Taxing Issues: Expatriate Terminology - Understanding The Tax Adviser

As we continue to come out of the Covid restricted mobility period, businesses are once again starting to move employees to work in other countries. You may not have dealt with a 'traditional assignment' for some time, so this article seeks to provide a quick refresher of some of the terminology you will encounter and will need to navigate when dealing with a new assignment and a tax adviser.

For example, let's assume you were busy working when your HR director called to tell you that you needed to deal with expatriate issues relating to an employee who is to work in another country. They are due to start in the next two weeks and the HR director is immediately off on holiday. You have just talked to the individual and now it is time to talk to the tax adviser to take matters forward.

If you are new to dealing with expatriates, the terminology used may appear to be a totally different language to that with which you are familiar. This article looks at some of the terminology and aims to help you understand why the adviser is asking you so many questions. As ever, different meanings and terminology may be used within your own company and by tax authorities and advisers around the world. .

Assignment Recap

A quick recap... The individual has told you that they are going on an assignment of 6 to 12 months with a possible extension, and they are remaining employed in the home country. They will be paid various assignment allowances and tax equalisation will apply. You have drafted out the assignment letter, wanted an idea about the tax implications and have now called the tax adviser to talk through the issues.

The initial questions from the adviser are aimed at gathering sufficient data about the assignment, the individual, the assignment package, and the aims of the company. Once we have an overview we can start to advise on the potential implications, the possible alternatives/variations if indeed feasible, and the next steps.

Residence And Domicile Status And Other Determining Factors

Tax is usually based on a variety of factors which may include the residence status, the domicile status, citizenship, centre of vital interests and the place of performance of the duties. Consequently, you will be asked many background questions.

Residence Status - individuals who are resident in a country may often be subject to taxation on their worldwide income. Non-residents are usually only subject to taxation on income arising in the relevant country. It is therefore essential to ascertain whether an individual will be tax resident or not. In many countries, residence status is based on one or a combination of the following:

- A numerical day test
- The availability of a permanent home
- Intentions about the individual's presence in the country
- Registration for immigration purposes
- Nationality
- Employment by a governmental/state organisation

The days test is usually based on whether the individual will be in the country concerned for 183 days or more. You do need to check whether the 183 days are restricted to a single calendar year or tax year or whether the period can span years, for example, Germany. Do remember that most countries tax year is based on the calendar year but as ever there are exceptions such as India, Australia and the UK.

The permanent home factor is not always restricted to one which the individual owns. A 'permanent home' can be rented accommodation or potentially the same hotel room or a room always available with a family member. An assignee's intentions may also play a part in determining the residence status. Registration status with the local municipality, police authorities or residence status for immigration purposes can also influence the residence status. The nationality of the individual may be a determining factor, for example, US citizens are taxable on a worldwide basis. Employment by a government organisation or state authority usually leads to continuing taxation by that organisation or authority.

You do need to check the rules applying to the assignment country as determining factors for residence status will vary.

Domicile Status - is used by a few countries, for example, the UK, in determining taxes. Domicile usually has a degree of permanence and temporary absence may be insufficient to avoid continuing taxation. The status may focus on where the individual was born, their family background and where they usually live.

Centre Of Vital Interests - This test is often also associated with treaty claims. It looks at the wider connections to a particular country such as where the family is located, where are the business ties such as the place of work, the employer and where are personal ties such as investments and property?

Place Of Performance Of Duties – In general, taxation is based on the physical location of the performance of duties and not on the actual work being undertaken. For example, if you are sitting physically working in Germany then even though you may work on a project for a Spanish company this is work in Germany.

Do remember that even though the individual may not be resident for tax purposes in the country a tax liability may still arise there. The general rule applying is that an individual working in a country is subject to taxation there unless a double taxation treaty will apply to allow tax exemption.

Please be aware that certain countries, for example, Switzerland and the US, operate both Federal and State or Cantonal taxes. Municipal and City taxes may also be levied in other locations. The various subsets may also have slightly different resident definitions and/or taxation rules. For example, an individual may be liable to US tax on a State but not Federal level.

The tax advisers' guidance will focus on ascertaining original intentions so that key dates and cut offs can be identified. Deferring, accelerating, curtailing and extending an assignment can have a material impact notwithstanding the fact that mere days may be involved. The adviser will provide guidance as to whether or not the individual will be resident in a location, what that means, and potential tax breaks that may exist, together with qualification requirements. Background information about the individual including information such as the length of assignment, the accommodation available, the whereabouts of the family, the employer and place of performance of duties are essential in helping the adviser to provide best possible advice. The more information you can provide, the easier and cheaper it is for the adviser to provide you with guidance.

Income Tax

With regard to income tax, you need to distinguish between three different taxing issues. These being;

- Wage withholding tax
- Individual income tax
- Tax equalisation/hypothetical tax.

Wage Withholding Tax – as the name suggests this represents a withholding from the wage as advance payment towards the individual's income tax liability. Examples include the UK's Pay As You Earn (PAYE) and Australia's Pay As You Go (PAYG) systems. The exact withholding mechanism will vary from country to country although usually the burden of withholding is imposed on the employer that has the use of the individual's services whilst they are on assignment. Related monthly, quarterly and annual filings may be required by the revenue authorities. Questions from the adviser are aimed at determining who will operate wage withholding if applicable, together with an outline of the various requirements.

Please be aware that even though an individual may be exempt from tax in a particular jurisdiction due to, for example, application of tax treaty exemption, this may only apply on an individual basis. You cannot assume that corporate withholding is similarly and automatically exempted. You may need to apply for such corporate withholding exemption – sometimes in advance of the commencement of the assignment.

Individual Income Tax – tax on wages is mostly collected through the withholding system, although in some countries it may be collected through a system of advance payments. At the year end, usually, there is the requirement for the individual to file an annual tax return. Do note that China, for example, requires individual monthly tax returns. In some countries filing as a family unit is required, whereas in others partners/spouses have to file separately. Additionally, in some countries such as the US you may get a choice. Tax liabilities can depend on family status and questions around the marital, personal status and number of children are aimed at determining the impact. The tax return is usually the reconciliation with any withholding tax deducted, with the tax return based on actual income figures and deductions/exemptions. Excess tax will be refunded or additional tax will need to be paid.

Advice provided will focus on the procedure, relevant dates and requirements, together with an overview of the tax rates and bands applying.

In addition, the adviser will review the proposed assignment package on offer to the individual to consider whether the proposed salary components and benefits can be provided more tax effectively in a slightly different manner. Provision of housing for example, is sometimes more tax effective where it is provided by the employer. The added cost, direct or indirect, of employer involvement needs to be considered. The adviser will also seek clarification of the exact employer throughout the assignment. They will need to know whether the home country entity remains the underlying contractual employer or not. Expatriate tax concessions usually hinge on this point. Please be aware that the entity paying the individual is not necessarily the contractual employer, and this often gives rise to confusion.

Tax Equalisation/Hypothetical Tax – Where this applies this is not 'real' tax, but a calculation agreed between the employee and the employer. It is generally based on what an individual would have paid in taxes on their standard pre-assignment enhanced package had they remained in their home country. This is usually the number on which the assignee is most focused.

Once you are aware of the differences between the three potential taxing issues, both the issues and terminology start to fall into place.

Social Security

Social security (National Insurance in the UK) liabilities can be greater than the tax liabilities particularly for the employer. As with tax it is important to know which entity is the contractual employer, the duration of the assignment and the place of performance of duties. An understanding of the family situation and personal ties is also required. Do be aware that social security definitions such as residence status may vary from those used for income tax purposes.

On provision of the data the adviser can ascertain where the social security liability will arise, the mechanism for payment, and potential variations by, for example, changing the contractual employer. This may of course have tax or legal implications and immigration issues may also need to be considered.

Tax And Social Security Treaties

Treaties are primarily designed to avoid dual liabilities that arise under domestic rules and to determine which country has the right to levy tax or social security and, if dual liabilities arise, which country allows the tax credit.

Tax treaties tend to follow a pattern but all are different and you do need to look at each one in order to identify the variations. Increasingly tax treaties are designed for short-term assignments only with 183 days being a critical factor in relation to employment income. Generally, a liability to tax will arise where the individual is at the location for 183 days or more. Exemption is usually possible where the individual is at the location for less than 183 days, although issues such as the identity of the contractual employer and the inter-company charging position will need to be ascertained.

Social security treaties generally attribute liability to just one country. Such treaties are separate to tax treaties, will have different conditions and definitions and a liability can arise in a different location to the tax liability. Social security treaties are not as numerous as tax treaties and where treaties do not exist, dual or overlapping liabilities can arise. Credit for dual social security contributions is generally disallowed and is an added assignment cost.

The adviser will let you know whether treaties will apply, the implications including how the situation will interact with the domestic position, together with how the assignment might be adapted to minimise costs.

Summary

The more facts you know about the assignee and the assignment the better. This will help the adviser to guide you through the various issues and possibilities. If you do not understand the terminology or issues do ask. The adviser should be only too willing to assist you.

Having spoken to the adviser you now know what to say to the expatriate and the HR director, how to take the assignment forward, potential pitfalls to avoid and possible variations to make it more cost-efficient. With a good adviser it is relatively easy to understand the main tax and social security issues relating to an assignment. If you don't have an adviser how do you go about choosing one in the first place? This will be the subject of my next article in the September edition of International HR Adviser.

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