Global Tax Update

UNITED STATES

US-Hungary Tax Treaty ceased for taxable periods from 1 January 2024

Back on July 8, 2022, the US provided diplomatic notification to the government of the Republic of Hungary of its termination of the US - Hungary income tax treaty, which had been in force since 1979. The US Treasury Department stated that the treaty's benefits were no longer mutual and cited low economic benefits for the US as the reason for the termination.

The termination of the US - Hungary income tax treaty was effective on January 8, 2023. However, in accordance with Article 26 (Termination) of the convention, the treaty will cease to have effect with respect to tax withheld at source on amounts paid or credited on or after January 1, 2024. For other taxes, the treaty ceases to have effect with respect to taxable periods beginning on or after January 1, 2024.

Key provisions that impact globally mobile employees are highlighted below.

Employment Income

Under Article 14 (Dependent Personal Services) of the terminated convention, income earned for services performed in the US by a US non-resident individual who was a resident of Hungary - which would generally be taxable income under US domestic law - could be exempt from US tax under certain conditions. Generally, income received by an individual:

(1) who was present in the US for less than 183 days in the taxable year,

(2) whose income was paid by a non-US employer, and

(3) whose compensation was not borne by a US permanent establishment of the foreign employer, could be exempt from US income tax. In the absence of the treaty, this same income will now generally be subject to US income tax, even if the same conditions continue to be satisfied.

Residency

An individual who was a resident of both the US and Hungary under each country's domestic laws previously could rely on Article 4 (Fiscal Domicile) of the terminated convention to assign a single country of tax residency under the tie-breaker rules. Now that the treaty is not in force, this same individual will be subject to tax in both countries on their worldwide income.

Taxes Covered

Article 2 (Taxes Covered) of the terminated convention designated specific Hungarian and US taxes to which the income tax treaty applied, and which Hungarian taxes would be creditable in the US. The 2022 foreign tax credit final regulations included a treaty coordination rule that allowed foreign taxes treated as income taxes under a US income tax treaty to continue to be creditable for purposes of the foreign tax credit. However, in the absence of a US income tax treaty, a US individual must determine under the new foreign tax credit regulations - which now require that certain attribution rules be met - if a foreign levy is a creditable foreign income tax under the Internal Revenue Code. For the 2023 tax year, the IRS provided temporary relief when determining the creditability of a foreign tax, and allows taxpayers to determine creditability under the former foreign tax credit rules.

Tax Withholding On Some US - Source Income

With the termination of the income tax treaty, the reduced withholding rates on some items of income that individuals previously enjoyed will no longer be available. For example, under Article 9 (Dividends) of the terminated convention, dividends paid to a resident of the other country were generally subject to a withholding rate of 15%. In the absence of the treaty, US - source dividends received by a resident of Hungary who is not a resident of the US will generally be subject to US federal income tax withholding at a rate of 30%.

Similarly, under Article 10 (Interest) of the terminated convention, US - source interest income was exempt from tax at source. Now, with the treaty no longer in effect, this same income will generally be subject to US federal income tax withholding at a 30% rate.

BDO Comment

Termination of a double tax treaty is rare and this decision, while not expressly pointing to Hungary's opposition to the adoption of the planned global minimum tax, did refer to inequities following the adoption of the current low corporate tax rate. It could, as a result, have a big impact on employers. With the 2023 tax filing season upon us, employers with cross-border employees who previously relied on the US-Hungary income tax treaty to exempt employment income from US taxation, should review their global mobility population to consider any additional tax exposure caused by the termination of the treaty. In addition, in preparation for the 2023 tax compliance season (and especially the 2024 calendar tax year), employers with US individuals in their international assignment programmes who are subject to Hungarian tax will need to review whether such tax is creditable for the purposes of foreign tax credit in the US.

BELGIUM

New Tax Treaty between Belgium and the Netherlands expected to enter into force next January

The new income tax treaty signed by Belgium and the Netherlands is expected to enter into force on January 1, 2025, subject to approval by the legislative bodies of both countries.

While the new treaty introduces changes that will affect corporations, a number of adjustments will have an impact on directors, employees, and individuals.

The most important change for company directors is that under the new treaty any remuneration paid for attending board of directors meetings will be taxable in the country where the company is established. All other remuneration – for example, remuneration received for the day-to-day management of the company -- will be taxed in accordance with the rules that apply to employees.

Under the current treaty, the taxation of director fees is more complex, and differs depending on whether the director operates under an employment contract or not.

In view of this upcoming change, directors are advised to review the current agreements in place and document which part of the agreement relates to board meetings and which part relates to other activities.

Another important change, for both directors and employees, is that stock options will no longer be included in the so-called 'compensation allowance' when the taxable moment in both countries is not the same. As a reminder: Belgium usually taxes stock options at the time of grant, while the Netherlands usually taxes at the time of exercise of the stock options.

The compensation allowance is a correction mechanism that provides for financial compensation to Dutch residents if their employment in Belgium results in a higher tax burden than in a (hypothetical) situation whereby they are solely taxable in the Netherlands. From January 1, 2025, stock options taxed in Belgium at the moment of grant will be excluded from the basis on which the compensation allowance calculation will be based.

Changes Not Coming

Two expected changes were not included in the new treaty.

First, observers anticipated that the complex pension article in the current treaty would be modified but, in the end, the pension article remained unchanged.

Second, the article on employment income has not changed. For a while now, the two countries have been negotiating to find an appropriate solution for the taxation of cross-border teleworkers, the number of which has significantly increased since the end of the Covid pandemic.

The Administrative Commission for the Coordination of Social Security Systems in Europe introduced a Framework Agreement, signed by most but not all EU countries, that allows employees, under certain conditions, to remain subject to the social security scheme of the country where they usually work, even when they are working remotely from their home country.

No such exception exists in the tax rules, so that employees who work remotely in a country other than their normal place of activity will always be confronted with the prospect of split taxation, which leads to additional complexity and also has financial consequences. On the table is the introduction of a de minimis rule allowing employees to work from home for a certain number of days while continuing to be fully taxable in the other country. For example, Belgium and Luxembourg already have such an agreement in place.

Discussions are still ongoing, but in order not to jeopardise the timing of the ratification and application of the new treaty, negotiators decided not to amend the article on employment income and to include those rules in a separate agreement once a compromise has been reached.

Permanent Establishments

One other additional agreement has been reached recently. On 23 November, 2023, both countries signed off on an agreement on the interpretation of the permanent establishment article in the treaty. The purpose of this agreement is to provide clarity to employers in Belgium and the Netherlands on the elements that are relevant in assessing whether remote working situations in the employee's home country will result in a permanent establishment under article 5 of the treaty.

In general terms, the agreement states that remote work activities in the employee's home country will not in themselves result in a permanent establishment if those activities cover less than 50% of the total employment time in a rolling period of 12 months. Special attention should be paid to dependent agents/employees whose activities cannot be considered to be of a preparatory or auxiliary nature, because they may still create a permanent establishment.

BDO Comment

The agreement of an interpretation of the permanent establishment article of the treaty as it relates to remote working is a particularly welcome aspect of the work to deliver the new treaty as it provides a level of certainty in a complex area for employers to navigate. There is also an increased clarity with regards to arrangements for Directors with this treaty. Less advantageous seems to be the change to the inclusion of stock options within the compensation allowance which may lead to a higher tax burden.

UNITED KINGDOM

The end of P11Ds – or is it?

As part of an effort to simplify and modernise the tax system, on January 16, 2024, the UK's HMRC announced their intention to mandate the reporting and paying of benefits in kind via payroll software from April 2026.

The two-year warning is much better than the few months' notice HMRC provided in 2023, on the cessation of paper filing of P11Ds, so that at least is welcome, but there are still many unanswered questions.

HMRC confirmed that they will work with 'industry experts' to produce guidance. The Payroll governing bodies should be high on this list of experts, as their job is about to get even more complicated.

Although HMRC have hinted at this move for several years, there remain some benefits in kind that currently cannot be payrolled because of their complexity, including accommodations and beneficial loans. Whether these will have to be payrolled from 2026, and just how that can be achieved in practice, remains to be seen.

There are other practical areas that need clarification, including the following:

- Under current UK tax law, employers cannot deduct more than 50% tax from employees' salaries. What do employers do when this blocks full payrolling for an employee?
- What happens to the current requirement that employers must notify HMRC of the Class 1A liability on employee benefits - the P11D(b)?
- Will HMRC be able to change its systems to ensure that the tax code of everyone who currently has a BIK restriction is updated correctly for 2026/27?

Although the proposed changes are two years away, and the employer year-end filing season for 2023/24 is approaching fast, employers may wish to start considering now how they will move to payrolling of benefits and the steps needed to get there by 2026.

BDO Comment

The principle of payrolling all benefits may lead to a simplification of the system in time, but there are still some practical hurdles that will need to be overcome in order to make this a working reality. While there is time before the intended mandatory payrolling of benefits, this is an issue that will occupy employers in the intervening period as they determine how their payroll processes need to be adapted in advance of the change.

AUSTRALIA

Increased data available to tax authority brings Superannuation payroll obligation to the fore

The Australian Taxation Office (ATO) plays an important role as a guardian of Australia's superannuation system. For more than 14 million Australian workers, the ATO ensures that employers make their mandatory contributions to superannuation.

While the overwhelming majority of employers do comply with their obligations, the ATO estimated - in its 2022-23 superannuation guarantee compliance snapshot - that the gap in superannuation compliance was 5.1% or $3.6 billion. This is a significant amount that employees are potentially missing out on.

To reduce this gap, the ATO uses a variety of compliance methods, from simple reminders to investigations of employee complaints and full-scale audits.

Following the introduction of Single Touch Payroll (STP) reporting, the ATO now has access to real-time salary payment data, and it matches this against contribution data provided by superannuation funds. This process allows the ATO to quickly identify instances where employers are not making their mandatory contributions and to take proactive actions, including sending reminders and prompts for employers to check their obligations.

When the required superannuation has not been contributed on time, the employer is required to lodge a superannuation guarantee charge (SGC) statement with the ATO and pay the SGC liability. In 2022-23, AUD 1.13 billion was raised via SGC liabilities.

Most of the funds raised through SGC liabilities - AUD 534 million - came from just 23,300 employees who made complaints of superannuation underpayments to the ATO, but to date the ATO has completed only 54% of its investigation into those cases. Clearly, employees now have a higher awareness of their superannuation entitlements and are prepared to use the ATO as their champion to recover underpayments.

The ATO also initiated 1,400 audits, which resulted in a further AUD 70 million of SGC liabilities raised. While the number is smaller than the number of employee complaints,

it shows the ATO is active in keeping employers compliant, even if employees are unaware or ambivalent.

In the cases of ATO compliance actions, the SGC liabilities raised include additional penalties of AUD 157 million.

Ther ATO also raised AUD 445 million of SGC liabilities from cases where employers made a voluntary disclosure to the ATO. Importantly, in those cases the ATO has discretion to waive additional penalties and it appears the ATO has waived penalties in most voluntary disclosure cases.

Company directors can be held personally liable for unpaid superannuation when the company has not made payment; 3,660 director penalty notices have been issued.

BDO Comment

The ATO's ability to obtain and analyse enormous amounts of data in close to real time means employers must be on top of their game.

It's important for employers to regularly review their time and attendance and/or payroll systems to ensure superannuation contributions are correctly calculated and remitted to the right superannuation accounts by the due date.

When an error is detected, correcting it by making a voluntary disclosure to the ATO provides the best opportunity for having additional penalties waived. It is also easier for employers to manage the employee engagement aspects, rather than being on the back foot when employees have made a complaint to the ATO.

Employers who receive a reminder or prompt from the ATO should immediately check their contribution records and, if required, take steps to correct any instances of non-compliance. The ATO is right in most cases.

Finally, superannuation compliance may become even more challenging from 1 July, 2026, with the proposal presented in the 2023–24 budget that would require employers to pay superannuation contributions at the same time as they pay wages. If legislation is enacted, payday superannuation would be a game changer.

KAREN MCGRORY

Karen McGrory is head of Expatriate Tax Services at BDO LLP. She has over 30 years' experience in the field of expatriate taxation. Karen is indebted to Stuart Strong for his major contribution to this article. BDO is able to provide global assistance for all tax issues arising from an internationally mobile workforce. If you would like to discuss any of the issues raised in this article, please do not hesitate to contact Karen McGrory on +44 (0)20 7893 2460, e: karen.mcgrory@bdo.co.uk.

The 2024 Expatriate's Guide to Living in the UK

is now available online on

www.expatsguidetotheuk.com

Please forward this link to your expatriate colleagues who are going to relocate to the UK over the next year.

This Guide provides useful information on:
Banking • Conversion Charts • Driving in the UK
Education • Embassies • Family Law • Healthcare
Property • Tax • Wealth Management

A handy A5, suitable for expatriates of all nationalities

Please also feel free to share the link on your own company or organisation's intranet site

For further information, please email: helen@expatsguidetotheuk.com

VISIT WWW.EXPATSGUIDETOTHEUK.COM TODAY!