Tax And Social Security Issues When Entering A New Location

Increasingly, HR professionals are faced with the challenge of supporting the home business as it expands into new locations.

If you have an existing overseas assignee population the challenges of individual tax and social security may be familiar. However, when entering an entirely new location there are wider considerations to address, from payroll compliance, VAT, Corporate Tax to Transfer Pricing.

Many of the decisions made in setting up an assignment could impact other areas of taxation and if you fail to consider these, potential planning and cost savings could be missed.

Some Familiar Ground

From an HR perspective you will be under pressure from the employees to confirm their tax position.

Tax rates vary greatly between countries from 0% in UAE through to top rates in excess of 50% in Denmark. Therefore the answer to this question will be determined by where they are taxed.

Typically countries tax in two ways - they tax individuals who work in their territory and/or individuals who are resident in their country. There are exceptions, for example, the US taxes its citizens and green card holders on their worldwide income wherever they are resident or perform their duties.

It is also possible, based on the above, that two countries may seek to tax an individual on the same income bringing about what is commonly known as 'double taxation'.

Double Tax Treaties

In this scenario, the first option will be to check if your country has a double tax treaty with the new location.

Typically, but this will vary, taxation of employment income is covered in Article 15. As a rule of thumb, employment income will be taxable in the country in which the employment is exercised.

The article will usually contain a second test useful for your short-term assignees and business travellers.

If this test is met, then the assignee may be exempt from tax in the host location where;

- They have spent less than 183 days in the host country
- Remuneration is not paid by, or on behalf of a resident of the host country
- Remuneration not borne by a permanent establishment (PE) or fixed base of the employer in the host country.

However, it is important to note that treaty wording varies, always check the relevant treaty. Do also check that you meet all the conditions within the treaty. Most individuals are aware of the 183 day test but forget that there are other tests that must also be met. You do need to meet all requirements of the treaty test and not just one.

Do bear in mind that Base Erosion and Profit Shifting (BEPS) rules have lowered the threshold for what constitutes a PE. Additionally, the BEPS rules also seek to improve the alignment of transfer pricing outcomes with value creation with the greater expectation and scrutiny going forward of recharges of costs. Both of these action points are likely to limit the scope for treaty exemption in the future. As opposed to treaty exemption we are likely to see a need to file in multiple countries but with associated claims for double taxation relief. The reporting and compliance burden is on the increase.

Tax Planning

Once you have established the tax rates and obtained local cost of living and salary information the next step will be to establish the package the employee will receive.

Many countries operate special tax regimes for expatriates. Before drafting the assignment contract confirm which local rules and tax savings might be applicable.

One of the biggest tax savings available can be the choice between paying cash or providing a direct benefit. For example, paying for accommodation directly could offer tax savings in Hong Kong but cash is generally taxed at a higher effective rate.

Timing can also be a great planning tool. Leaving a country for a complete tax year may result in non-resident status for the whole tax year whereas leaving part way through the tax year may result in continuing resident status for the remainder of the tax year. Regular return visits and continuing ties to the home country may also be factors considered when considering home country residence status.

Social Security

So where will the employee (and employer) pay social security?

International social security is a complex area and it will usually be best to consult a specialist where there is any doubt over social security.

The world of social security is essentially governed by three separate sets of rules,

- Europe (EEA) - EC Regulations
- Bi-lateral Agreement countries ('Reciprocal' or 'Totalisation')
- Non-Agreement countries.

Which rules apply may depend on the following:

- Home / host country combination
- Nationality of the assignee
- Where assignee was last insured (paying contributions)
- Duration of assignment
- Location (residence) of the employer.

For moves within Europe the general rule is that you 'pay where you work'. As an exception to this you may apply for an A1 certificate to keep the employee within their home system.

For other moves, do check if your country has a bi-lateral agreement with the new location. That agreement should exempt them from social security in the new location where a valid Certificate of Coverage is obtained.

Time limits and conditions will apply to both of the above situations, and individual rules and agreements should always be consulted.

Where no agreements exist at all, then home and host country rules will determine whether social security is payable and for how long. It may be payable in both!

Payroll

Typically, either as a matter of policy or because there is no local payroll in the new location, an individual may be kept on the home payroll.

Many companies do not realise that there may still be an employer withholding obligation in the new location. It is essential that you explore local rules and regulations in advance of an assignment, and where necessary establish a "shadow payroll" to account for local taxes from day one.

It may be possible to run this payroll through a local agent, and some countries offer relaxed payroll rules for certain expatriates, so always seek advice.

Do not assume that just because an individual may be treaty exempt that there is no employer withholding obligation in the host country/country of working, and there is no need to seek local tax authority approval for not withholding. Increasingly, countries are focussed on business travellers and are more aware of the issue of recharges. Formal steps and ongoing reporting obligations may be required in order not to withhold in the host location.

Dual Withholding

Where you keep assignees on your home payroll, and also find that there is a withholding requirement in the assignment location, this can create a cash flow issue.

Companies often overlook possible solutions to dual withholding requirements which might be available in your home country. For example, in the US it may be possible to take advantage of certain exclusions and foreign tax credits within the payroll, rather than waiting for the employee to file a tax return, providing the relevant forms are completed.

Unfamiliar Territory

Business needs and opportunities can mean that before premises, a branch or subsidiary have been established, an employee may be deployed to the new location. They often work out of temporary office accommodation, a client site, or even a hotel.

It will be crucial to understand the exact nature of the individual's role in the new location to ensure that you are not faced with an unexpected corporate tax bill or penalties for failure to comply with local laws or regulations.

Corporate Residence

In some situations, the seniority of the individual posted overseas, and the role which they undertake, may actually jeopardise the existing company residence status and therefore the corporation tax bill.

A company is generally taxed based on its residence status. Each country will have its own definition of residence. In the UK for example, a company is generally resident when it is incorporated, or centrally managed and controlled in the UK.

As an illustration, a senior member of the board who relocates to the UK from Iceland to establish a new UK company, but holds board meetings of the Icelandic company in the UK, will find that the UK authorities will argue that the central management and control of the Icelandic business is being carried out in the UK and the company is resident and subject to corporation tax there.

Advance planning around the role the director performs in the UK and the location of board meetings could avoid this issue.

What Is A 'Permanent Establishment'?

Countries may also seek to tax a non-resident company where it has a taxable presence as defined by local laws, as a result of the activities of individuals assigned there.

Where a double tax treaty exists between the home and host location countries, it will typically exempt the non-resident company from local corporation tax if its presence does not amount to a 'permanent establishment'.

Double tax treaties generally define a permanent establishment (PE) as being a 'fixed place of business through which the business is wholly or partly carried on', with certain exemptions.

The important issue to highlight is that a PE can be created by the activities of employees, or in some circumstances agents or contractors. Prior to BEPS, the key test of whether an employee's activities can create a PE concerned their ability to conclude contracts with customers. The new BEPS changes will look more closely at the exact involvement of individuals and one who 'habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise' can create a PE. Other factors can also lead to a PE, and all fact and circumstances should be explored before the individual is assigned to the new location.

Where you become aware of an assignment to a new location, simply linking in with the appropriate colleagues such as company group tax, company secretarial and legal, could allow significant savings to be made and avoid unintentional corporate taxation and unexpected filing.

Recharging Costs

Another significant issue that is often overlooked at the planning stage of the assignment is the recharge of costs. It may seem essentially an internal company matter, however, this decision can have three major tax implications;

1. Treaty Exemption

As we saw above, the decision to recharge the costs for short-term assignments to the new location may mean exemption under the treaty is not available.

2. Transfer Pricing

This refers to the payment for assets, services, and funds transferred within an organisation, including costs of assignees.

This is a major concern for tax authorities around the world who have become increasingly concerned that multi-national companies set transfer prices on cross-border transactions in order to reduce taxable profits in their jurisdiction and/or shift profits to low tax cost countries. This has led to the new BEPS rules, making transfer pricing even more of a major tax compliance issue for multi-national companies.

You should consult with group tax or a tax adviser before finalising recharge arrangements between locations.

3. VAT

Cost recharge of expatriate salaries may also attract irrecoverable Value Added Tax (VAT).

For example, a UK company assigned several UK employees to work with a Swedish company as part of a joint venture. The costs of the assignees' salary were recharged to Sweden. This recharge was subject to Swedish VAT. As this was a joint venture and the companies were not within the same VAT group, the VAT cost could not be recovered.

By establishing a shadow payroll in the UK to account for social security and pension contributions, and transferring the assignees to a local Swedish payroll, the company was able to recover the cost of the VAT.

Prevention Is Better Than Cure!

As an HR professional you may be one of the first within your organisation to hear of a new assignment. Many of the decisions made in setting up that assignment could impact other areas of taxation.

In international tax, the only consistent rule is that the rules will be different! An awareness of the key issues is a great asset when setting up in a new location.

This should help you establish controls and strong lines of communication to ensure that all key teams, HR, Tax, Legal and external advisers are involved at the planning stage to maximise tax relief and minimise exposure to penalties.

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