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Expatriate News

This issue of Expatriate News begins by looking at the cost of employing labour in the various EU Member States and the income taxes that are imposed on employees' personal income. A case in the European Court of Justice has considered the discriminatory property purchase tax imposed in Hungary and the European Court of Human Rights has confirmed the general principles demonstrated by the United Kingdom's historic tax-allowance system. We conclude with news regarding the UK 2008 Finance Act and the US expatriation tax.





EUROPE

Tax trends in the European Union

The European Commission has issued its latest survey of the trends in European taxation. The statistics provide interesting reading both for employers, in terms of the true costs of labour, and for their internationally mobile employees. The survey also offers an insight into the global competitiveness of the EU Member States.

Tax proportion of Gross Domestic Product (GDP)

The weighted tax-to-GDP ratio (the percentage of the Gross Domestic Product that is absorbed by taxes and social security contributions) in the 27 countries that make up the European Union (the EU27) increased to 39.9% in 2006 (39.3% in 2005), which was the highest annual increase for ten years. The EU27 are Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Spain, Sweden and the United Kingdom.

In 2006, the overall tax ratio in the euro currency area was 40.5% (39.8% in 2005). In the ten years 1996 to 2006 taxes in the euro area have followed a similar trend to those in the EU27 as a whole, although at a slightly higher level. The euro area now comprises Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovenia, and Spain.

EU tax levels remain generally high in comparison with the rest of the world, in particular with those of the US and Japan. However, the 2006 tax burden

varied significantly between the EU Member States, ranging from less than 30% in Romania (28.6%), Slovakia (29.3%) and Lithuania (29.7%), to almost 50% in Denmark (49.1%) and Sweden (48.9%). The largest falls in the tax-to-GDP ratio were recorded in Slovakia (where the overall tax burden dropped from 39.4% in 1996 to 29.3% in 2006) and in Estonia (reduced from 35.1% to 31.0% over the same period). The highest increases were in Cyprus (an increase from 26.4% to 36.6%) and in Malta (an increase from 25.4% to 33.8%).

Labour taxes

Labour taxes remain the largest source of tax revenue in the European Union and they represent almost half of the total tax receipts in the EU27. In fact, for the EU27 as a whole, the average implicit tax rate (ITR) on labour was 34.8% in 2006, compared with 34.6% in 2005. The ITR is the ratio between the taxes and social contributions that are paid on earned income and the cost of labour. It includes all direct and indirect taxes, together with the employer and employee social contributions on employment income. The cost of labour is the total earnings of employees working in the relevant country (including any wage and payroll taxes).

There was a general reduction in labour taxes in the period 2000 to 2004. This reduction ceased in 2005, although the tax burden is still lower than in 2000. Despite the presence of a number of low-tax countries, on average the tax on labour is much higher in the European Union than in the other main industrial economies. The average implicit tax rate on labour in the 27 EU countries is compared in the following table.

EU27 Implicit Tax Rate on Labour (%)

Country	1996	2005	2006
Austria	39.5	41.0	41.2
Belgium	43.4	43.9	42.8
Bulgaria	-	34.7	30.9
Cyprus	22.3	24.5	24.2
Czech Republic	39.5	41.7	41.0
Denmark	40.2	37.5	37.0
Estonia	39.1	34.1	33.9
Finland	45.3	41.5	41.5
France	41.5	41.7	42.1
Germany	39.6	38.6	39.6
Greece	35.7	37.8	38.1
Hungary	43.1	37.8	39.0
Ireland	29.3	25.1	25.1
Italy	41.5	42.8	43.0
Latvia	34.6	33.2	33.5
Lithuania	35.0	34.9	34.1
Luxembourg	29.6	30.0	29.6
Malta	17.8	21.9	21.5
Netherlands	33.3	30.5	33.5
Poland	36.3	33.1	34.4
Portugal	26.5	28.4	28.5
Romania	-	29.1	-
Slovenia	37.1	37.5	37.6
Slovakia	39.4	32.9	30.3
Spain	29.5	30.6	31.6
Sweden	48.0	44.7	44.5
UK	24.8	25.3	25.5

**Personal taxes**

The top personal income-tax rate differs substantially within the European Union, but in general the top personal income-tax rates are lower in the new Member States. The top personal income-tax rate is the tax rate for the highest income bracket. In Denmark, Finland and Sweden it includes the county and/or communal income tax, in Germany it includes the solidarity surcharge, and in Hungary it includes the solidarity tax.

The highest top tax rates in 2007 on personal income were in Denmark (59.0%), Sweden (56.6%), the Netherlands (52.0%) and Finland (50.5%). The lowest were in Romania (16.0%), Slovakia (19.0%), Estonia (22.0%) and Bulgaria (24.0%).

Top personal income tax rates 2007

Country	Austria	Belgium	Bulgaria	Cyprus	Czech Republic	Denmark
Rate (%)	50.0	50.0	24.0	30.0	32.0	59.0
Estonia	Finland	France	Germany	Greece	Hungary	Ireland
22.0	50.5	40.0	47.5	40.0	40.0	41.0
Italy	Latvia	Lithuania	Luxembourg	Malta	Netherlands	Poland
43.0	25.0	27.0	39.0	35.0	52.0	40.0
Portugal	Romania	Slovenia	Slovakia	Spain	Sweden	UK
42.0	16.0	41.0	19.0	43.0	56.6	40.0

HUNGARY: PURCHASE OF RESIDENTIAL PROPERTY

The European Commission (EC) has issued a formal request to Hungary to change its fiscal provisions in relation to the duty charged on the purchase of property (Case number 2007/40160).

Hungarian law provides that a person who buys a house in Hungary must pay a duty (*visszterhes vagyonátruházási illeték*), which is calculated as a percentage of the value of the property. If the property will be the taxpayer's home and the purchase is either preceded, or followed, by the sale of the individual's previous home in Hungary, the duty only applies where the value of the property being acquired exceeds the value of the previous one that is sold. In addition, the duty is only charged as a percentage of the difference in the two values.

On the other hand, if the purchase of an individual's home in Hungary is preceded or followed by the sale of that individual's previous home in another EU Member State, the duty is calculated as a percentage of the whole value of the new property, regardless of the value of the individual's previous home.

The effect of the legislation is that people who relocate their homes to Hungary and sell their homes in other Member States are treated in a less favourable way than Hungarian residents who change their home within Hungary. The European Commission considers that the situation of such inbound individuals is similar to the situation of Hungarian residents, because the duty that the inbound individuals pay on purchasing a property in Hungary is broadly charged on a comparable basis to the duty paid by Hungarian residents who buy a property abroad.

The Commission has indicated that it considers that the Hungarian rules pose a restriction on the right of every citizen of the European Union to move and reside freely within the territory of the Member States, as set out in Article 18 of the EC Treaty. More specifically, the legislation infringes the right of free movement of workers within the European Community (EC Treaty Article 39) and the principle of freedom of establishment (Article 43).

The Commission's view is that the Hungarian provisions discriminate against taxpayers whose purchase is preceded, or followed by, the sale of their previous home in another Member State. This being so, these rules are incompatible with the free movement of persons and the freedom of establishment, as guaranteed by Articles 18, 39 and 43 of the EC Treaty and the corresponding articles of the EEA Agreement. The Commission's request to Hungary takes the form of a Reasoned Opinion, which is the second step of the infringement procedure set out in Article 226 of the EC Treaty. If a satisfactory response to the Reasoned Opinion is not received within two months, the Commission may decide to refer the matter to the European Court of Justice (ECJ)



UNITED KINGDOM

Discrimination in tax allowances

The European Court of Human Rights has heard a case (*Hobbs and others v United Kingdom*) that was referred to it from the UK House of Lords and which related to the historic differing UK tax allowance positions of female widows and male widowers.

The decision in the case confirmed some important principles regarding the extent to which European law permits EU Member States to discriminate in their domestic legislation.

The UK legislation provided a widow's bereavement allowance (WBA) up to 5 April 2000. No WBA was given to widowers, but for certain years they continued to receive the full married man's allowance for the year of their wife's death. In certain circumstances, a wife could share the married man's allowance with her husband and the WBA was originally intended to compensate women for the financial impact of the loss of the married man's allowance on their husband's death.

The applicants in the case were widowers who had claimed entitlement to the WBA and who had lost their case in the UK Courts. They had claimed that the UK Parliament had not respected their rights under the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950 (as set out in the Human Rights Act 1998), because it had not abolished the allowance for widows. They also felt that they should be treated in the same way as widows.

The Court confirmed that the Convention does not prohibit Member States from treating different groups

in a different way, in order to correct inequalities between them. A difference in treatment was only discriminatory if it had no objective and reasonable justification. It was held that although the WBA was intended to rectify an inequality which was produced by the UK legislation up to the tax year 1992/93, in the period up to the abolition of the allowance on 6 April 2000 the different treatment that it produced in relation to men and women was not reasonably and objectively justified. Therefore, the Court agreed that the UK had violated the individuals' rights under Article 14 of the European Human Rights Convention.

However, no compensation was awarded to the applicants. This was because the WBA was an anomalous feature of a tax system that had effectively ceased to exist on the introduction of independent taxation in the UK with effect from the tax year 1990-91, and which had not only favoured widows over widowers, but also over other groups of taxpayers.

Statutory residence test

The 2008 Finance Act introduces new rules that set out which UK days are counted when determining whether an individual is resident for tax purposes. However, the UK authorities (HMRC) continue to decide the individual's UK residence and ordinary-residence status on the basis of a number of factual and subjective tests (including the number of days spent in the UK in the tax year or during a longer period), which have evolved from the decisions in various tax cases.

During the debates on the 2008 Finance Bill, the topic of a statutory residence test was discussed. In particular, it was suggested that a factual residence test should be introduced for foreign nationals, which would to some extent mirror the US substantial-presence test. The proposal was that a non-UK domiciled individual would be UK-resident if he or she spent more than 31 days in the United Kingdom in the current tax year and the UK days in the current year, plus one-third of the days in the previous year, plus one-sixth of the days in the year before that, total 183 days or more.

It was also suggested that certain UK days should be ignored for the purposes of this test, including arrival and departure days, in-transit periods of less than 24 hours, the UK days of crew employed on foreign ships, periods of full-time higher education, and days on which a medical condition prevents the individual from leaving the United Kingdom. Foreign individuals who were UK-resident under this test would be taxed in the United Kingdom on all of their UK income and capital gains, together with any foreign income and gains remitted to the United Kingdom.

As a response to these proposals, the UK government has confirmed that it is willing to introduce a statutory test in 2009 for non-domiciled individuals. This would have the advantage of providing foreign nationals who live or work in the United Kingdom with more certainty regarding their residence status. The UK Chartered Institute of Taxation (CIOT) is now working with legal and tax professionals to develop the details of the test. It appears likely that further details will be released later in the year as part of the 2008 pre-Budget Report and that the test could

take effect from 6 April 2009 (UK tax years 2008-09 onwards).

Share-based incentives

Where an individual comes to work in the United Kingdom for a period of two or more years and the date of the individual's UK arrival or departure is part-way through the UK tax year (which ends on 5 April), the UK tax year is split into a period of UK residence and one of non-residence under a published HMRC Extra-Statutory Concession (ESC A11).

Gains on employment-related securities or securities options may accrue to an individual in respect of the non-resident part of the UK tax year. The guidance issued by HMRC has for many years indicated that the split-year concession does not apply in the year of the individual's departure to the legislation that charges to tax securities acquired at an undervalue (the notional-loan tax charge). However, the situation has been less clear in regard to the UK tax year of arrival and in relation to the other UK tax charges on securities and options.

Changes to the legislation and the concession are likely to mean that in the future securities and options will be within the UK tax charge if they are awarded at any time in a tax year in which the individual is UK-resident. In the meantime, HMRC has accepted that some employers, taxpayers and their advisers may not have been aware of its view that the split-year concession does not apply to securities income in the year of arrival.

As a result, where the individual's liability has not been settled (and until a statutory basis is introduced), HMRC will accept that the concession applies in the year of arrival. In addition, HMRC will also accept that the concession applies on the same basis to the year of departure (other than in the case of the notional-loan tax charge).

However, it should be noted that liabilities for earlier tax years which have been settled will not be reopened, irrespective of whether the concession has been applied to the employment-related securities gains or not. HMRC has also indicated that it reserves the right to depart from this position in cases of tax avoidance.

EEA & Switzerland social security contributions (research & development staff)

In certain circumstances the UK legislation provides a deduction from the business profits of certain small and medium-sized enterprises for staffing costs associated with research and development. In the past,

staffing costs have included salaries, non-cash benefits, pension contributions, and the UK social security contributions paid by the employer on the employees' earnings (national insurance contributions or NICs).

The 2008 Finance Act includes a new provision that will extend this deduction to cover the employer's compulsory contributions paid under the social security legislation of another EEA State or Switzerland in respect of directors or employees of the company. Social security legislation, for this purpose, means legislation relating to any of the branches of social security listed in Article 3(1) of EC Regulation 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (as amended from time to time).

This deduction should be particularly helpful in the situation where an employee is assigned from elsewhere in the EEA or from Switzerland to work on a UK research or development project, and who remains, under the EC social security regulations for under his or her home-country social security system during the assignment.

UNITED STATES

Expatriation tax

US taxpayers who are considering giving up US citizenship or their long-term permanent resident status might now need to think twice. New legislation was recently signed (passed by the US Congress on 22 May), which brings dramatic changes to the US expatriation regime, with the imposition of a new mark-to-market tax rule with effect from 17 June 2008.

The new rule will not only affect wealthy US taxpayers, but also certain employees. The new mark-to-market tax, which is imposed by the Heroes Earnings Assistance and Relief Tax Act 2008 will impose a US tax charge on the expatriating individual's net unrealised gain on his or her worldwide assets. Broadly, the individual's assets are deemed to be sold for their market value on the day before the date of US expatriation.

Although certain exceptions apply, expatriates who will be subject to this tax (known as 'covered expatriates') will generally include individuals with a net worth of USD 2 000 000 or more on the date of their expatriation and individuals who are not in compliance with their recent US tax obligations.

Covered expatriates will be subject to US tax to the extent that any unrealised gain exceeds USD 600 000 (this limit will be indexed for post-2008 inflation). It should be noted that gifts and bequests made to US persons may also be affected.

The new rules apply from the date of expatriation, unlike the tax rules and filing requirements, which previously applied to a ten-year post-expatriation period.

Employers need to be aware that certain deferred earnings, such as bonuses, stock options, restricted stock units, and pension rights, may be subject to a new US flat-rate 30% withholding tax (instead of the mark-to-market tax) if these earnings are paid after the date of the employee's expatriation.



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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