

MERCER

Consulting. Outsourcing. Investments.



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Mercer webcast



2010

Expatriate Tax Planning: A Complex Issue?

Slagin Parakatil, Geneva

Corné J. Leeuwenhaag, Amsterdam

Agenda

- **OECD Model Convention**
 - Residence
 - Employment Income
- **Social Security**
- **Tax Planning**
 - Tax Equalization
 - Tax Protection
 - “Laisser Faire”
 - Local Contract
- **Example: Tax Equalization**
- **Gross Up: Steps & Case Studies**
- **Q&A**



OECD Model Convention

OECD Model Convention

Definition of Residence: Article 4 (1)

- For the Purpose of this Convention, the term “resident of a Contracting State” means any person who, **under the laws of that State, is liable to tax therein by reason of:**
 - his domicile
 - his residence
 - the place of management
 - or any other criterion of a similiar nature

OECD Model Convention

Definition of Residence: Article 4 (1)

Based on national law of country

Sometimes conflicts



Deemed residence, citizenship
(USA)

General rule:

- Residents: World-wide income
- Non-residents: Local-source income

OECD Model Convention

Definition of Employment Income: Article 15 (1)

General Principle:

Employment Income is exclusively taxed in the Residence State

Exception:

Unless the work is exercised in the other State (known as Work State)

Example:

Employee is assigned from the UK (home) to work a year in the Netherlands
Which country has the right to levy taxation:

-The Netherlands

OECD Model Convention

Definition of Employment Income: Article 15 (2)

General Principle:

The **Work State** is allowed to tax if:

1. Employee present for more than **183 days in the Work State**

OR

2. The **remuneration is paid by**, or on behalf of an employer who is **resident in the Work State**

OR

3. The **remuneration is borne** by a **Permanent Establishment** of the employer in the **Work State**

OECD Model Convention

Example:

- John, a UK resident is sent by his UK employer to work in NL:
 - 1st August 2010 to 31st December 2010
- His employer wants to send him again to NL:
 - From 1st May 2011 until 31st September 2011



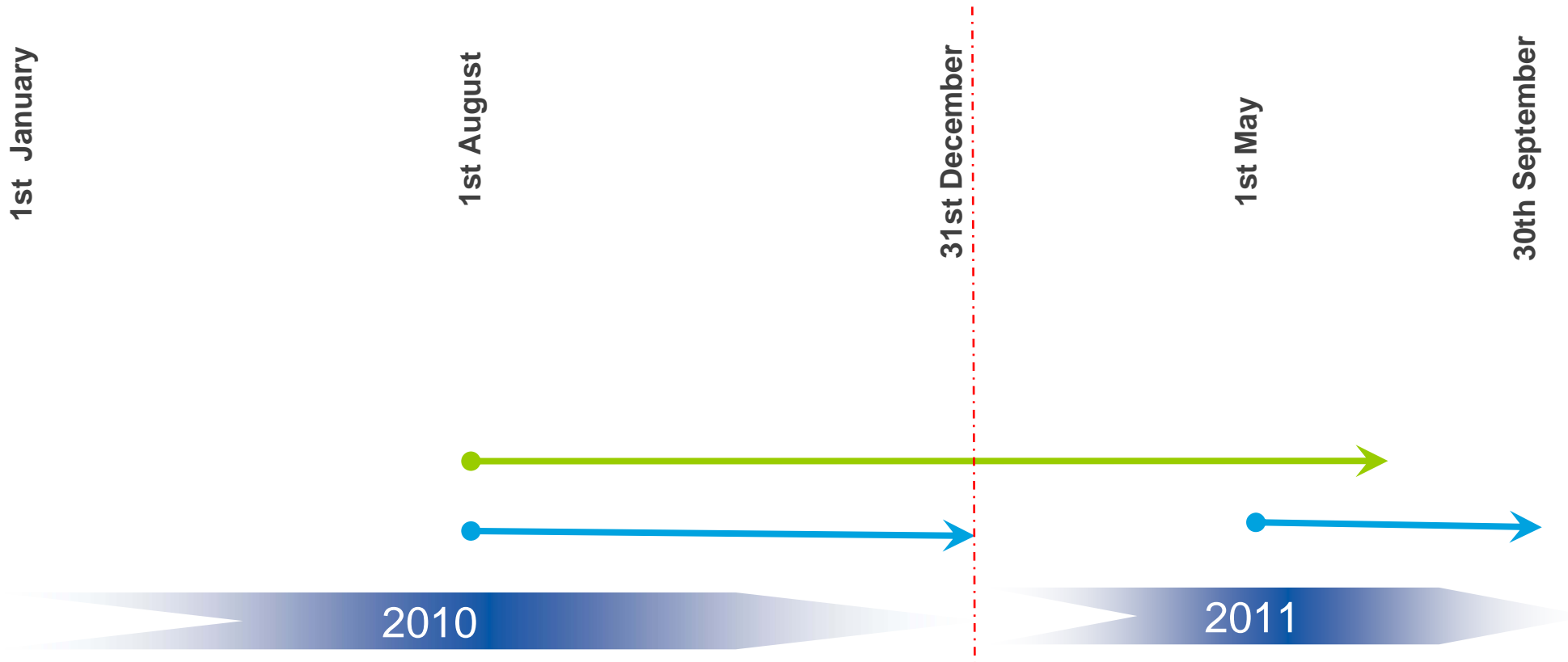
Questions

- Where is this person taxable?
- What happens if he is paid by the Dutch employer?
- What happens if there is a direct salary charge to the Dutch entity?
- What happens if this person is a Statutory Director?

Answers

- UK, as the assignment is shorter than 183 days and fail other tests.
- The Netherlands, see second test.
- The Netherlands, see third test.
- Depends on where the company is residing, follows that.

OECD Model Convention



- Any 12 months periods (1st August 2010 to 30th July 2011)
- Assignment period during calendar year
- Tax Year in United Kingdom



Social Security

EU Regulation 883/2004 (former 1408/71)

- Rules for the avoidance of double Social Security: **EU Regulation 883/2004 (former 1408/71)**.
- **Valid only for EU member states and members of EFTA**
- **Basic Rule:**
 - Employee covered by the legislation of the Member State where he normally performs activities (work state-principle)

Three exceptions for employees:

- 1. Secondments/assignments**
- 2. International transport employees;**
- 3. Employees with two or more work states.**

- **Secondments/Assignments:**

- For a maximum period of twelve months
- Employed by a company to which employee is normally attached;
- To perform work in another Member State;
- Not sent to replace another person who was assigned;
- Anticipated duration of that work does not exceed 12 months

Home Social Security Authorities issue a Document E 101

Extension of the initial secondment by 12 months:

- Extension due to unforeseeable circumstances
- Continuation of the home coverage:
 - Other Member State has to agree

Home Social Security Authorities issue a Document E 102

EU Regulation 883/2004 (former 1408/71)

- Assignment longer than 12/24 months
- Article 17
- Employees with two or more working states
 - Old rule one day per month working in resident state
 - New rule 25% criterium
- Transitory rules for existing cases, until 1 May 2020



Tax Planning

Tax Planning

Typical Tax Arrangements

Tax Equalization

The expatriate pays **no more or less tax or social security** than he/she would have paid if he/she had remained working in his/her home country.

Tax Protection

The expatriate pays **no more** tax or social security than he/she would have paid if he/she had remained working in his/her home country.

“Laissez Faire”

The employee agrees **their own "deal" with their employer.**

Local Contract

The employee transfers their employment to the host location and moves **on to local terms and conditions**

Tax Planning

Tax Equalization

Principle:

- Expatriate pays “hypothetical” tax and social security based on the emoluments that he would have got if he was not assigned.
- The employer of the expatriate pays the actual home and host taxes and social security on the total taxable amounts in both home and host.
- The employer will provide tax assistance for filing both host and home income tax returns.
- After the tax year the hypothetical taxes are recalculated on the non-assignment emoluments of the expatriate; any balance will result in a refund or payment from the expatriate to the employer.

Tax Planning

Tax Equalization

Advantages:

- Ensures equal treatment for all expatriates
- Helps to stimulate cross border employment of expatriates
- The benefit from an assignment to a host country with lower tax rates results in cash flow for the employer
- Compliance of both host and home income tax return is included

Disadvantages:

- Expensive for the employer
- Complicated to understand for expatriates
- Complicated for administering purposes:
 - What emoluments do you include in the equalization?
 - In order to calculate the hypothetical taxes you need all tax information from the expatriate

Tax Planning

Tax Protection

Principle:

- After the tax year the amount of taxes and social security that the expatriate paid in both home and host location are compared with the amount of taxes and social security he or she would have paid if he remained working at home
- If the expatriate paid more taxes and social security: the negative balance is received from the employer
- If the expatriate paid less taxes and social security: the benefit is for the expatriate
- In most policies: it is determined that the expatriate has to take care of filing his home and host income tax return

Tax Planning Tax Protection

Advantages:

- Easier to understand for expatriates
- Simpler and less costly to administer

Disadvantages:

- The expatriate gets all the benefits, if any
- Could affect the expatriates' choice for accepting an assignment
- Tax compliance for both home and host is not taken care
- Who will pay the taxes for both home and host on any payment of the balance of taxes to the expatriate?

Tax Planning

Laissez Faire

Principle:

- Employee usually remains employed in their home country
- Employee agrees assignment package with their employer
- Employee is then responsible for ensuring compliance with host location withholding, reporting and filing requirements

Tax Planning

Local Contract

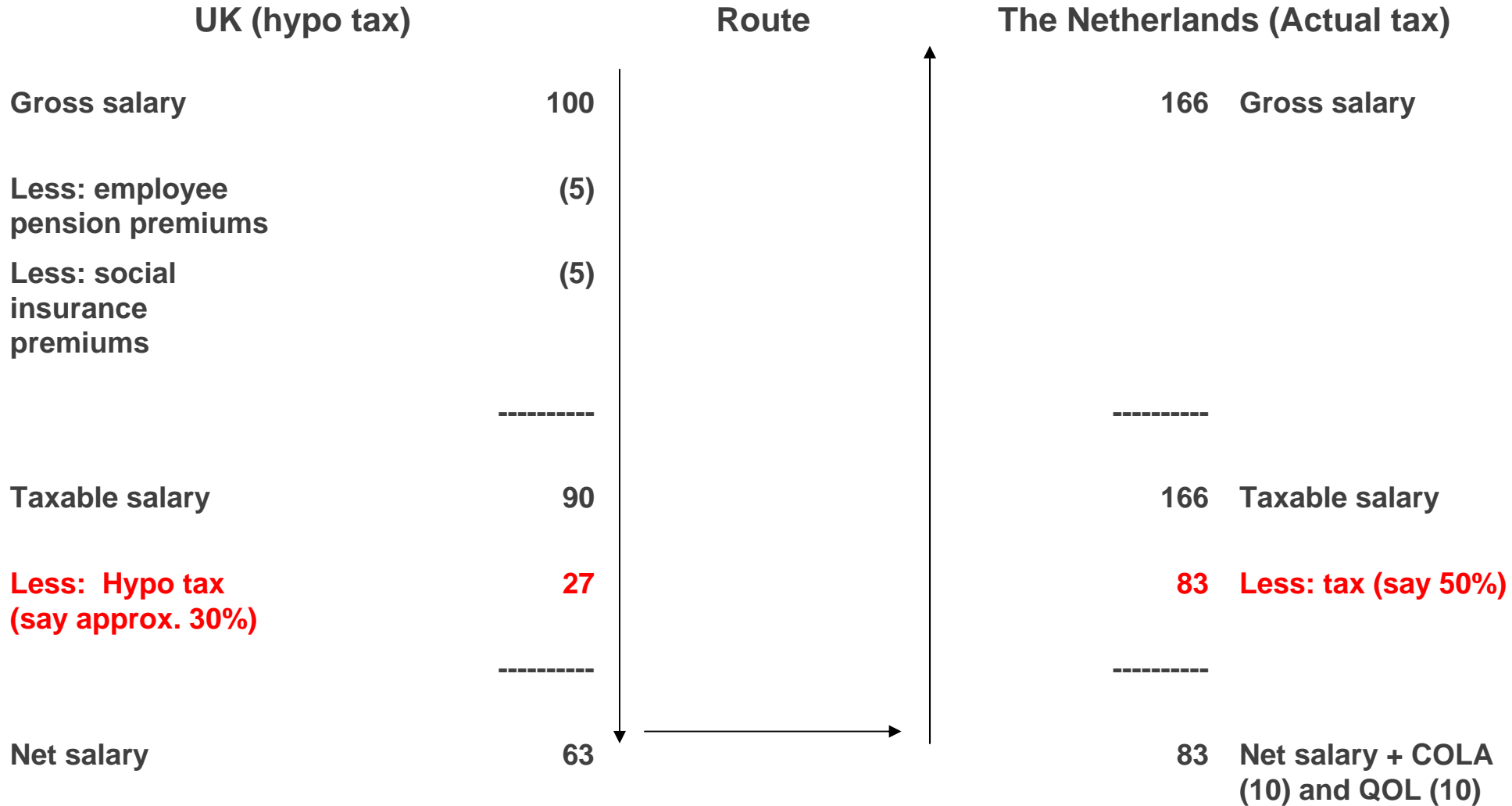
Principle:

- Individual becomes an employee of the host location
- Is remunerated according to salary package for equivalent role in host location
- Pays their own tax and social security (host)
- Employee is then responsible for ensuring compliance with host location filing requirements



Example: Tax Equalization

Example: Tax Equalization Overview





Gross Up: Steps & Case Study

Gross Up

Steps to follow

- **Step 1:** Balance Sheet Calculation & Gross up
- **Step 2:**
 - Check the expatriate package
 - What the items which are taxable and non-taxable allowances
 - Why is this relevant?

Net home country pay	200'000
Taxable allowances	75'000
Non-Taxable allowances	40'000
Partial Taxable allowances	10'000
Partial Non-Taxable allowances	6'000
Total Expatriate Package	331'000

Gross Up

Steps to follow

Total Expatriate Package Gross Up in Host

	USD	
Net Home Country Pay	200,000	
Taxable Allowances	85,000	
Total Net to be Grossed Up	285,000	50%
Assume 50% of Tax	285,000	50%
Gross in Host Country:	570,000	100%

	USD	
Net Home Country Pay	200,000	
All Allowances (Taxable & Non Taxable)	131,000	
Total Net to be Grossed Up	331,000	50%
Assume 50% of Tax	331,000	50%
Gross in Host Country:	662,000	100%

Difference in Total Cost: USD 92,000

Gross Up

Steps to follow

- **Step 3:** Keeping Home or Host Social Security?
 - **For European Union & EFTA Member Countries:** Check out the European rules for avoidance of double SS.
 - **For other countries:** Check out if there are any Totalization Agreements
 - **If no Totalization Agreement:**
 - Possibility of Double Coverage: Home & Host SS

Gross Up

Case Studies 1: Amsterdam to Shanghai

- Base Salary: EUR 100'000 ✓
- Marital Status: Married with 2 Children ✓
- Cost of Living Allowance (Mean to Mean): ✓
- Housing Allowance: ✓ (cash allowance)
- Quality of Living Allowance: ✓
- Mobility Premium: ✓ (10%)
- Education Allowance: ✓
 - International Schools (including: Annual Fee; Entry Fee; Non Refundable Fee; Refundable Fee)
 - Primary
 - Kindergarten
- Car Allowance: ✓ (EUR 10,000 per annum)

Gross Up

Case Studies 1: Amsterdam to Shanghai (cont'd)

Marital Status: Married with 2 children	Home City AMSTERDAM (EUR)	Host City SHANGHAI (CNY)		EUR	CNY
1. Gross home country reference salary	100000		5. Housing		
- Hypothetical social security	7635		a) Host location expatriate accommodation costs	56397	579144
- Hypothetical personal income tax	35642		b) Hypothetical home country housing costs *	11027	113236
- Other Deductions	0		c) Housing allowance	45370	465908
+ Family Allowances	1840		* set amount to 0 if employee is to receive free housing.		
2. Net home country pay (based on May 2008 tax data)	58563		6. Equalized net host country pay		
Breakdown of net home country pay				103933	1067290
(Index Related)	% of Net		7. Expatriation premiums		
- Housing	18.829	11027	- Quality of Living allowance based on 15% of Gross	15000	154035
- Savings and other expenses	30.661	17956	- Mobility premium based on 10% of Gross	10000	102690
- Spendable income	50.510	29580	8. Equalized net host country pay including expatriation premiums	128933	1324015
Total Net	100.000		9. Other allowances (according to company policy)		
			- Education allowance	34190	351100
a) Spendable income level applied in this calculation**	29580		- Car allowance	10000	102690
b) Cost-of-Living Index (Mean to Mean with home as 100)	94		- Other allowances		
c) Exchange rate		1 EUR = CNY 10.26903	10. Equalized net host country pay including other allowances	173123	1777805
d) Cost-of-Living Index to be applied in this calculation	94				
e) Cost-of-Living Allowance (COLA)	0				
Host Location Compensation Build-Up					
3. Net home country pay (same as item 2 above)	58563	601382			
4. Cost of Living Allowance (COLA)	0	0			

Gross Up

Case Studies 1: Amsterdam to Shanghai

Taxable:

- There is no actual receipt of the housing costs, therefore we have to consider the housing allowance as a taxable allowance.
- QOL Allowance; Mobility Premium
- Car allowance: if we assume this as a cash allowances it is taxable and therefore we do have to include it in the amount we gross up.

Non-Taxable:

- Education allowance (CNY 351,100) sees to children it is non taxable and therefore we don' t have to include it in the amount we gross up.

Net home country pay	601,382
Housing	465,908
QOL	154,035
Mobility premium	102,690
Car allowance	102,690
Amount to be grossed up	1,426,705

Gross Up

Case Studies 2: Amsterdam to Shanghai

- Base Salary: EUR 100'000
- Marital Status: Married with 2 Children
- Cost of Living Allowance (Mean to Mean): ✓
- Housing : Free Housing (Employer pays rent directly to the landlord)
- Quality of Living Allowance: ✓
- Mobility Premium: ✓ (10%)
- Education Allowance: ✓
 - International Schools (including: Annual Fee; Entry Fee; Non Refundable Fee; Refundable Fee)
 - Primary
 - Kindergarten
- Car Allowance: ✓ (EUR 10,000 per annum)

Gross Up

Case Studies 2: Amsterdam to Shanghai

Marital Status: Married with 2 children		Home City AMSTERDAM (EUR)	Host City SHANGHAI (CNY)	5. Housing	EUR	CNY		
1. Gross home country reference salary		100000		a) Host location expatriate accommodation costs	56397	579144		
- Hypothetical social security		7635		b) Hypothetical home country housing costs *	0	0		
- Hypothetical personal income tax		35642		c) Housing allowance	56397	579144	56397	579144
- Other Deductions		0		* set amount to 0 if employee is to receive free housing.				
+ Family Allowances		1840		6. Equalized net host country pay			114960	1180526
2. Net home country pay (based on May 2008 tax data)		58563		7. Expatriation premiums				
Breakdown of net home country pay (Index Related)	% of Net			- Quality of Living allowance based on 15% of Gross			15000	154035
- Housing	18.829	11027		- Mobility premium based on 10% of Gross			10000	102690
- Savings and other expenses	30.661	17956		8. Equalized net host country pay including expatriation premiums			139960	1437251
- Spendable income	50.510	29580		9. Other allowances (according to company policy)				
Total Net	100.000			- Education allowance			34190	351100
a) Spendable income level applied in this calculation**		29580		- Car allowance			10000	102690
b) Cost-of-Living Index (Mean to Mean with home as 100)		94		- Other allowances				
c) Exchange rate			1 EUR = CNY 10.26903	10. Equalized net host country pay including other allowances			184150	1891041
d) Cost-of-Living Index to be applied in this calculation		94						
e) Cost-of-Living Allowance (COLA)		0						
Host Location Compensation Build-Up								
3. Net home country pay (same as item 2 above)		58563	601382					
4. Cost of Living Allowance (COLA)		0	0					

Gross Up

Case Studies 2: Amsterdam to Shanghai (cont'd)

Taxable:

- Car Allowance: if we assume this as a cash allowances it is taxable and therefore we do have to include it in the amount we gross up.
- QOL Allowance; Mobility Premium

Non Taxable:

- Housing (CNY 579,444) is paid directly to the landlord it sees to actual costs and therefore is a non-taxable allowance.
- If we assume the Education Allowance (CNY 351,100) sees to children, it is non taxable and therefore we don' t have to include it in the amount we gross up.

Net home country pay	601'382
QoL	154'035
Mobility premium	102'690
Car allowance	102'690
Amount to be grossed up	960'797

Questions and contacts



Slagin Parakatil
Geneva
+41 22 869 3079
slagin.parakatil@mercer.com



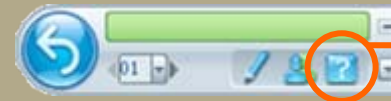
Corné J. Leeuwenhaag
Amsterdam
+31 6 4628 8231
corne.leeuwenhaag@mercer.com

Questions

Please type your questions in the Q&A section of the toolbar and we will do our best to answer as many questions as we have time for.

To submit a question while in full screen mode, use the Q&A button on the bottom right-hand side of your screen.

To submit a question while in half screen mode, use the Q&A panel on the bottom right-hand side of your screen.



CLICK HERE TO ASK A QUESTION TO "ALL PANELISTS"

Survey

Please take the time to fill out the survey at the end of this web briefing so we can continue to improve. The survey will pop-up in a new window when the session ends.

mercer.com/webcasts

View past recordings and sign up for upcoming web briefings

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN