Taxing Issues: Expatriate Myths

Many people believe in the existence of the Loch Ness monster, the yeti and mermaids. Similarly, international assignees and employers believe in a number of expatriate myths. These legends and tales are passed from person to person and the international aspect adds yet another element of mystery to them. This article provides an overview of some of the common myths that circulate – the tax ones!

General myths

Over the numerous years that I have assisted employees and employers with international moves, I have heard of many common myths such as:

- I am not resident anywhere and therefore not liable to tax anywhere
- The assignee spent less than 183 days in the location and is therefore tax treaty exempt
- I received payment before I arrived or after I left so I can ignore it
- The assignee is not paid in the country and wage withholding does not therefore apply
- My work permit did not come though so I do not have to file a return for this period.

This article will focus on the above myths, primarily from a UK perspective but similar principles apply in most countries and with most cross border moves.

Myth - I am not resident anywhere and therefore not liable to tax anywhere

It is feasible for an individual to be not resident in any country to which they are connected under that country's domestic tax legislation. This may well be the case where an individual has a roving role or is engaged in project work and rarely spends a concentrated period in any one location. In such cases individuals often assume that they are not taxable anywhere. This assumption is likely to be incorrect, particularly where you are dealing with employees.

Non-residence generally means lack of tax treaty protection and consequently each country in which that individual works may have a right to tax the related employment income. Most countries want to tax an individual if they work there and generally only exempt the related income if a tax treaty applies or the income is so insignificant as to be below any de-minimus limit set on grounds of practical expediency. Treaty exemption is explored in more detail below and assuming relevant conditions are not met, tax is probably due in the country in which the individual works and usually the taxable income is determined on a time apportioned basis.

The nature of the duties can have a bearing on the tax liability. For example, the UK will in certain circumstances ignore return working visits for training purposes but will seek to tax return visits by a director to attend a board meeting.

Additionally, where an individual is non-resident, the employer may well have withholding obligations in each and every country with filing obligations in all for the employee. Whilst this can be costly and time consuming, it can be even more costly for all if these obligations are overlooked and tax, penalties and interest are imposed. Most individuals who do not pay tax in such circumstances do so via non-reporting as opposed to tax planning!

Do bear in mind that some countries look beyond mere physical presence when determining residence status for tax purposes. For example, in France and Belgium the continuing presence of property and family may well result in the individual remaining resident there for tax purposes despite minimal time spent in that country. The US taxes its citizens and green card holders on a worldwide basis so leaving the US does not mean that US filing obligations and tax liabilities cease on departure. Additionally, non-employment income such as bank interest or rental income may well be taxable in the country of origin regardless of residence status.

Myth - The assignee spent less than 183 days in the location and is therefore exempt

I have alluded to tax treaty exemption above. Firstly, do check that there is a tax treaty between the relevant countries and that the individual is covered by the treaty. Brazil for example, does not have a full tax treaty with the UK. Also bear in mind that many US states do not follow US Federal rules when it comes to application of a tax treaty.

Assuming there is a treaty, the article entitled 'Dependent Personal Services' usually covers employment income. In contrast, the article entitled 'Independent Personal Services' usually covers self-employment income. This may include contractors, consultants and possibly partners. Directors may fall under a separate article as may certain professions/roles such as doctors and teachers. Do remember this as many assume the "183 day rule", which relates to employees only, applies to all.

Looking specifically at the employment income article, a common myth is that an individual is only taxable in a country if they spend 183 days or more 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; and
- 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.

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 fail the test. Notwithstanding this, some countries (for example Australia), look beyond the legal employer and want to consider who exercises real control over the individual. In such circumstances the local employer may well be regarded as the 'real' employer and treaty relief could be denied, irrespective of any 183 day test.

The last condition may appear straightforward, but again care needs to be exercised. Some treaties also include two little words '….as such'. In addition, some revenue authorities consider 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 by HM Revenue & Customs (HMRC) as the economic employer. The Netherlands and Germany broadly follow HMRC's thinking on this point. 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 does not mean that the income is also exempt in the home country and a tax liability may still arise there.

Many countries have reduced filing obligations if treaty exemption is likely, although this should be reviewed depending on the circumstances.

Myth - I received payment before I arrived or after I left so I can ignore it

On many occasions I have been told by employers and employees that assignment related payments made before the employee arrives on an assignment should be ignored for tax purposes. This is on the basis that it occurred before the assignment started and therefore any payment is irrelevant. Variations to this myth are touted such as; a different company paid it in a different currency so equally the payment can be discounted.

If an individual receives money or benefits in relation to a forthcoming assignment then the country to which they are being assigned will generally want to tax the payment. For example, relocation payments paid overseas are taken into account when looking at eligible relocation expenses in the UK and the £8,000 qualifying limit

Equally when an individual leaves a host country, it is often assumed that a payment received after departure is exempt from tax in the host country. You might also hear that it is exempt in the home country as it relates to the assignment period. Sorry to shatter any illusions you may be harbouring but generally this is not true, although an element of truth may apply to the non-taxation of bonuses paid post departure in relation to Brazilian services.

It is therefore necessary for individuals and employers to be able to identify, track and report as necessary, assignment related income and benefits to the host country. It is recognised that particular difficulties can arise in tracking bonuses and even more so items such as share options and stock awards/incentives as individuals may be assigned to several countries before the taxing event takes place. Notwithstanding this, where income clearly relates to the assignment country, pre or post departure, it should be reported as appropriate. It is increasingly feasible and likely that the assignment country will want its' share of tax.

Myth - The assignee is not paid in the country and wage withholding does not therefore apply

Another common myth is that where an individual is paid in a different country, sometimes by a different employer, then wage withholding does not apply. Some countries, for example the UK and the Netherlands, disregard such factors and may impose a withholding obligation on the company, which has the use of the assignee in the host country or alternatively, impose withholding on the assignee themselves. As employers you face added risks; if withholding is not operated then revenue authorities usually come after the employer and not the assignee. This can be particularly expensive for an employer where the assignee no longer works for the company or has no intention of making good any shortfall in withholding to the employer. To add to the expense the revenue authorities may also insist on a gross up calculation for the tax paid by the employer. An employer ignores withholding taxes at their peril.

Myth - My work permit did not come though so I do not have to file a return for this period

How many times has an employer not obtained a work permit for an individual before an assignment commences and therefore sent the individual anyway to the host country on a 'business trip' as the 'assignment' has not yet started? In such circumstances both employees and employers are often reluctant to file returns and acknowledge the existence of the individual at the host location. Two wrongs do not make a right. Failing to file a return and report income as appropriate is incorrect. Despite the permit or visa failing, the tax return should be filed correctly. Date of arrival for tax purposes usually means physical arrival not the date the work permit was issued.

Summary

I have only briefly covered a few of the myths that circulate. I am sure you all know many more and please do let me know what they are. Most tax myths that you hear either started off as true stories that have been embellished along the way and are not quite right or, plain and simply, are incorrect. Whilst they are legendary they rarely have any real substance today unlike the Loch Ness Monster, the yeti and mermaids!

Future articles

I would welcome suggestions for future articles on the subject of tax, social security and international assignments. As a general rule such articles seek to be of a generic nature, as opposed to country specific, and aim to be of interest and use to HR professionals. Constructive feedback is most welcome.

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