Global Tax Update

CHINA

Full Text Amendment on PRC Individual Income Tax ("IIT") Law Released

The Chinese National People's Congress (NPC) published a draft amendment of the Individual Income Tax ("IIT") Law ("the Draft Amendment") on 29 June 2018. The Draft Amendment solicited public comments.

Key Changes to the Draft Amendment

Definition of China residents

An individual who is Chinese domiciled or is a non-domicile but has resided in China for 183 days or more in a tax year will be deemed as a Chinese tax resident. A Chinese tax resident is responsible for PRC IIT on all the income derived within and outside China according to the provisions of China IIT Law.

An individual who has no domicile and does not reside in China or who has no domicile but has resided in China for less than 183 days in a tax year will be deemed as a Chinese non-tax resident. A Chinese non-tax resident shall pay China IIT on income derived from China according to the provisions of PRC IIT law.

Consolidation of certain income types for taxation

The Draft Amendment is considering consolidating four types of labour income, including wage and salary, remuneration for personal services, author's remuneration and royalty into one category (hereafter referred to as "consolidated income").

Update of PRC IIT rate table and basic standard deduction

Currently, an IIT rate ranging from 3% to 45% is applied on wage and salary income. The unified progressive tax rate applicable for consolidated income has been issued. The tax brackets of the income applicable to tax rates between 3% and 25% are adjusted to allow taxpayers to enjoy lower tax rates while those of the tax rates from 30% to 45% remain unchanged. Basic standard deductions applied to wages and salary will continue to be applicable to consolidated income, whilst the monthly deduction amount will increase from RMB3,500 to RMB5,000 (i.e. RMB60,000 per year).

Specific additional tax deductions

As well as the above mentioned basic standard deduction and mandatory individual social security contributions, specific additional tax deductions such as child education, continued education, medical expenses for serious illness, housing loan interest and housing rent are under negotiation by the financial and tax department of the State Council and other relevant governments.

Proposal of annual reconciliation filing on consolidated income

Tax residents shall calculate IIT on consolidated income on an annual basis. However, for tax residents who have withholding agents, the tax liabilities shall be withheld and prepaid by the withholding agent on a monthly basis or based on the occurrence of the income. An annual reconciliation return should be performed from 1 March to 30 June following the year end if there is additional tax due or any overpayment. In the event of tax residents providing relevant information of specific additional tax deductions, the withholding agent shall not refuse to deduct such amounts while prepaying the monthly IIT.

Non-tax residents shall also calculate IIT on consolidated income on a monthly basis. The withholding agents shall withhold and prepay the IIT liability on behalf of the non-tax residents on a monthly basis or based on the occurrence of the income, and no annual reconciliation filings are required. If there is no withholding agent, non-tax residents need to perform self-declaration within 15 days in the following month upon receiving the income.

Anti-tax avoidance and collaboration among relevant authorities

Referring to anti-tax avoidance regulations of PRC Enterprise Income Tax, the tax authorities are given the power to make tax adjustments and impose interest in a reasonable manner in respect to individual tax avoidances - such as transferring of property between an individual and his/her related parties in violation of the arm's length principle, tax avoidance in tax havens outside China, and obtaining improper tax benefits from other unreasonable commercial arrangements.

BDO Comment

Impact on taxpayers

Taxpayers' tax burdens will be reduced, especially for middle and low income groups, through the modification of the tax rate and improvement of the tax deduction and specific additional tax deductions of the consolidated income.

The existing annual tax filing will be replaced by the annual reconciliation filing with the filing period to be updated from 31 March to 30 June of the following year.

Anti-tax avoidance and collaboration among relevant authorities indicates that China will strengthen information exchange among relevant parties and enhance the IIT administration.

According to the existing PRC IIT implementation rule, foreign nationals who reside in China for more than five full consecutive years will be subject to PRC IIT on their worldwide income. In light of the fact that the Draft Amendment may apply a 183-day period to determine the status of China tax residence, attention should be paid to any proposed changes to the aforesaid five-year rule. If any changes are made, it may significantly impact certain foreign nationals.

Based on the above, taxpayers should take extra care to ensure they can claim necessary tax benefits and avoid potential tax risks generated by these new policies.

Individual income tax policy for cash awards received by scientific and technological staff

In support of the implementation of the "Mass Entrepreneurship and Innovation" initiative and facilitating the transformation of scientific and technological achievements, notice has been issued on the Individual Income Tax Policy for Cash Awards Received by Scientific and Technological Staff for the Transformation of On-duty Scientific and Technological Achievements.

The main points of the Notice are:

(1) 50% of cash awards distributed to scientific and technological staff by non-profit research and development institutes and institution of higher learning is counted as "wage and salary income" for the current month to calculate the individual income tax due

(2) When distributing cash awards to scientific and technological staff, non-profit research institutes and colleges shall withhold and remit the individual income tax in compliance with the individual Income Tax Law.

This Notice came into force on 1 July 2018. It may apply if cash awards are offered within 36 months of this date.

EUROPEAN UNION

Changes to the Posting of Workers Directive

The Posting of Workers Directive (PWD) is in place to protect the employment rights of individuals on a work assignment in another European country. It assures that the worker has certain core rights in relation to pay, annual leave, maximum working hours and protection from discrimination etc.

The duration of time that an assignee can be classed as a "posted worker" is changing from the current 24 months. This will in future be limited to 12 months with the potential to extend it to 18 months. After this time, all employment rights available to local employees within the host country will be applicable to the assignee, not just the core rights applicable through the PWD.

BDO Comment

No date has been set as of yet for the changes to come into place, but there will be a two year implementation period. However, it is best to start thinking about the affect this will have on you as an employer now. The term "posted worker" covers the spectrum of employees, from short-term business visitors to commuters to long-term assignees. Therefore, the PWD and the changes coming into place will most likely affect your employees. Brexit may of course add an additional complication.

NETHERLANDS

Dutch Tax Treaties with the Gulf States/ Tax Exemption instead of Tax Credit

According to current tax treaties between the Netherlands and some Gulf States (such as Bahrain and Oman), a tax credit must be taken to ensure there is no double taxation on employment income. For Dutch tax residents this means it is possible to deduct the actual taxes paid in the foreign country.

As the income relating to the activities carried out in those counties may not be taxed there would be no reduction of Dutch taxes and the income relating to the duties performed would be fully taxed in the Netherlands (maximum tax rate in 2018 is 51.95%).

The Dutch State Secretary of Finance issued a decree in 2017, which includes an approval for Dutch residents to use the tax exemption method instead of the credit method on certain employment income relating to activities in the Gulf States. By using the tax exemption method, the income relating to the activities in the Gulf States is relevant and not the actual tax paid. By using this method these employees benefit from the fact that that there may be no taxes due in the other country.

Recently the Dutch State Secretary of Finance informed the parliament that it is an exceptional situation that there is low or no taxation in these countries. He mentioned that the decree only applies to Dutch residents with income relating to employment performed in these countries.

The State Secretary does not foresee any tax-constructions on this point because there must be real employment relationships. However, the Dutch tax authorities are alert to signals of possible abuse.

UK

Benchmark Scale Rates and Overseas Scale Rates – abolition of receipt checking

From 6 April 2019, there will no longer be a requirement to evidence claims which fall under the threshold set out in Benchmark Scale Rate (BSR) and Overseas Scale Rates (OSR). However, this treatment is only applicable to claims that fall within scope of these rates, therefore it is important to remember that a claim still needs to be verified as such before assuming this treatment.

New Double Taxation Agreements (DTA's) with Guernsey, Jersey and Isle of Man

The UK has signed new DTAs with the 3 Crown Dependencies. They are expected to come into force by the start of the next tax year. These new treaties will replace the existing treaties, which have not been updated since the 1950s. They are OECD model treaties and BEPS compliant.

There are key changes regarding residence and taxation of employment income:

- The old treaty defined residence by reference to the domestic laws. This is still the basis for the new treaty but there is now a tie breaker test so it is clear where an individual is considered resident when applying the terms of the treaty
- Revision to the employment income article on the period over which 183 days is calculated and bringing in the concept of economic employer
- Inclusion of a specific article to cover director's remuneration.

> Non-resident directors may also find they are now liable to tax on income for board positions they hold in the other location

- **BDO Comment**

Individuals and employers need to be aware of these changes. It is now more difficult to be exempt from tax in the host location as the parameters have been tightened up. Non-resident directors may also find they are now liable to tax on income for board positions they hold in the other location (i.e. the country in which they are not resident).

HMRC Consulting on Extending the Application of the Short-Term Business Visitor Agreement

For a number of years now, companies have been able to put a business visitor agreement in place with HM Revenue & Customs (HMRC) to ease the strict PAYE withholding regulations for overseas employees coming to work in the UK. This covers those employees that would ultimately be exempt from UK tax under a double tax treaty, including employees of overseas subsidiaries but not those employed by an overseas branch of a UK company.

The government is looking to simplify the tax and administrative treatment of visitors from overseas branches and comments have been sought by HMRC. Two broad options were proposed:

1. Extending the availability of the annual PAYE scheme to those coming to work for up to 60 days in a tax year.
2. Implementing a new exemption under the business visitor arrangements such that branch employees would be treated in a similar fashion to employees of overseas subsidiaries.

BDO Comment

It is welcome news that the UK government and HMRC is looking at ways to simplify the tax and administrative burden for overseas branch employees. This should encourage further inward travel and investment to the UK, especially with the backdrop of Brexit to consider and the ever increasing scrutiny on international businesses to ensure they are compliant. As we progress through the consultation period we will provide any relevant updates.

Biometric Residence Permits and National Insurance Numbers

From August 2018, a National Insurance (NI) number will be issued alongside UK residence permits regardless of an expatriate's liability to pay NI contributions. This will not automatically mean all expatriates will now be liable to NI – this will still be determined by the underlying social security legislation. HMRC has advised that a NI number will assist them in tracing expatriate records.

BDO Comment

Employers should be aware that NI numbers will now be issued even where no liability to NI contributions arise. They still need to understand the relevant social security legislation to ensure NI is paid where it is due.

US

New IRS Compliance Campaigns: Increased Risk of Examination for Tax Returns with Foreign Elements

The Internal Revenue Service (IRS) announced on 21 May 2018, six additional compliance campaigns in addition to twenty-nine campaigns that are currently in process. Considering the new tax legislation enacted on 22 December 2017, and also their stagnating (or decreasing) budget, the IRS Large Business and International division (LB&I) is moving toward issue-based examinations. It appears that the IRS is deploying its limited resources (personnel and budget) into areas where it can achieve the biggest gains. The latest compliance campaigns announced in May, focus heavily on international topics (five out of the six compliance campaigns address international individual compliance issues).

Form 1042 (Annual Withholding Tax Return for US Source Income of Foreign Persons) and Form 1042-S (Foreign Person's US Source Income Subject to Withholding) Compliance – if payment of US source income (interest, dividends) is made to foreign persons, the payer is required to comply with withholding and reporting requirements. Those requirements may create significant burden for payers who do not make those payments often and who may not have staff who are adequately trained.

Form 1040NR (US Non-resident Alien Income Tax Return) – the LB&I lists three specific topics in its campaign with respect to non-resident aliens:

- Tax treaty exemptions
- Deductions reported on Schedule A (itemised Deductions), and
- Tax credits.

Non-resident aliens can exempt certain income based on income tax treaties between the US and their home country; however, as each treaty may be somewhat different, it is often difficult to navigate the complex and confusing set of rules. Incorrect application may trigger an examination that could result in additional tax, penalties and interest.

Even though Form 1040NR is similar to the US Individual Income Tax Return (Form 1040) filed by most US citizens, green card holders and resident aliens, there are differences that have a significant impact on an individual's taxable income and ultimately their income tax liability. One of those differences is the tax treaty exemption described above. In addition, the itemised deductions allowed on a non-resident alien return are very limited compared to the itemised deductions allowed on Form 1040. Lastly, many of the credits available to US citizens, green card holders and resident aliens are not available to non-resident aliens.

Form 3520/3520-A (Foreign Trust Reporting) - The last of the internationally focused compliance campaigns may have the most significant consequences for those affected. A US tax resident who receives a distribution from, or contributes to a foreign trust, is required to file Form 3520. If a US tax resident owns a foreign trust or is considered the owner of a foreign trust, the trust must file Form 3520-A. It may come as a surprise but many foreign investment instruments can fall under foreign trust reporting (e.g. Canadian Registered Education Savings Plan). Depending on the situation, generally the initial penalty for failing to file Forms 3520 or 3520-A can be $10,000 or up to 35% of the gross reportable amount (whichever is greater).

BDO Comment

The IRS is focusing its resources on many of the foreign elements reported on income tax returns or informational forms. The penalties can be substantial and corrective action time-consuming and expensive. It is important to remember that each compliance campaign lists several treatment streams (such as education and outreach), but every single campaign addresses non-compliance and errors through examination.

Prepared by BDO LLP. For further information please contact Andrew Bailey on 0207 893 2946 or at andrew.bailey@bdo.co.uk