taxation treaty provides that income from the use of immovable property located in France is exempt in Germany. Therefore, the negative imputed French income was not taken into account in Germany, so that the imputed French loss did not reduce the tax base for the German income tax assessment. In addition to the tax treaty provision, section 2a(1) of the German Income Tax Code only allowed negative income from a foreign country from the use of immovable property to be set off against positive income of the same type and from the same country.

Consequently, the German tax authorities rejected the request to grant a negative tax progression by taking into account on the couple's German income from employment the reduced rate of tax which would have applied if the negative French rental income was considered for tax progression purposes. On the other hand, a corresponding higher rate of tax would have applied on their German income if the French income was positive.

The ECJ decided that the German tax rules in question (sec. 2a(1) and sec. 32b(1)(2) of the German Income Tax Code) were generally incompatible with the principle of freedom of movement of workers as stated in Art. 48 of the EEC Treaty (now Art. 39 of the EC treaty). On the other hand, the ECJ rejected the application of the principle of freedom of establishment in this case (due to the fact that the couple were not self-employed) and the application of the principle of freedom of capital movement (as this principle was not applicable in 1987). However, the ECJ stated that the case may fall within the scope of the principle of freedom of capital movement as the EC law now stands.

The ECJ held that there was a hidden discrimination, despite the fact that the German legislation was not specifically directed at non-residents, because the latter were more likely to own a house outside Germany than resident citizens.

Furthermore, the ECJ stated that this unfavourable treatment of non-resident taxpayers is not justified by the need for fiscal coherence in the German national tax system of which that legislation forms part.

Consequently, according to this ECJ decision, non-resident workers can claim that losses derived in the member state of their residence, in respect of income sources which are tax exempt under the relevant double tax treaty with the state in which they are subject to unlimited income taxation, must be taken into consideration for the determination of their applicable tax rate (negative progression) in the latter state.

The ECJ decision did not comment on the general question of whether, under European law, any foreign losses from another member state have to be included for the determination of the income tax rate of any European taxpayer.

Italy:

2006 social security rates

The Italian social security contribution rates were recently issued for the calendar year 2006 by the Istituto Nazionale per la Previdenza Sociale (INPS), which is the primary social security authority in Italy.

Employees

It should be noted that the social security rates can vary substantially, depending on the company's sector (such as industrial, commercial or credit), the number of employees, and the employee's seniority (for example, senior manager or office worker). The following table sets out the rates for an office worker of a company in the industrial sector which has more than 50 employees. The table should be used as general guideline to the Italian social security rates.

2006 social security rates for an office worker employed by a company in the industrial sector with more than 50 employees:

	Employer contribution	Employee contribution
Pension, disability and survivor's benefit	23.81 per cent	8.89 per cent + 1 per cent on income exceeding Euros 39,297
Unemployment	1.31 per cent	Nil
Severance pay fund	0.20 per cent	Nil
Family allowance	0.68 per cent	Nil
Mobility allowance	0.30 per cent	Nil
CIGS earning equalisation fund	0.60 per cent	0.30 per cent
CIG earning equalisation fund	2.20 per cent	Nil
Maternity fund	0.46 per cent	Nil

Self-employed individuals

The rates for self-employed individuals who contribute to the Gestione Separata (special fund for autonomous workers for whom no professional fund exists) are as follows for 2006:

	Company contribution	Worker contribution
Worker contributing to another obligatory regime	6.67 per cent	3.33 per cent
Worker receiving a direct pension	10 per cent	5 per cent
All other cases (income up to Euros 39,297)	12.13 per cent	6.07 per cent
All other cases (income exceeding Euros 39,297)	12.8 per cent	6.4 per cent

Contributions to the Gestione Separata are payable on a maximum income of Euros 85,478 per year.

It should be noted that the social security rates can vary substantially, depending on the company's sector

Netherlands:

ECJ case: Dutch non-resident taxpayers not entitled to threshold and levy rebates

A German resident taxpayer by the name of Bujura owns a holiday home in the Netherlands. The holiday home is taxable in the Netherlands by virtue of the Netherlands/Germany double tax treaty. When determining the Dutch taxable income, the Dutch non-resident taxpayer is not entitled to the threshold and the levy rebates.

The European Court of Justice decided that, in accordance with the decision taken in the so-called D-case (see Expatriate News November 2004), European legislation does not force the Member States to apply most favourite nation clauses. The fact that Belgian resident taxpayers in the same situation would be entitled to the Dutch threshold and levy rebates cannot lead to the conclusion that the German resident taxpayer is discriminated against under EU regulations.

Determination of workdays for Dutch double tax relief

A Dutch resident taxpayer works in the Netherlands and in Belgium. The question arises as to how the relevant double tax relief should be calculated. In principle, the double tax relief should be calculated as follows: the number of days worked outside the Netherlands/the total number of workdays (the total calendar days, minus weekend days).

The Dutch Supreme Court ruled that, when determining the total number of work days, this should be calculated as the total number of calendar days minus weekend days, holidays, and public holidays on which the employee does not actually work. In addition, the Dutch Supreme Court ruled that sickness days that the employee would spend in the state of his employment activity should be included in the number of days worked outside the Netherlands.

Dutch 30 per cent ruling reduction to the maximum application period

A Dutch national lived and worked abroad for foreign employers in the period 14 August 1989 to 1 October 1997. In the period up to 1 October 1999 he worked in the UK for the permanent establishment of B BV (established in the Netherlands). The Dutch national lives in the Netherlands as from 1 October 1999. He is employed by the Dutch parent company of B BV, which is also established in the Netherlands. He applied for the Dutch 35 per cent ruling (the predecessor of the Dutch 30 per cent ruling) with effect from 1 October 1999. The Dutch tax authorities denied the application of the 35 per cent ruling.

The Dutch Supreme Court ruled that the period for which the 35 per cent ruling applies should be reduced for any periods during which the taxpayer was employed by Dutch domestic employers. The consequence of the fact that the individual was employed by a Dutch domestic employer in the 10-year period prior to application of the 35 per cent ruling, was that any period of stay in the Netherlands that ended in the 15 years prior to the application of the ruling should be deducted from the maximum period of 10 years for which the ruling applies. Consequently, the employee could not apply for the 35 per cent ruling.

It should be noted that with effect from 1 January 2001, the periods of former stay and former employment in the Netherlands should be deducted from the maximum application period of the ruling. The period of time during which the employee stayed outside the Netherlands or conducted employment activities outside of the Netherlands is not regarded as relevant for the application period of the 30 per cent ruling.

Dutch 30 per cent ruling applies to members of a supervisory board

A lower Dutch Court decided on 13 December 2005 that the 30 per cent ruling is applicable to members of the supervisory board of Dutch companies.

In general, a member of a supervisory board has no employment in the Netherlands due to the fact that the company has no instructive power over supervisory board members. However, members of a supervisory board are deemed to be employed by the company under the Dutch Wage Tax Act. Consequently, a member will be taxed on a fictional employment. Formerly, the members of a supervisory board were specifically excluded from applying for the 35 per cent ruling. Until recently, this was the reason why a commissioner was not able to apply for the 30 per cent ruling.

The decision was made by a lower Court and it is possible that the Dutch Supreme Court may have a different point of view. In anticipation of the decision of the Supreme Court, it is recommended that members of supervisory boards of Dutch companies should apply for the 30 per cent rule. It should be noted that, in order for an employee to apply for the ruling, he should have specific knowledge or expertise that is scarce on the Dutch labour market. In addition, in order for the 30 per cent ruling to apply retrospectively to the first day of the Dutch employment, the ruling should be applied for within four months of the first day of the Dutch employment.

Deemed Dutch residency applies for the entire calendar year

A taxpayer resided in Belgium from 1 April 2001, and from that date he was employed by a Dutch domestic employer and was regarded as a Dutch non-resident taxpayer. He decided to opt to be treated as a Dutch resident taxpayer with effect from 1 April 2001. Under this optional regime, he may deduct the mortgage interest paid on the Belgian first and primary home which he owns for Dutch tax purposes. The Dutch tax authorities included in his Dutch taxable income the income derived in the period from 1 January 2001 up to and including 1 April 2001.

A lower court in the Netherlands decided that the option to be treated as a deemed Dutch resident taxpayer applies to the entire calendar year. The deemed Dutch resident taxpayer can, in the same way as an actual Dutch resident taxpayer, make a claim to avoid double taxation on any income that is taxable in the other country under the double tax treaties concluded by the Netherlands.

Annuity taxable in the Netherlands

Due to the termination of his employment from 1 January 1990, an employee received a severance payment. Part of the severance payment was an annuity benefit which was payable from 1 April 1998. At the end of 1993 the employee emigrated to the Netherlands Antilles and some time later the annuity was transferred to a Netherlands Antilles insurance company. In May 1994 the employee decided to buy out the annuity insurance.

The Dutch Supreme Court ruled that the amount received from the buy out of the annuity insurance was taxable in the Netherlands. As the benefit was not received periodically, but in one amount, the payment could not be regarded as a pension payment. Also, the amount did not qualify as an 'equal payment' as indicated in the Netherlands/ Netherlands Antilles double tax treaty. According to the Dutch Supreme Court, these are payments that provide the taxpayer an income from the date of the termination of the employment up to pensionable age. Facts specifically taken into consideration by the Court were that the annuity benefit would commence eight years after the employment agreement was terminated, that the benefit would continue to be paid after pensionable age, and that the employee already had a separate pension insurance.

Spain:

ECJ decisions on taxation of non-residents

Background

In July 2005 the European Commission sent Spain an official request to amend its tax legislation for non-residents, with regard to matters related to employment income and capital gains. As Spain has not changed its legislation despite the July 2005 formal request, the European Commission has referred Spain to the European Court of Justice (ECJ) over these two tax provisions.

Non-residents' employment income

Spanish tax legislation taxes the employment income of resident taxpayers at progressive rates ranging from 15 per cent to 45 per cent. However, the employment income of non-resident taxpayers is taxed at a 25 per cent flat tax rate.

As a consequence of this different tax treatment, low-income non-resident taxpayers are subject to a higher tax burden that low-income resident ones. This higher taxation of non-residents makes it less attractive for Spanish employers to recruit labour from other European member states than from Spain, which represents an obstacle to the free movement of workers in Europe.

Non-residents' capital gains

Spanish tax legislation taxes resident taxpayers on capital gains realised over a period of one year or less through progressive tax rates ranging from 15 per cent to 45 per cent. Where capital gains are realized over a period longer than one year, a flat tax rate of 15 per cent applies.

The Spanish legislation taxes the capital gains of non-resident taxpayers through a 35 per cent flat tax rate.

Therefore, after one year of ownership non-resident taxpayers are always subject to a higher tax burden than a resident taxpayer when they sell their property. Furthermore, in some cases where the property is sold within a year after acquisition, a non-resident may also be subject to a higher 35 per cent tax burden than a resident taxpayer's liability calculated at the progressive rates.

Recommendation

Since Spain has not amended its legislation and the outcome of the ECJ case is awaited, we recommend that non-resident taxpayers should pay their flat tax rate liability of 25 per cent (employment income) or 35 per cent (capital gains) and claim a tax refund if there is a favourable result in the ECJ.

This action will enable the taxpayer to avoid any penalty and at the same time, they will be eligible to receive a tax refund if the ECJ determines that the tax provisions are not in line with the European non-discrimination principle.

Where capital gains are realized over a period longer than one year, a flat tax rate of 15 per cent applies.

Sweden:

ECJ case on non-residents' share purchase

The ECJ has decided on 19 January 2006 in the case of Margaretha Bouanich v. Skatteverket (C-265/04) that the unequal treatment of non-resident shareholders, in the situation where a Swedish company repurchases its own shares, is incompatible with the European principle of free movement of capital. The previous comments of the ECJ in this case were covered in Expatriate News in January 2006.

The case between Margaretha Bouanich (a French national and shareholder in the listed Swedish company Ratos) and the Swedish Tax Agency concerns the question of the repayment of tax which was levied on the repurchase of the company's own shares (see Expatriate News January 2006).

The first question put before the ECJ was whether the different tax treatments of residents and non-residents on a payment relating to the repurchase of a company's own shares is compatible with EC Articles 56 and 58 for the free movement of capital within the community.

A payment to a Swedish-resident taxpayer in respect of a share repurchase is treated as a sale of the shares and taxed as a capital gain at 30 per cent, with the opportunity to deduct the acquisition cost of the repurchased shares in calculating the capital gain. However, a payment made to a non-resident on a share repurchase is regarded as a dividend according to Swedish national tax law. The tax rate for a dividend is also 30 per cent, but the share acquisition cost cannot be deducted from the payment to calculate the taxable amount.

The Swedish Government acknowledges that the Swedish legislation discriminates against non-resident taxpayers and they have announced a proposal to enable non-residents to deduct their share acquisition cost from the payment, so that the net amount is treated as the taxable dividend.

According to the ECJ, the current Swedish legislation is in breach of Articles 56 and 58 because it treats residents and non-residents differently.

The second question raised with the ECJ was to clarify whether the answer to the first, discrimination question would be different on the basis that the France/Sweden double taxation treaty limits the taxation of dividends for non-residents to 15 per cent a lower tax rate than the one for residents) and allows the deduction of the nominal share value amount from the payment for the repurchased shares.

The ECJ found that national legislation which derives from a tax treaty would only be compatible with the principle of the free movement of capital if the treatment of non-residents, as set out in the treaty, is at least as favourable as that of residents. However, it is up to each member state's national court to determine whether the treatment is less favourable to a particular non-resident or not.

UK:

Tax and social security contributions withholding arrangements

The UK tax law requires the employer to withhold income tax and social security contributions at source from the earnings of employees, under the Pay As You Earn (PAYE) system. These rules apply to the employer and anyone who acts as the employer's agent in making payments of earnings. In certain circumstances a UK-resident business, or the UK trading presence of a non-UK employer, is treated as the host employer for PAYE withholding, even where the legal employer is a different legal entity, is resident outside the UK and the UK business has no access to, or control over, the employee's earnings.

The UK Revenue allow a special modified PAYE arrangement to be used to pay over the income tax and social security contributions of tax equalised expatriates working in the UK. This arrangement can be operated by the employer, but is usually handled by the company tax adviser who deals with the individual expatriates' personal tax affairs. Changes to this PAYE arrangement come into effect from 6 April 2006 and are covered below.

Benefits of a modified PAYE arrangement

The arrangement enables the employer to settle the total income tax liability on the cash and non-cash earnings of all equalised employees (including the grossed-up tax payments) in a simple way. UK social security contributions can also be paid via a similar arrangement from 6 April 2006 for the first time. The employees must be fully equalised (apart from stock and share option gains and payments on termination of employment) to fall within these arrangements.

Process

At the start of each tax year, the employees' cash earnings are estimated and grossed up for tax purposes, to calculate the estimated amount of income tax payable under PAYE. Various deductions can be included in the calculation, such as relief for non-UK workdays and pension contributions. During the tax year, the calculation is adjusted when an employee arrives in, or

leaves, the UK. In addition, a re-calculation is undertaken between January and the end of the tax year on 5 April, so that the final tax paid under PAYE for the tax year reflects any taxable bonuses, share option gains or share awards.

The tax payments for all the expatriates in the arrangement are paid in one sum to the UK Revenue. Where an employer has five or less tax equalised employees in the UK, the estimated income tax is paid to the UK Revenue on a quarterly basis in July, October, and January in the tax year, with the final payment in April after the end of the tax year. If there are six or more equalised employees in the arrangement, the estimated income tax must be paid to the UK Revenue on a monthly basis.

The UK Revenue accepts that under the modified arrangement, the amount of tax paid during the year may vary significantly from the amount that would have been paid under normal PAYE procedures. Provided the employer follows the correct procedures, interest will not be charged on any additional tax liabilities shown by the equalised employees' tax returns. However, interest will apply to any part of the estimated tax which is not paid in the final payment at the end of the tax year.

Non-cash benefits are reported separately to the UK Revenue on an extended deadline of 31 January following the end of the tax year (normally benefits must be reported by 19 July following the end of the tax year). This extended deadline of 31 January is the same date as the filing date for the individual's personal tax return and also the date on which any outstanding tax liability must be paid. The extended deadline allows the employer and tax adviser a longer period to obtain full details of the employees' earnings, in particular of any payments and benefits outside the UK and the amount of the tax equalisation payments.

Social security contributions

Where an expatriate in the modified PAYE income tax arrangement is also liable to pay UK social security contributions, with effect from 6 April 2006 these contributions can be paid under a similar arrangement.

The social security contributions are paid at the same time as the estimated tax payments (either monthly or quarterly) and they are based on the estimated earnings used to calculate the income tax. After the end of the tax year, a final calculation is prepared to take account of differences in the calculation method for social security contributions (for example, the non-UK workday deduction is based on a 365-day year, but the income tax calculation is based on the individual's working year).

General

In entering into modified PAYE and social security agreement, the employer is agreeing to pay all UK liabilities to the UK Revenue. This includes any additional grossed-up tax and any additional social security contributions that arise when the final computations are prepared as part of the individual tax return preparation. Where the tax return reflects a tax repayment, this is authorised by the employee for direct payment by the UK Revenue to the employer. Therefore, the modified process assists company cash-flow and the employer's control over the tax equalisation process.

Important UK immigration changes

The UK Home Office has announced important changes in Immigration Rules, which will affect people applying for leave to remain, and indefinite leave to remain (or settlement). The changes will take effect from 3 April this year.

The changes, in summary, are:

- For all employment-related categories of entry to the UK, and those who have entered under the Ancestry category, the qualifying period for indefinite leave to remain (settlement) is now five years.
- The initial grant of leave to remain will now be two years (except for Work Permit holders and Retired Persons of Independent Means), followed by a subsequent period of up to three years. The rules previously allowed for an initial period of up to 12 months leave to be granted, followed by a subsequent period of up to three years.
- The UK ancestry provision has been changed to allow leave to be granted in a two and three year pattern, rather than allowing one single period up to the settlement qualifying period.
- Retired Persons of Independent Means will still be eligible for one single period of leave all the way up to the settlement qualifying period as before.
- Work Permit holders will still be eligible for an initial grant of leave up to the currency of their work permit.
- Highly Skilled Migrants will now be able to amalgamate continuous time spent in the UK as a work permit holder, Highly Skilled Migrant and / or an Innovator when applying for indefinite leave to remain as a Highly Skilled Migrant.

If there are six or more equalised employees in the arrangement, the estimated income tax must be paid to the UK Revenue on a monthly basis.

USA:

Filing season for 2005 tax returns

The IRS has launched the 2006 tax filing season with the issue of the 1040 packages for 2005 to taxpayers. The due date for filing the federal income tax returns for 2005 is 17 April 2006. However, it should be noted that the filing date for taxpayers living in states served by the Andover, Massachusetts Internal Revenue Service (IRS) service centre will be 18 April 2006.

2006 will be the first year in which extensions for additional time to file the income tax return will be an automatic six-month extension, instead of the four-month extension.

Changes to Individual Taxpayer Identification Number acceptance agent programme

IRS Procedure 2006-10 outlines the new rules and instructions for Individual Taxpayer Identification Number (ITIN) acceptance agents. These changes are part of the IRS effort to ensure that the ITIN's are used strictly for tax administration purposes. The primary purpose of an ITIN is to serve as a tax processing number for individuals who have a tax filing requirement, but are not eligible to obtain a social security number (SSN) from the US Social Security Administration. An IRS official, in a conversation with BDO Seidman LLP, noted that of the ten million ITIN's issued, only half were used for tax purposes.

The role of an acceptance agent is to facilitate the ITIN application process by forwarding the completed Form W-7 (together with the required documentary evidence) to the IRS at the address listed in the Form W-7 instructions.

Procedure 2006-10 introduces four new changes that apply to an agent:

- Acceptance agent applicants may be required to submit to a suitability check that includes an IRS review of the applicant's tax filing history, a credit history check, and an FBI background check.
- Acceptance agents will have to periodically reapply to retain their acceptance agent status. The acceptance agent agreement entered into after the publication of the new IRS procedure will expire on 31 December of the fourth full calendar year after the year in which the agreement takes effect.
- Existing agreements will expire on 31 December 2006, unless an application is submitted by the acceptance agent to retain the status.
- Acceptance agents may request inclusion on a public list of acceptance agents published by the IRS.

No changes have been made to the ITIN application process.

Tax Court disallows earned income exclusion for US citizen working in Antarctica

A US citizen's claim to exclude from his gross income the wages he earned while working in Antarctica for a company contracted with a US research agency was denied by the US Tax Court, on the basis that earnings in Antarctica did not qualify as foreign earned income from sources within a foreign country.

This judgment relied on a 1961 treaty between the United States and a number of other nations regarding Antarctica which is still in effect, and also on the precedent established in Martin v. Commissioner, 50 T.C. 59 (1968). The Antarctica treaty provides that Antarctica is to be used for peaceful purposes and that all questions of sovereignty over it are to be put in abeyance. As sovereignty cannot be established over it, Antarctica is not a foreign country for the purposes of the foreign earned income exclusion. The Tax Court also cited Section 863, which specifically sources income earned from activity conducted in Antarctica to the United States, if that activity was performed by a US person.

Tax Court disallows deduction for French pension plan contribution

The case of Isabelle Bichindaritz v. Commissioner of Internal Revenue (T.C. Memo 2005-298 dated 29 December 2005) involved a French citizen who was teaching at a US university. She claimed a deduction on her US tax return for a contribution to a French pension plan.

The taxpayer contended that the amount that was contributed to the French pension plan was properly deducted under the US/France double tax treaty and Section 219(a), as the plan generally corresponded to a Code Section 501(c)(18) trust. Section 219(a) provides that, in the case of an individual, an amount equal to the qualified retirement contributions of the individual for the taxable year shall be deductible. Section 501(c)(18) describes trusts that are exempt from taxation.

Article 18(2)(a) of the 1994 US/France tax treaty provides that, in computing US tax, contributions to a French retirement plan are generally treated as though they were paid to a pension or other retirement arrangement established and recognised for tax purposes in the US, if the competent authority of the United States agrees that the French plan generally corresponds to one recognised for tax purposes by the US.

The Tax Court denied this deduction on the basis that the French pension plan to which the contributions were made did not generally correspond to a trust as defined by Section 501(c)(18). The Court also held that the French Foreign Ministry publication which the petitioner cited as the basis for deductibility was superseded by the 1994 tax treaty.

The Tax Court may not in itself set a precedent. However, based on BDO Seidman LLP's interaction with the IRS on similar issues, the deduction of the contributions on the basis of the tax treaty will not apply unless the US has agreed that the pension scheme established in the taxpayer's home country generally corresponds to a pension scheme established in the US. Notes to some of the tax treaties provide that certain pension schemes have been determined to "generally correspond" to schemes in the other country. Where the individual is an employee, the relevant home plans are those which correspond to employer plans in the host country. There are also specific reporting requirements at the individual level which complete the process of claiming the deduction, and these may include disclosure on Form 1040NR and the submission of a written request to the employer to reduce the Federal income tax withholding under Internal Revenue Code Section 1441.

It is also important to bear in mind that even where the pension contributions are accepted as deductible for US federal tax purposes, certain US states, such as California, may not allow the deduction.

More information

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