

Tax And Social Security For Different Types Of Assignment

In the last of our recent articles covering international assignment policies we seek to provide an overview of the tax and social security implications arising from different types of assignment that may occur.

Types of assignment

As a quick recap, assignments are increasingly of varying length and remuneration package.

They include:

- Virtual assignments
- Commuter assignments
- Business trips
- Short-term assignments
- Longer-term assignments
- International continual assignments
- Unaccompanied assignments
- Local assignments with variations.

Your company may well have additional types of assignment depending on your business and location of company sites and employees. For example, those in oil and gas industries may have rotational assignments and those with employees and offices in close proximity to national borders may have trans-frontier issues. These types of assignment are not considered within the scope of this article.

Employee tax and social security liabilities are considered below. There is a danger with all assignments that the activities of the individual may result in a taxable presence for corporate purposes of the foreign entity. There may also be Value Added Tax issues in respect of cross border charges for the provision of an assignee.

A brief description of the types of assignment follows:

Virtual Assignments - These assignments do not have any minimum or maximum duration. The individual remains living, working and usually paid in their home country, but the duties they perform are in respect of work generally connected to, or being undertaken in another country. The individual may travel to the host location.

Commuter assignments - During a commuter assignment the individual is based at the home location but commutes to spend regular time at the host location. This time can vary in length. These

assignments used to be project based and of a limited duration but increasingly involve an ongoing role and regular travel.

Business trips - These typically last from one to thirty days and are not really an assignment but merely a part of an employee's existing duties. Tax consequences may arise if the trips become too extensive and frequent.

Short-term assignments - The definition for our purposes covers those assignments that typically last from 31 days to 364 days.

Longer-term assignments - These assignments are traditionally between eighteen months to three years for an overseas move.

International continual assignments - The type of assignment envisaged here is that where the individual moves from one assignment to another and does not really have a home location or contact with a home country.

Unaccompanied assignments - These assignments can be of varying length but are unaccompanied.

Local assignments with variations - The individual is usually employed by local entity on a local package, although they can be employed in the home country. Additional elements of remuneration may be paid for a period of time to supplement the base package.

Issues to consider

When reviewing tax and social security it is helpful to separately consider:

- Individual taxation - home and host
- Withholding issues - home and host
- Social security

Looking at each of these in turn:

Individual Taxation - Home And Host

This section deals with tax for the individual in both the home and host countries. There could be several host countries depending on the employment duties. It is important to remember that each country has its own tax rules and tax rates. Whilst the method of taxing employment income is generally the same, there are usually differences with regard to the taxation of employment related benefits.

Residence status

The main criterion for taxation is usually residence status. Residents tend to be taxable on worldwide income whilst non-residents are generally taxed on income from sources arising in the country. The source of employment income is generally the place of physical performance of the duties. Countries rules do vary and, for example, the US taxes its citizens and long-term residents on the basis of worldwide income. Thus a US citizen will remain taxable in the US even if they are on a long-term assignment to another country. Various factors can influence an individual's residence status for tax purpose and these may include:

- Time physically spent in the country
- Availability of accommodation - this can be rented accommodation
- Location of a home
- Location of the family
- The individual's usual or habitual abode
- The centre of economic interests - where for example, the employer is located where the job is performed, where bank accounts and other investments are located
- Other factors including citizenship, nationality, resident permits etc.

Having determined that an individual is potentially liable to tax in two or more countries under domestic tax rules and legislation, it is necessary to review tax treaties, if in existence, to ascertain how the individual will be taxed and where. If tax treaties do not exist countries may provide unilateral tax relief under domestic legislation.

Tax treaties

If an individual works in two or more countries a tax liability can arise, even though the individual may be not resident for tax purposes in a country where duties are undertaken. This is where tax treaties are likely to apply. Reference will need to be made to any applicable tax treaty to determine which country has primary taxing right and how exemptions or tax credits will apply. Notwithstanding tax treaties, individuals may well have filing requirements in both countries and this will need to be examined on an individual

case and country basis.

Most treaties, but not all, tend to follow the OECD (Organisation for Economic Co-operation and Development) model. Within a treaty there are usually articles covering the scope of the treaty, definitions, taxes covered by the treaty, residence status, and employment income, elimination of double taxation, non-discrimination and exchange of information. Treaties also include articles covering issues such as self-employment income, interest, capital gains and pensions. They may also cover certain specific issues such as government employees, mariners and aircrew, artistes, athletes and entertainers, directors, students, teachers and offshore activities. In summary, you do need to look at the specific treaty that may apply and do remember that existing treaties get revised and new treaties are signed.

The residence article is intended to define the meaning of “resident” and address cases where an individual is resident in two countries. It covers application of the treaty to the individual and who has primary taxing rights. Where an individual is resident under domestic rules in two countries, tiebreaker tests determine the country of residence for treaty purposes. These tiebreakers consider various issues in turn such as availability of a permanent home, centre of vital interests – personal and economic, habitual abode, nationality and, in event of continuing uncertainty, mutual agreement procedure between the two states.

Tax Treaties and Employment Income

The treaty article entitled “Dependent Personal Services” usually covers employment income. In contrast, the article “Independent Personal Services” covers self-employment income. This may include contractors, consultants and partners.

A typical treaty article covering employment income, mentions that employment income will only be taxed in a country if duties are performed in that country. The next section in the article is the source for the common myth than an individual is only taxable in a country if they spend more than 183 days in that country.

There are usually two other conditions that must also apply in addition to the 183-day rule.

These are:

- The remuneration is paid by or on

behalf of an employer who is not resident in that country

- The remuneration is not borne by a permanent establishment or fixed base, which the employer has in that country.

Only if all three conditions are met is treaty exemption possible. Further consideration must also be given to each specific condition. For example, older treaties often refer to 183 days in a calendar or fiscal year, whereas newer treaties tend to refer to 183 days in a cumulative twelve-month period. The more traditional test means that it may be possible to spend more than 183 days in a country by spanning the relevant calendar or fiscal tax year. The cumulative test prevents this but additionally means that you have to keep the position under constant review. Generally any part of a day spent in a country is counted as a whole day when considering the 183 days test. It is usually clear whether the individual is or is not employed by an employer resident in the host country. Most assignees remain employed by the home country employer and meet this test, although assignees on a local employment contract will typically fail the test. The last condition may appear straightforward, but again care needs to be exercised. Some treaties also include the words “... as such ...”. In addition, some revenue authorities consider who is the “economic employer” as opposed to the legal employer. In these cases it is necessary to consider for example, who directs, controls and manages the individual and the impact of any recharges. For example, a recharge to a UK entity whether this is for direct costs or a management recharge for the provision of an individual’s services could result in the UK entity being regarded as the economic employer by HM Revenue & Customs (HMRC). The Netherlands and Germany follow the UK Revenue’s thinking on this point but are not as strict in interpretation. In such cases tax will be due in the host country even if at first glance the assignee appears to be exempt by virtue of the treaty.

If an individual meets all treaty conditions then employment income will be exempt from tax in the host country. This may well be the case for assignments of limited duration or regular but minimal visits. For example, business trips, virtual assignments, commuter assignments and some short-term assignments. Planning utilising treaties can minimise

tax liabilities. Additionally, many countries have reduced filing obligations if treaty exemption is likely, although this should be reviewed depending on the circumstances. Liability and filing obligations for shorter assignments will usually continue in the home country.

Tax treaties and double taxation

All is not lost if shorter assignments do not meet the treaty conditions. Here it is necessary to consider the article covering double taxation. A tax credit will usually be allowed in the home country for taxes due in the host country. This will also apply to longer-term, and possibly both unaccompanied and local plus assignments if a dual liability to tax arises. As an alternative to a tax credit some countries, for example France and Germany, give “exemption with progression”. In essence this means that whilst the exempt income will not be taxed in the country, it is taken into account in determining tax rates applicable to income that is taxable. This provides relief but at lower tax rates. The actual mechanism for double taxation relief will be covered in a future article. Where treaty exemption is not possible there may well be a dual filing obligation in home and host countries. As assignments increase in length the greater the likelihood that filing obligations switch from home to host country.

For human resource individuals one of the key issues is to ensure individual assignees track where they are and what they are doing. Tax advisors can then help to provide the additional guidance required.

What is taxable?

Once you have ascertained whether someone is taxable you need to consider what is taxable.

Individuals on many assignments, in particular those for a shorter period, tend to remain on their home payroll and on their home base salary but may receive per diems and expenses to cover the time spent at those locations. Additional remuneration elements may also be provided such as:

- Accommodation
- Home leave
- Travel costs
- Education expenses
- Transportation
- Subsistence costs
- Per diems

- Cost of living allowances
- Expatriate premiums
- Bonuses
- Shares and share options
- Pensions
- Tax equalisation

In general, cash items are taxable. Certain items, such as per diems, travel costs and home leave may not be taxable. Additionally, provision of accommodation at the host location may be subject to preferential treatment where the organisation provides the housing, for example in France, Japan and Hong Kong. For shorter assignments and sporadic visits, special rules can also apply to accommodation and for example where dual housing costs in home and host countries are incurred these may be exempt. Germany, UK and the US are some of the countries where special rules apply.

Expatriate exemptions or allowances may also be available for shorter assignments. Conditions apply and it is necessary to review these in depth. Countries such as France, UK, Netherlands, and Denmark have rules relating to international assignees whereby reduced amounts may be assessable or a reduced rate of tax applicable.

It is probably true to say that the tax rules become less favourable as the length of the assignment increases or once the individual becomes employed in the host country. The tax burden on assignments tends to move from home only to home/host jointly and finally to host only as the assignment length increases. Additionally, the tax burden trends to move from home to host in accordance with employer changes. Generalisations are however very tricky with tax, and you do need to look at the rules in each country and the particular circumstances applying to both the assignment and the individual.

Payroll withholding issues

The individual tax position may differ from the payroll withholding tax position for the organisation. Do remember that withholding tax can usually be refunded, although things may not always be the case and in some countries withholding tax is a final tax.

Withholding tax may be applicable in the host country depending on issues such as the employer, the length of the assignment and whether treaty exemption is available. It may not matter where the individual is paid, the currency they are paid in or the paying entity as withholding tax may still apply. For

shorter assignments in particular there is also likely to be a continuing withholding tax in the home country, especially if the individual remains either resident or employed there. Consideration may have to be given as to how to avoid dual withholding and the adverse cash flow impact this may bring. This usually involves the employer advancing funds to the individual, although certain countries, such as the UK, recognise the problem and measures exist to provide cash flow relief. For longer-term assignments, especially where an individual ceases to be resident in the home country, home country withholding is less of an issue.

From the organisation's perspective withholding, both tax and social security, is probably the most important aspect to get right, unless tax equalisation applies. This is because revenue authorities tend to focus on targeting the employer and not the employee. Assignees, especially those in certain industry/business sectors and those with short-term contracts, move between employers and countries with increasing ease. Trying to recover taxes from an errant employee is difficult, time consuming and costly, and it is best to get the real withholding taxes and tax equalisation withholdings correctly operated from the outset. This can be a hard task given that assignments frequently change from short to long and long to short assignments. Human resource professionals should liaise closely with colleagues in payroll and finance to keep in control of the situation.

Social security (UK National Insurance)

Social security can often be overlooked but it is a very important factor as employer costs in particular can be significant. For business trips and short assignments, social security implications in the host country may not arise. A commonly cited rule of thumb is that for a period under 6 weeks no action is necessary. This may be a dangerous assumption. It does depend on issues such as, the countries involved, the employers, nationalities, length of assignment and social security agreements.

With regard to the latter, agreements determine whether social security will be payable and for what period. Within the EU and for most reciprocal agreements, short-term assignments coupled with continuing employment in the home country, often means a liability in the

home country only. Certificates of coverage should be obtained to confirm exemption from host country social security. As assignments increase in length, or the employer changes, liability tends to switch to the host country. Depending on the circumstances this could be from the first day of the assignment, possibly with effect from the fifth anniversary or potentially even later. As with tax treaties the specific social security agreement applying must be considered in detail and do remember that agreements change.

A major problem can arise where there is no social security agreement. In some cases a dual liability to social security can arise. There is no equivalent to double taxation relief and in such instances this may be a case where both the individual and the company have to bear the cost. Invariably employees merely look to the company to compensate them. A tax gross up may therefore also arise. Again, differing circumstances will vary the outcome.

Summary

The above comments can only provide a general overview of tax and social security issues and how they vary with different types of assignment. At a later date we will explore in-depth some of the issues and topics raised in this current article.



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