

# Asia Pacific Tax Adviser

Grant Thornton 

A quarterly round up of recent tax developments in the Asia Pacific region

This edition of the Asia Pacific Tax Adviser examines issues concerning overseas secondments and expatriate taxation. The costs can be significant and one which is often overlooked during arrangements is the taxation cost to either the expatriate or the employer. In this issue we consider how secondments can be structured to reduce tax implications for both the employer and the employee.

## Counting the tax cost of expatriate secondments

by David Southwood

With the increasing globalisation of business many companies, not just large multinationals, now regularly second staff from one tax jurisdiction to another.

The secondment or relocation of an employee to another jurisdiction can be an expensive exercise for an employer in terms of the transportation of the employee, his or her family and personal effects together with the costs of establishing the employee in the new location. In addition, there can be the cost of providing cost of living allowances and/or additional benefits such as home flights and education for the employee's children. These costs are usually recognised at the time of

negotiating the employment contract or secondment agreement with the employee.

However, a cost that is often not given due consideration is the additional taxation cost arising from relocating the employee. These costs can occur either as a result of a higher rate of tax in the new jurisdiction, or a difference in the taxation treatment of a particular benefit enjoyed by the employee. For example, stock option schemes attract different tax treatment in different jurisdictions. The employee may also face additional tax liabilities due to a difference in the treatment of non employment income such as investment income and capital gains.

The minimisation of the tax consequences of relocation should be a significant consideration in the reassignment of staff to different jurisdictions. Many companies use tax equalisation programmes to ensure that the employee is not unduly disadvantaged through an overseas secondment. Under a tax equalisation programme the employees will typically suffer the same tax liability during the secondment as they would have borne if they had remained in their home jurisdiction, with any additional taxation liabilities over and above that amount paid by the employer. Conversely any tax savings will go to the employer. Thus there is an incentive for the employer to structure the employment package to reduce the overall tax liability and reduce the cost to the employer. Tax equalisation schemes are very flexible and can be

tailored to the requirements of individual employers and their employees.

If there is no tax equalisation programme there is still an incentive to structure the employment contract in a tax efficient manner to reduce the employee's tax liability, especially if the tax is paid wholly or in part by the employer.

A fundamental part of expatriate tax planning is a knowledge of the tax systems in both the employer's home jurisdiction and the jurisdiction to which the employee is to be located as well as the country where the employee is a resident or citizen if he or she has a tax liability in that jurisdiction. The expatriate tax teams of Grant Thornton International's member firms in the Asia Pacific region can advise both employers and employees on planning and compliance matters.

The member firms of Grant Thornton International in the Asia Pacific region have issued a series of factsheets setting out information regarding the taxation treatment of expatriates in various jurisdictions in the Asia Pacific region. These factsheets also identify some tax planning opportunities.

Copies of these factsheets can be obtained from your local Grant Thornton contact or from Leela Murugasu (lmurugasu@gtwa.com.au) or David Southwood (david.southwood@gthk.com.hk).

# Structuring Overseas Secondments to minimise tax

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BNA International's "Tax Planning International Review", October 2005

by Lloyd Pinto & Nitesh Mehta

Travelling employees can sometimes constitute a permanent establishment (PE) in a foreign country – a taxable presence for their employer. The employer may be required to file a tax return and comply with other statutory requirements. Multinational companies regularly send their employees to work in foreign group companies. In order to avoid the creation of a taxable presence in the foreign jurisdiction, it is possible for the company to enter into a secondment agreement. A properly structured secondment arrangement can help companies alleviate the risk of establishing a service PE.

The secondment of technical personnel from a parent company to an overseas affiliate on short term (less than 183 days) assignments, to assist in the provision of technical services to clients of the affiliate or to provide training for the affiliate's staff is a common occurrence in the services sector. It is important that these secondment arrangements are appropriately structured to ensure it is clear the affiliate is being provided with a service, not an employee.

In the international scenario, income from services can be taxed in the source country either as business income or fees for technical/included services. The latter is more peculiar to treaties entered into by developing countries such as India.

Business income may not be taxable in the source country in the absence of a permanent establishment. However, fees for technical services may be subject to withholding tax even though the same may not have been rendered in the source

country. Certain tax treaties contain what is popularly known as a "Service PE clause" whereby furnishing of services through employees in other countries gives rise to a Service PE of the enterprise rendering the services. If a Service PE is created then it would be essential for the company to count income from such services as taxable and comply with the domestic tax laws of the country where the services are carried out by their employees. In this context, it is essential to determine whether a secondment arrangement is a "provision of services" or "provision of employees". If the secondment arrangement is regarded as "provision of services" there are a variety of tax implications:

- exposure to service PE
- withholding tax as fees for technical service.

All of the above difficulties could be avoided if the secondment arrangement is regarded as merely "provision of employees".

There are no defined principles or guidelines available to determine whether a secondment arrangement results in "provision of services" or "provision of employees." Some countries, for example Germany and Russia, have issued guidelines and there is guidance from the OECD.

Based on the OECD guidelines, the following broad parameters can be set out for a secondment agreement to be regarded as "provision of employees" and not "provision of services".

- Passive service – the seconded's role in the secondment arrangement is limited to provision of secondees with requisite abilities i.e. seconded should render passive service and not an active service
- Continuation of employment with seconded – secondees continue to remain employees of seconded
- Control and direction – the entity to which the secondees are sent should exercise control over the secondees
- Quality of output – the seconded is not responsible for the quality of output/work performed by the secondee. In



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other words, the place of work to which secondees have been sent should be responsible for quality, timeliness and other aspects of work performed by the secondee

- Secondment fees – should reflect that the payment is for “provision of employees” and not for “provision of services” where the fee would usually be higher

If the above parameters are met, it is possible to contend that the secondment agreement is for “provision of employees” and not “provision of services.” However, from a commercial and practical point of view, it may be difficult to comply with all the parameters set out above, particularly the fourth point. In practice, the seconder is usually liable for the actions of the secondees and such responsibility is an important part of the seconder’s reputation as a good service provider.

To avoid this problem one approach is to establish a special services company to employ all transferring executives and second them to the foreign company. This structure may, in some situations, avoid the creation of a taxable presence for the seconder in a foreign jurisdiction. Another alternative is to transfer the secondee to the payroll of the client but this could disadvantage the employee, possibly affecting their entitlement to benefits they would have enjoyed if remaining an employee of the seconder.

### **Employee share schemes in New Zealand**

*by Murray Brewer*

Under New Zealand rules an employee is taxed on the “discount” enjoyed when acquiring shares under a ‘share purchase agreement’ connected with the employee’s employment or service. The tax trigger point is the time the employee acquires the shares. Employees account for these gains through their annual personal income tax returns.

By way of an example, if an employee acquires shares under a share purchase agreement for a cost of \$2,000 and those shares have a market value of \$5,000 on the date the employee acquires the shares, then the employee derives a taxable gain of \$3,000, being the discount to market value on the date of acquisition.

In the case of expatriate employees, the tax treatment for share purchase agreement gains is complicated by the fact that the employment from which the gains arise may have been performed in multiple countries thereby giving rise to potential multiple taxation on the same income. Employees falling into this category should seek professional tax advice well before exercising options or purchasing shares under share purchase agreements. The OECD report on cross border income tax issues arising from employee stock option plans gives guidance on the treatment of cross border equity gains under tax treaty rules. However, in many cases expatriate employees may not have the benefit of a tax treaty to rely on to limit exposure to double taxation.

A tax bill is currently before the New Zealand Parliament. If passed into legislation, new income tax exemptions will be available to individuals who become first time New Zealand tax residents on or after 1 April 2006. The exemptions will also apply to returning New Zealanders who recommence New Zealand tax residence status on or after 1 April 2006 if they have been non resident for New Zealand tax purposes for 10 years or more. These individuals will be exempt from New Zealand tax on various categories of foreign source income including foreign service gains attributable to employment related equity schemes. These proposals will provide planning opportunities to individuals who come to New Zealand with unexercised share options and/or fully or partly vested share scheme benefits. The proposed exemptions are potentially more generous for individuals arriving in New Zealand to take up employment.

Individuals considering relocation to New Zealand should consider obtaining professional advice on the various categories of exemption and to ensure they structure their New Zealand tax residence status start date so as to qualify for these exemptions.

# Changes to rules for non permanent residents in Japan

## Proposed changes to close non-permanent resident “loophole”

by Kasumi Tsujimura

The recent income tax law reforms include a proposal on how non-permanent residents will be determined in Japan for tax purposes. These changes are expected to be implemented in 2007.

There are three classifications of residency provided for in Japan’s tax laws for the purposes of Japanese tax.

### Permanent resident taxpayer

A permanent resident for Japanese tax purposes is a person who has the intention of residing permanently in Japan or has maintained residence in Japan for a period of five years or more. Such a person is taxed in Japan on their Japan sourced income and worldwide income. This definition should not be confused with permanent residency as defined under Japanese immigration law. Under the Japanese immigration law, an application must be made to obtain permanent residency status.

### Non-permanent resident taxpayer

A non-permanent resident for Japanese tax purposes is a person who intends to reside

in Japan for more than one but less than five years and never forms the intention of residing permanently in Japan. Non-permanent residents are taxed in Japan on their Japan sourced income and any income they remit into Japan during the first five years they reside in Japan. Therefore, any income earned offshore is not taxable in Japan, until it is brought into Japan. If the individual stays longer than five years he is then classified as a permanent resident taxpayer (see above).

### Non-resident taxpayer

The third classification is that of a non-resident. A non-resident may visit Japan for short trips and other purposes, however the individual must stay for less than one year and never form the intention of taking up residency in Japan. Such taxpayers are taxed in Japan only on their Japan sourced income.

### Current law

Currently, taxpayers who have been in Japan for less (or more) than five years are able to leave Japan, i.e. “break residency,” and return 12 months or so later and “start again” as non-permanent residents for another five years before they become permanent residents for tax purposes. This

is done in order to avoid the unwelcome burden of Japan tax levied on their worldwide income.

### Proposed change

The proposed law change is designed to restrict the practice of non-permanent residents “breaking residence” as described above. In future, in order to qualify as non-permanent residents, individuals must not have been resident in Japan for an aggregate of five years in the past ten years. The treatment of non-permanent residents’ worldwide income will not change, they will only be taxed on Japan sourced income and income remitted into Japan.

This change in the law may have some ramifications for companies with expatriates in Japan and a review of their tax position including their tax equalisation policies may be required.

If you would like to find out more about how Grant Thornton member firms can assist you, please contact one of the divisional offices, or visit [www.gti.org](http://www.gti.org)

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