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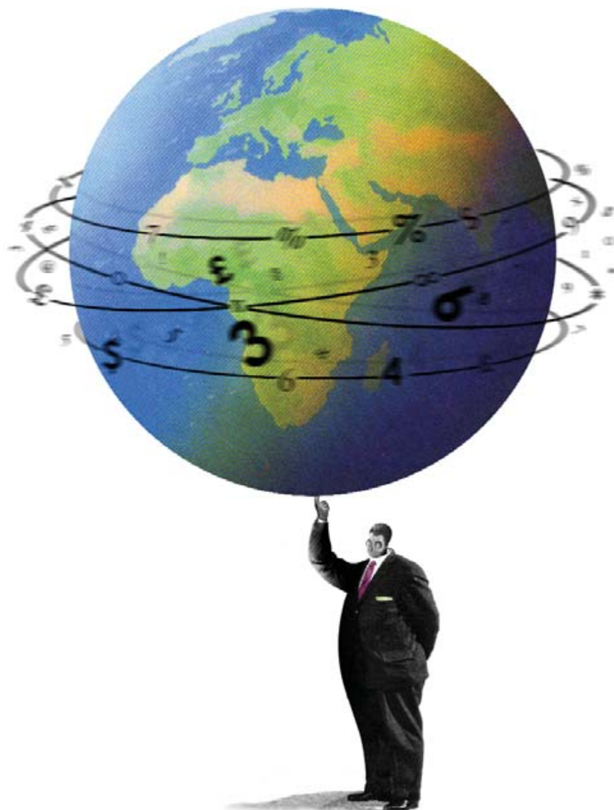
Expatriate News

This issue of Expatriate News captures several topical updates for expatriates following changes in a number of countries. Highlights include full details of the UK budget changes for 2006/07 and the new UK pensions rules for expatriates, in force from April 2006. Expatriate News also looks at the changes to US tax withholdings and the 2006 exclusions for US citizens and green card holders.

Other updates include the Italian filing deadlines for 2006 and, in Immigration, changes to the Working Holiday Visa in Australia and EEA family permits.



ITALY:

Italian tax filing deadlines for 2006

There are numerous tax filing deadlines provided by Italian law. As a general principle, the filing and tax payment deadline depends on the types of income earned by the taxpayer.

Form 730

This tax form must be filed by tax resident individuals who have employment income which is paid by an Italian withholding tax agent, income which is considered to be employment income, income derived from land and buildings, capital income, self-employment income not requiring VAT registration, certain forms of income subject to separate taxation and other specific income.

A taxpayer required to file form 730 must be aware of two filing deadlines:

30 April: If the taxpayer's employer has communicated to the tax authorities that it intends to offer professional tax assistance to its employees, in principle the taxpayer may file the return by 30 April following the end of the tax (calendar) year. As 30 April fell on a Sunday in 2006 and Monday 1 May was a public holiday in Italy, the deadline was extended to the next business day, Tuesday 2 May 2006.

15 June: As an alternative to the 30 April deadline, the tax payer may file form 730 by 15 June through a Centro Assistenza Fiscale, or through a professional who is qualified to provide tax assistance.

UNICO 2006 PF

Where the taxpayer is not required to file form 730, or the deadlines above are missed, the appropriate form to file is UNICO 2006 PF. There are two deadlines associated with this form:

31 July: The form UNICO 2006 PF may be filed at the post office or a bank.

31 October: Where the taxpayer is required to file the form electronically, or chooses to have their return filed by a tax professional who is required to file electronically, the deadline for form UNICO 2006 PF is 31 October.

Tax payment deadlines

If form 730 is filed, the employee's income tax liability on earnings will have been withheld by the employer. Any other income tax which is due to be paid is normally collected through payroll, usually in July following the end of the tax year.

Any tax liability resulting from form UNICO 2006 PF must be paid by 20 June following the end of the tax year. This deadline can be extended to 20 July by the payment of interest at 0.4 per cent. After 20 July, any unpaid tax is subject to higher levels of interest and penalties.

Payments on account

If the amount of tax which is due because certain forms of income were not subject to withholding exceeds € 51.65 for 2006, payments on account must be made for the current year. These payment on account must amount to at least 99 per cent of the tax liability. 40 per cent of the liability must be paid by 20 June (or 20 July with interest of 0.4 per cent) and the remaining 60 per cent must be paid by 30 November in the current tax year.

SWEDEN:

Recruitment incentives for sole proprietorships

A law proposal (proposal 2005/06:164) to introduce incentives to facilitate the hiring of employees by sole proprietorships was submitted to the Swedish parliament on 17 March 2006.

If the proposal is approved, sole proprietorships who employ one individual will be granted reduced social security contributions rates. The standard social security contribution rate for 2006 is 32.28 per cent. However, under the proposals sole proprietorships will only be obliged to pay the retirement pension insurance contribution (ålderspensionsavgift) of 10.21 per cent.

The new rules will apply to one-man businesses (enskild näringsvrerksamhet) and to limited liability companies (aktiebolag) with either no employees, or with only one employee who is a shareholder or related to a shareholder. It should be noted that partnerships (handelsbolag) with only two partners and no employees are considered to be sole proprietorships. However, according to the proposals, the new law will not cover fishing, farming or transportation businesses.

The proposed reduction in the social security contributions rate would apply for a maximum of 12 months. It would apply to remuneration paid as salary that does not exceed SEK 25,000 per month, provided that the employment lasts for at least three months with a minimum of 20 working hours per week.

If approved, the new law will enter into force on 1 June 2006. The rules will apply retrospectively to employment contracts entered into with effect from 1 January 2006, but the social security contributions rate reduction will only apply to remuneration which is paid between 1 June 2006 and 31 December 2007.

UK:

2006/07 Budget Changes

The UK Budget announcement in March and the 2006 Finance Bill include the following changes.

Personal Tax Allowances

The personal tax allowances have been increased for 2006/07 (year to 5 April 2007) as follows.

	2005/06 £	2006/07 £
Personal allowance	4,895	5,035
Age-related personal allowance – persons aged 65 – 74 – persons aged 75 and over	 7,090 7,220	 7,280 7,420
Married couple's allowance – either spouse born before 6.4.1936 – either spouse aged 75 or over	 5,905* 5,975*	 6,065* 6,135*
Blind person's allowance	1,610	1,660
Income limit for age-related allowances	19,500	20,100

*Relief restricted to 10 per cent.

Income Tax Rates

The bands of income to which the tax rates apply have been widened for 2006/07. The 20 per cent tax rate applies to savings income other than share dividends (to which the 10 per cent tax rate applies up to £33,300 and the excess is taxed at 32.5 per cent).

Rate of tax	2005/06 Taxable income (£)	2006/07 Taxable income (£)
Lower (10%)	2,090	2,150
Savings (20%)	2,091 – 32,400	2,151 – 33,300
Basic (22%)	2,091 – 32,400	2,151 – 33,300
Higher (40%)	Over 32,400	Over 33,300

Social Security Contributions

The National Insurance Contributions (NICs) annual lower earnings limit (below which no NICS are payable) was increased to £5,035 for 2006/07 and the annual upper earnings limit for employee contributions was increased to £33,540.

Therefore, employees pay 11 per cent on their annual earnings between £5,035 and £33,540 and they also pay 1 per cent NICs on their earnings in excess of £33,540 (with no maximum amount).

Employer contributions for 2006/07 are paid at the rate of 12.8 per cent on all the employee's cash and non-cash earnings in excess of the £5,035 lower earnings limit.

Pensions

The new UK system of registered pension schemes came into effect from 6 April 2006 and the 2006 Finance Bill includes certain measures which are covered in the separate article below.

Company cars

The level of carbon dioxide (CO2) emissions which qualifies a petrol-driven company car for the lowest benefit in kind has been frozen for 2006/07 at the 2005/06 level of 140g/km. A new lower benefit for company cars with a CO2 emissions rate of 120g/km or less will be introduced for 2008/09.

Employer-provided computers and mobile phones

The 2006 Finance Bill includes legislation which, from 6 April 2006, will remove the exemption which applies to the first £500 of the benefit of the private use of an employer-provided computer. However, the first £500 of benefit from computer equipment which was first provided to the employee before 6 April 2006 will continue to be exempt.

The number of tax and NICs-free mobile phones which can be provided by the employer for the tax years 2006/07 onwards will be limited to one mobile phone for each employee. Therefore, the tax and NICs exemption for an employee's mobile phone will not apply to the members of the employee's family or household, where such individuals are first provided with a mobile phone after 5 April 2006.

VDU users

The list of exempt benefits in kind is extended from 6 April 2006 to include the benefit of a Visual Display Unit (VDU) user's eye and eyesight test and any necessary corrective eye appliances.

Employment-related securities

New rules in the Finance Bill will affect employers and employees involved in planning to avoid tax and NICs through options over shares and securities. In particular, rights over shares under arrangements which have the main purpose of avoiding tax or NICs will fall within anti-avoidance rules which have retrospective effect from 2 December 2004.

Where an employer is treated as making a payment which falls within the anti-avoidance rules which take effect from 2 December 2004, that employer is liable to deduct income tax under the UK Pay As You Earn (PAYE) system and also to account for NICs. This income tax and NICc must be paid by the date that the new rules become law, or interest charges and penalties may arise.

In addition, the corporate tax rules will be revised to ensure that the tax deduction obtained by the employer for options granted under UK Revenue-approved Enterprise Management Incentive (EMI) option plans is no less beneficial than the tax deduction for options which are taxed in full as employment income.

International tax enforcement

The UK will be able, with effect from the date that the Finance Bill becomes law, to enter into bilateral or multilateral arrangements to exchange information in relation to direct and indirect taxes. The UK Revenue will be able to exchange information with all of the UK's tax treaty partners and enter into agreements which include mutual assistance provisions for tax collection.

Expatriate pensions from April 2006

A new system of registered company and private pensions came into effect in the UK on 6 April 2006 and the changes have significant effects on both UK inbound and outbound expatriate employees.

The new rules allow employees to make annual pension contributions of the greater of £3,600 or the amount of their UK-taxable earnings, up to a maximum of £215,000 for 2006/07.

On the introduction of the new pension rules, transitional relief continues to be given for contributions paid in any tax year after 2005/2006, if corresponding relief was received on contributions made to that plan in the year ended 5 April 2006.

UK inbound expatriates

Prior to 5 April 2006 a non-UK domiciled employee working in the UK for a non-UK employer could normally obtain UK tax approval for a non-UK pension plan which was broadly comparable ('corresponding') to a UK approved pension plan. The employee could join the non-UK plan either before or after UK arrival and it was not necessary to be UK-resident to obtain tax relief for the employee's contributions.

On the introduction of the new pension rules, transitional relief continues to be given for contributions paid in any tax year after 2005/2006, if corresponding relief was received on contributions made to that plan in the year ended 5 April 2006. In addition, transitional relief applies where there is a block transfer of employees from the non-UK pension plan to which contributions were made in 2005/2006, to the new non-UK plan to which contributions are made at any time after 5 April 2006. The new scheme must correspond to a UK registered pension scheme and there must be no unacceptable change to the plan rules. This enables UK tax relief to continue where employees are required to transfer to a new non-UK pension plan because of a company take-over or reorganisation.

Migrant member pensions

New migrant member tax relief applies to certain contributions to non-UK pension plans after 5 April 2006, where the employee comes to the UK as an existing member of a non-UK plan. The rules are more flexible in some ways than the previous corresponding relief rules, in particular:

(a) There is no requirement that the employee must be non-domiciled in the UK and employed by an employer resident outside the UK and not resident in the UK.

Instead, the individual must have joined the non-UK pension plan when non-resident in the UK, and must be UK-resident and in receipt of UK-taxable earnings when the pension contributions are made. In addition, at some time in the 10 years before the beginning of the period of UK residence (whether before or after 6 April 2006), the individual must have been entitled to tax relief for contributions under the law of the country or territory in which he or she was then resident.

(b) Previously, a non-UK plan had to be established in a country in which the employee was either working or resident immediately before coming to the UK, or in a country in which the employer has an operating presence. Plans in third countries were only allowed where they covered all of the expatriate employees of a multi-national organisation.

The new rules from 6 April 2006 impose no restrictions on where the plan is established. Instead, it must be regulated as a pension plan in the country in which it is established, or established in an EC member State, Norway, Iceland or Liechtenstein. The manager of the scheme must undertake to provide certain specified information in respect of the individual plan members.

Therefore, from 6 April 2006 employees who transfer to the UK as existing members of a non-UK pension plan can normally continue to participate in it when UK-resident without incurring a tax charge on the employer's contributions and they can also claim UK income tax relief on their own contributions (within certain limits).

However, UK tax relief is not available for certain non-UK plans set up after the individual has become UK-resident. This is intended to prevent the use of pension plans for tax planning purposes, rather than the provision of genuine retirement benefits.

Non-residents

If an employee working in the UK is not UK-resident, no UK tax relief is available for contributions to a non-UK pension plan (regardless of the fact that the individual's earnings for their UK duties are taxable in the UK). This means that the non-resident employee could only obtain UK tax relief by joining a UK-based registered pension plan.

Therefore, the new rules impose a significant restriction on non-residents which was not present under the corresponding relief rules up to 5 April 2006. These employees will obtain no UK tax relief for their non-UK pension contributions and they will also be subject to UK income tax (and in some cases UK social security contributions) on their employer's ongoing contributions to the non-UK pension plan. In many cases, the employer will bear these additional costs under the company tax equalisation policy.

By 31 January following the end of the tax year in which a pension benefit occurs, the manager must provide the Revenue with the name and address of the relevant migrant member and of the date, amount and nature of the benefit.

Migrant member procedures

In order to be a qualifying overseas pension plan for migrant member relief, the non-UK plan must either be subject to specific regulation, or be established in an EC member State, Norway, Iceland or Liechtenstein.

The scheme manager must notify the UK Revenue that it is a non-UK pension plan and undertake to notify the Revenue if it ceases to be a non-UK pension plan. By 31 January following the end of the tax year in which a pension benefit occurs, the manager must provide the Revenue with the name and address of the relevant migrant member and of the date, amount and nature of the benefit.

If documentation is required, the UK Revenue will normally ask for a copy of the letter of tax approval (or similar letter) from the non-UK tax authority. If the country in which the scheme is established does not have a system of tax approval, a letter from the tax authority is required confirming that the scheme is resident there, or alternatively a copy of the plan rules may be requested.

The details of qualifying non-UK plans are held by the UK Revenue on a database which is accessible to the Revenue Expatriate Teams. This enables the team members to check the database as part of their work in examining the individual expatriates' UK tax returns.

UK outbound expatriates

Individuals who are assigned to work outside the UK can normally remain in their employer's company pension plan for many years, providing they intend to return to the UK. In addition, in certain situations an individual working outside the UK can participate in a UK personal pension and receive UK income tax relief. Minor changes have been made to these rules on the introduction of registered pension plans from 6 April 2006.

Individuals who can have a personal pension

In order to obtain tax relief on contributions into a UK personal pension plan, from 6 April 2006 the plan must be set up when the individual is UK-resident. In addition, the individual must either have UK-taxable earnings in the year in which the contributions are paid, or meet one of the following conditions:

(a) The individual is resident in the UK in the tax year in which the pension contributions are paid or;

(b) The individual was UK-resident at some time in the five years preceding the UK tax year in which the contributions are paid.

Non-residents

Where an individual is resident in the UK at the time that a personal pension is set up, limited contributions can be made into the plan for up to five tax years of non-residence and receive income tax relief.

Basic rate income tax relief at source (currently at 22 per cent) applies where the pension contributions are either paid direct to the pension provider, or where they are paid to the employer's UK registered pension scheme and the employer operates the tax relief at source system.

Non-residents who have UK-taxable earnings can currently obtain basic rate tax relief in this way for annual contributions of the greater of £3,600 and the amount of those UK-taxable earnings, up to an overall maximum of £215,000. Non-residents with no UK-taxable earnings can receive income tax relief at source on contributions of up to £3,600.

If a non-resident individual pays UK income tax at the higher rate of 40 per cent on earnings for UK duties, the additional tax relief in excess of the 22 per cent rate can either be given in the Pay As You Earn (PAYE) withholding tax code which is operated through the employer's payroll, or in the employee's self-assessment tax return.

Employer contributions from 6 April 2006

There is no specific limit on the employer's contributions paid to pension plans after 5 April 2006 which are deductible by the employer in computing his profits for UK tax purposes. Instead, the contributions must meet the test of being wholly and exclusively for the purposes of the employer's business (so that unreasonable and excessive contributions may be disallowed).

USA:

Tax withholding on payments to foreign persons

The US Treasury Department and Internal Revenue Service (IRS) have issued final regulations with guidance for tax withholding on payments to foreign persons under the applicable of the US Internal Revenue Code (IRC). The regulations address withholding requirements under IRC §§ 1441-1442, requirements governing collection, deposits, refunds and credits under IRC §§ 1461-1463, return requirements under IRC § 6049, and the requirement for taxpayers to report treaty-based return positions under IRC § 6114.

The final regulations adopt, with modifications, the proposed regulations issued on these topics on 30 March 2005. The modifications in the final regulations relate to two areas:

(a) The circumstances and effective date for a waiver of the requirement under the IRC § 1441 regulations to provide a US taxpayer identification number (TIN) in the case of payments to certain foreign grantor trusts.

(b) The circumstances in which an exception or waiver will apply to the requirement for taxpayers to report treaty-based return positions under the IRC § 6114 regulations.

Modification of Exclusions for US Citizens/Green Card Holders Living Abroad

In the House/Senate Conference Report to the 'Tax Increase Prevention and Reconciliation Act of 2005,' passed by Congress on May 11, 2006, and expected to be soon signed by the President, amendments were made that have the effect of increasing the amount of U.S. tax paid by U.S. citizens/green card holders living abroad.

There are two exclusions currently available to U.S. citizens and residents living abroad. The first is the Foreign Earned Income (FEI) Exclusion, whereby such taxpayers may exclude up to $80,000 (subject to limitations) of foreign earned income from their U.S. tax returns, provided certain facts and time tests are met.The second exclusion is the Housing Exclusion, which allows those taxpayers who qualify to exclude from their foreign earned income the cost of their foreign housing (eg rent, utilities) in excess of a certain threshold amount. The only upper limit to this second exclusion is the amount of foreign earned income.

The new legislation provides for taxable years beginning after December 31, 2005:

a) that the $80,000 FEI Exclusion limitation is to be adjusted for inflation commencing in 2006 (instead of beginning in 2008, as previously enacted). For 2006, the inflation adjusted amount will be $82,400;

b) a higher threshold over which housing costs are eligible for exclusion equal to 16 per cent of the FEI exclusion limitation (for 2006, this amount will be $82,400 x 16 per cent = $13,184);

c) an upper limit on the Housing Exclusion equal to 30 per cent (or a different per cent prescribed by the Treasury Department based on geographical differences in housing costs relative to housing costs in the United States) of the amount of the FEI Exclusion limitation (for 2006, this amount will be $82,400 x 30 per cent = $24,720); and

d) that the total of the FEI and Housing Exclusions is to be added back to income for determining the graduated tax rates applicable to all non-excluded income (ie the exclusions will no longer apply to reduce the taxpayer's average tax rate on all other income).

Example: To illustrate the effect of the Act on the Housing Exclusion, assume a U.S. citizen or green card holder taxpayer living abroad had foreign housing costs of $100,000 and foreign earned income in excess of that amount in 2005 and will have the same in 2006. For 2005, the taxpayer's Housing Exclusion is $88,106 ($100,000 less the threshold of $11,894 for 2005). For 2006, the taxpayer's Housing Exclusion will be $11,536 ($24,720 minus $13,184)).

Observations: The Act increases the U.S. taxes of U.S. citizens and green card holders living abroad. If affected taxpayers are tax equalized by their employers, the additional cost will be borne by the employers and increase their cost of assignments. Taxpayers located in countries with low foreign tax rates and high housing costs will be most affected. Usually, if the Housing Exclusion is reduced, taxpayers can still obtain some double tax relief through foreign tax credits, but if affected taxpayers are in a low or no-tax foreign country, then the exclusions are of greater significance. The countries where taxpayers are likely to be most impacted by these changes are those in the Middle East and in Asia, due to their low or no tax environments and relatively high cost of housing.

IRS to Increase Audit Activity

In a related development, the IRS announced a new audit initiative to increase the number of audits of nonresident aliens and expatriates living abroad to 10,000 for 2006.The IRS is hiring 100 additional staff to cope with the increased number of filers claiming residency tax breaks and foreign tax credits, among other international transactions.

AUSTRALIA:

Australia has a working holiday maker (WHM) programme that allows foreign visitors to earn money while temporarily travelling in Australia. Persons qualifying for this type of visa may also study in Australia for a short time.

Under a bill submitted this month, the program will be altered to expand these opportunities. Young people will now be able to stay longer with one employer and study an extra month while they are in Australia.

Under the previous working holiday makers, people could work for three months with one employer, but that will now be extended to allow work for the same employer for an extra three months (six months total). WHM holders will further be allowed to study in Australia for four months instead of the current three months.

The logic behind the proposed changes are for Australian employers to retain trained staff for longer periods of time to recoup their investment. Working holiday makers now have the opportunity to apply for jobs that require a stay of longer than three months.

Changes to the study time allowed under the scheme will have additional benefits. Working holiday makers who are evaluating full-time work or study in Australia, such as nurses wanting to qualify under Australian law, can now use this programme as an entry vehicle.

FINLAND:

Finland/Switzerland tax treaty

On 19 April 2006, Finland and Switzerland signed a protocol to amend the income and capital tax treaty of 16 December 1991. Among other changes, Article 23 was amended by eliminating the current Paragraph 1(c), which concerns the Finnish three-year rule, that is, the extension of residence of Finnish expatriates for tax purposes.

The content of the Paragraph is as follows:

'Notwithstanding any other provision of this Agreement, an individual who is a resident of Switzerland and under Finnish taxation law with respect to the Finnish taxes referred to in Article 2 also is regarded as resident in Finland may be taxed in Finland. However, Finland shall allow any Swiss tax paid on the income or the capital as a deduction from Finnish tax in accordance with the provisions of sub-paragraph a). The provisions of this sub-paragraph shall apply only to nationals of Finland and for a period not exceeding three years from the end of the year in which such person left Finland.'

The elimination of this paragraph may at first glance appear very significant, but in practice it does not change the situation greatly. The three-year rule has been rare in Finnish tax treaties, and hence the Finland/Switzerland treaty has been exceptional. This tax treaty, like other tax treaties, still includes rules (in Article 4) to deal with residence situations and dual residence conflict and Article 11 of the Finnish domestic Income Act still stipulates the three-year rule. Hence, the elimination of the rule in the treaty does not in practice limit Finland's right to tax its citizens after their move from Finland.

The Finnish Government will present a Bill concerning the amendment of the tax treaty to Parliament in summer 2006 and the amendment will take effect from 1 January 2007.

CHANGES TO EEA FAMILY PERMITS

On 30 April 2006, the new EU Free Movement of Persons Directive (FMOP) came into effect. The Directive has been enacted into UK law by the Immigration (European Economic Area) Regulations 2006. This means some changes in the way that applications for EEA family permits are now being dealt with.

The main changes are listed below:

1. Family members – Civil partners can now qualify for EEA family permits
2. Extended family members - new rights/restrictions including:
   - **Durable relationships** (equivalent to 'unmarried partners')
     A durable relationship exists where an EEA national is in a relationship similar to marriage with a non-EEA national. A durable relationship should be considered under the same criteria as the Unmarried Partner of a British citizen. If the applicant meets the criteria for an Unmarried Partner, they can be issued an EEA Family Permit if it seems appropriate in all circumstances.
   - **Extended family members** (applications considered under the Immigration Rules)
     An Extended Family Member is a relation of the EEA national who does not fall under the 'Family Member' definition. Unlike Family Members, they do not have a right to join the EEA national in the UK, but Regulation 8 of the new Regulations requires us to give consideration to their application and to issue an EEA Family Permit if "in all circumstances it appropriate to do so."
   - Lawful residence in an EEA Member State (now formally part of the regulations)
3. Retained rights of residence for non-EEA national family members - initial period of residence (3 months) no exercise of Treaty rights required, but for an extended right of residence in the EEA national must exercise a Treaty right in the UK.
4. The rights of EEA students and their family members – only certain family members to have the right of residence after three months when the EEA national is a student.

The Directive has been enacted into UK law by the Immigration (European Economic Area) Regulations 2006.

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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