Global Tax Update

HONG KONG

What Hong Kong employers need to know about the latest updates on statutory maternity leave

The Government of Hong Kong SAR announced that female employees will receive an additional four weeks statutory maternity leave (SML) from 11 December 2020. Women who are eligible should take the additional leave continuously after their 10 weeks' SML comes to an end.

The Employment (Amendment) Ordinance 2020 sets out the following enhancements to maternity benefits:

1. Employers must provide eligible employees whose due date is on or after 11 December 2020 with an extra four weeks' SML on top of the current 10 weeks.
2. Employers must pay the 14 weeks' statutory maternity leave pay (SMLP) to eligible employees. The government will reimburse them for the extra four weeks' SMLP afterwards.
3. SMLP will still be calculated at four-fifths of an employee's average daily wages (there are specific calculations to determine this).
4. The amount reimbursed for the additional four weeks' SMLP is calculated at four-fifths of an eligible employee's average daily wages, up to HK$80,000 per employee (this cap may be reviewed and adjusted from time to time).
5. The Amendment Ordinance also covers two technical changes. These are:
   (i) updating the definition of "miscarriage" so that women who have a miscarriage at any time from 24 weeks after conception (previously 28 weeks) will be eligible for maternity leave; and
   (ii) accepting that a certificate of attendance issued by a professionally trained person is documentary proof that an eligible employee is entitled to sickness allowance for any day on which she has attended a pre-natal examination (currently a medical certificate certified by a registered doctor is required).

Details of how the government will reimburse employers for additional maternity leave paid to employees under the Amendment Ordinance are not yet available. Once we have received any updates about the reimbursement system, we will provide further information.

The four-week increase of paid SML will align Hong Kong with the International Labour Organization (ILO)'s recommendation as well as other jurisdictions, such as those of Japan and the People's Republic of China (both of which provide 14 weeks' SML covering pay at 66.7% and 100% of employees' wages, respectively).

When the Amendment Ordinance comes into effect, it will not change the criteria that a female employee must meet to be entitled to maternity leave, as follows:

- The employee has been employed under a continuous contract for not less than 40 weeks immediately before the commencement of scheduled maternity leave
- She has given notice of pregnancy and her intention to take maternity leave to her employer after the pregnancy has been confirmed (for example, the presentation of a medical certificate confirming her pregnancy to the employer); and
- She has produced a medical certificate issued by a registered doctor specifying the expected due date if so required by her employer.

> It is expected that the 2020 Amendment Ordinance will have a positive impact on Hong Kong families and it is hoped that this will raise the low birth rate in Hong Kong in the future

BDO Comment

The enhancement of maternity benefits aims to safeguard the health of female employees and new born babies by aligning with the advantages of longer periods of maternity leave as stipulated by the ILO. According to the ILO, longer periods of maternity leave result in lower rates of premature births, pregnancy and postpartum depression, and reduces maternal, infant and child mortality.

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INDIA

Budget Update

The Indian Government presented the first ever digital Union Budget in the Parliament via the Finance Bill 2021 on 1 February 2021. The Budget was designed to give an impetus to the COVID hit economy by focusing on fostering resilience and aiming at recovery from the impact of the pandemic. It set out a clear path by pursuing comprehensive reform measures, aiming for social inclusion and paving the way for a speedy economic recovery without imposing additional burdens on taxpayers and consumers.

Some of the key amendments relevant for globally mobile employees are summarised below:

Tax Return Deadlines Deferred

Deadlines for filing belated as well as revised/amended Indian income tax returns are to be deferred by 3 months to 31 December from tax year 2020-21 onwards.

Leave Travel Concession (LTC) Scheme Introduced

Indian tax laws provide for exemption in respect of any value for leave travel to any place in India received/due to an employee/family from the employer/former employer. Owing to COVID, employees could not utilise this benefit due to travel restrictions.

The Finance Bill proposes to include a tax free cash allowance in lieu of LTC subject to prescribed limits and fulfilment of conditions. However, the amendment shall be applicable to tax year 2020-21 only.

Taxation Of Income From Notified Overseas Retirement Fund

Returning Indians qualifying as residents in India may have to face double taxation on withdrawal from overseas retirement funds. Such double taxation may be due to a mismatch in the residence status as well as taxability of income in the year of opening the retirement account and the year of withdrawal. Therefore, such withdrawal may be taxed on 'receipt' basis in the foreign country and on 'accrual' basis in India.

Based on representations to address this mismatch and remove genuine hardship, the Finance Bill proposes to provide for income of a specified person from a specified account in a notified country. From 1 April 2021, such income shall be taxed in the manner and in the year as prescribed by the Central Government.

Taxability Of Interest On Indian Provident Fund (PF) Account

Instances have come to the attention of Government where some employees are contributing huge amounts to the PF account and the entire interest accrued/received on such contributions is exempt from tax. To tackle this issue, the Finance Bill proposes to tax the interest accrued on the PF balance if the employee's PF contribution exceeds INR 250,000 in a tax year. This amendment shall be effective from 1 April 2021.

Once the Budget receives Presidential assent, the above amendments will become part of the tax law. Individuals should take these into consideration to understand the tax implications and plan their compliance timeliness accordingly.

ESOP Grant Held As Recognition For Indian Services Prior To Grant And Thereby Taxable In India

Background

Employee Stock Option ('ESOP') is a deferred compensation strategy opted by companies globally to motivate and retain employees. As per the Income-tax Act, 1961 ('IT Act'), ESOP benefits given to employees, free of cost or at concessional rates, are taxable as perquisites at the time of allotment/ transfer of shares. Given there is timing difference when the ESOPs are granted and taxed, it creates complexities in case the employees are working cross-border during such tenure.

In this regard, the Mumbai Tax Tribunal ('Tribunal') examined the tax implication in the case of an individual/ taxpayer who was granted ESOPs while in India but exercised the same while he was outside India (Dubai). A summary of the ruling and our comments on the impact are set out below.

Facts Of The Case

Taxpayer is an employee of HDFC Bank Limited, Mumbai, and was deputed to HDFC Bank Representative Office in Dubai on 1 October 2007. He was granted ESOPs on 27 June 2007 which vested equally in two tranches i.e., 27 June 2008 and 27 June 2009. The vested options were exercised by him during the Fiscal Year (FY) 2012-13 and 2013-14. Upon exercise, HDFC Bank Limited calculated the taxable value and deducted taxes. However, at the time of filing the return of income for the FYs, the taxpayer qualified as Non-Resident ('NR') and claimed relief under section 90 of the IT Act for taxes deducted by HDFC Bank Limited.

The taxpayer's return of income for FYs were selected for tax scrutiny. During the tax scrutiny, the Tax Officer ('TO') noted that the ESOPs were granted to the taxpayer in the year 2007 while the taxpayer was resident in India. The TO held that the ESOP grant was made in consideration for the services rendered in India and the TO disallowed the claim for relief under section 90 of the Act.

Aggrieved by the TO's Order, the taxpayer filed an appeal with the First Appellate Authority ('Authority') but the Authority upheld the TO's Order. Aggrieved by the Authority's Order, the taxpayer then filed an appeal with the Tribunal.

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Taxpayer's Contention

The taxpayer contended before the Indian tax authorities that the ESOP income was not taxable in India based on the below:

- Taxpayer qualified as NR in India for the FYs 2012-13 and 2013-14. As per the Act, the income received/deemed to be received, income accrued/deemed to be accrued and income arising/deemed to be arising in India would be subject to tax in India (source taxation rule)
- ESOPs are in the nature of salary and the right to receive salary income arose for the performance of services in Dubai (i.e. during vest period). Given that the services were rendered in Dubai during the vesting period, the ESOP income did not accrue or arise in India and therefore, not taxable in India
- Additionally, the taxpayer proclaimed that he qualifies as resident of UAE at the time of exercise of ESOPs, i.e. in FYs 2012-13 and 2013-14. Hence, the taxpayer made an alternate submission relying on Article 15 (Dependent Personal Services) of India-UAE Double Taxation Avoidance Agreement ('DTAA') which provides for taxation of "salary, wages and other similar remuneration" in the state of residence unless employment is exercised in the other contracting state. ESOPs were covered under the expression "other similar remuneration" and hence, taxable in Dubai, i.e. place of exercise of employment
- The taxpayer also placed reliance on several judicial precedents, which upheld that income cannot be taxed in India if the employment services over the period from years of grant to years of vesting/ exercise are rendered outside India.

Tribunal Ruling

On perusing the material on record and hearing contentions of the taxpayer and the TO, the following are the Tribunal's observations:

- There is no dispute with the fundamental proposition of source taxation rule
- Reliance was placed on the Apex Court's judgement where the terms "is received", "accrues" and "arises" was interpreted. It was observed that "accrual" or "arising" of income cannot be equated with "receipt" of an income
- The Tribunal observed that the ESOP income "accrued", i.e. came into existence in the year 2007 when the taxpayer was in India. The ESOP grant or the "accrual" was for services/employment in India prior to the year 2007. Hence, while the ESOP income was unclear at the time of grant, it did accrue in India
- The Tribunal based on the principles of the UN Model Conventions Commentary 2017 held that:
  - ESOP should not be considered to relate to any services rendered after the period of grant that is required as a condition for the employee to exercise such ESOP
  - ESOP should only be considered to relate to the services rendered before the time of grant as a reward to the services rendered prior to the grant itself

- Based on the OECD's publication, a benefit is accrued when the ESOP options are granted and the said benefit accrues in the jurisdiction in which the qualifying services are rendered
- The judicial precedents quoted by the taxpayer do not directly cover the issue in appeal.

In light of above, the Tribunal held that the ESOPs were granted in the year 2007 in consideration of services rendered by the taxpayer prior to grant. Given the taxpayer has rendered the services in India, the same would be taxable in India irrespective of year of receipt and also the benefit of Article 15 of India-UAE DTAA would, accordingly, not be available.

BDO Comments

Indian judicial precedents covering ESOP benefit have held that ESOP benefit is to be taxed in the year of allotment/exercise based on the source taxation rule during the vesting period.

However, this ruling has discussed at length the source taxation rule for ESOP benefit. It brings out new nuances for taxation of ESOP benefit in case of cross-border employment especially the accrual of benefit at the time of grant. Since the ruling is case-specific, it needs to be applied judiciously in other cases.

It is recommended that the ESOP plan and facts of each case is deliberated in detail to understand the taxability of income and appropriate reporting in the tax return.

UK

Brexit - Social Security rules from 2021

The UK-EU Trade and Co-operation Agreement (TCA) has now been published in full containing the details of the Social Security rules to be applied between the EU states and the UK from 1 January 2021. At the time of writing, whilst already approved by EU member states, the TCA is awaiting final approval by the EU Parliament.

Cross-Border Social Security From 1 January 2021

This agreement includes the Protocol on Social Security Coordination which is to apply to persons and their families who are, or have been, subject to the legislation of the UK and/or one or more of the EU States.

The agreement largely replicates the current EU social security coordination regulations. Therefore, individuals will be subject to the social security legislation of one country only and the scenario of compulsory payment of social security contributions on earnings in more than one country will not arise. Contributions will generally be payable in the country where activities are undertaken, with special provisions for multi-state and detached workers.

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Multi-State Workers

The rules for multi-state workers are to remain broadly the same, retaining the need to determine where someone is habitually resident and where they perform substantive work duties. Multi-state workers will be covered by the legislation of the State of residence if they carry out a substantial part of their activity in that State. If this is not the case, then generally the social security liability will fall under the legislation of the country in which the employer is situated. In the absence of new guidance, we are assuming for the time being that 'substantial' means 25% or more of an employee's work activity.

Therefore, we would expect the vast majority of multi-state worker A1 certificates in existence to continue to be valid and individuals should continue to apply for these as necessary.

Detached Workers

The detached worker rules apply to individuals seconded/assigned by an employer to work in the UK or an EU territory. The rules for detached workers are also to remain broadly the same. All EU countries have now agreed to apply the 'detached worker' rules. There is now certainty that an employee sent temporarily by their employer to perform work in another state will continue to be subject to the social security legislation of their home country provided that the duration of the posting doesn't exceed 24 months and they are not replacing another detached worker. There is currently no guidance that this 24 month period can be extended, in the way that it could be previously, and this could have ramifications including for UK employers sending international assignees to higher social security regimes such as Belgium, France and Italy.

Please note that there are special rules for posting between the UK and Norway, Switzerland, Iceland and Liechtenstein which started post 31 December 2020:

- **Norway:** employees remain within home country legislation for temporary postings of up to 3 years (must apply within 4 months of the start of the posting)
- **Switzerland:** employees remain within home country legislation for temporary postings of up to 2 years
- **Iceland:** individuals remain within home country legislation for temporary postings of up to 1 year if you're employed and a non-UK and non-EEA national (can be extended by a further year with agreement before the end of the first year)
- **Liechtenstein:** there are no special rules and there is the possibility of double contributions. Postings from the UK will generally need to continue paying UK National Insurance contributions for the first 52 weeks.

We understand that the UK government is seeking to conclude a new, comprehensive EEA-EFTA wide agreement on social security coordination, including healthcare with the EEA-EFTA states and also a new reciprocal agreement with Switzerland as soon as possible.

Employer Responsibilities

Where the new Protocol applies, employers should continue to apply to the home country social security office on behalf of the employee going to work in the EU or the UK. This will exempt any host country social security contributions.

However, where individuals become liable to the host social security legislation then the employer will be required to register and pay employer social security contributions in that jurisdiction and, potentially, facilitate the withholding of employee social security contributions. Please note that if the employer has no place of business in that jurisdiction then the employee may, by mutual agreement, take on the responsibility for the employer contributions. While relatively common in other European countries, historically, HMRC has not endorsed employees making contributions on their employers' behalf.

Working Abroad Since 2020

Workers posted between the UK and the EU States, Norway, Switzerland, Iceland and Liechtenstein prior to 1 January 2021, should be protected by the Withdrawal Agreement or equivalent agreements. The Withdrawal Agreement states that individuals "shall be covered for as long as they continue without interruption to be in one of the situations ...involving both a Member State and the United Kingdom".

What this effectively means is that a posted worker with a valid A1 certificate who remains on their posting will continue to covered by that A1.

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