

Working Worldwide Newsletter

July 2006



Welcome to the Summer 2006 edition of Working Worldwide, our quarterly round up of changes to tax, immigration and employment legislation as they affect businesses and expatriate workers around the globe.

As the World Cup reached a thrilling climax in Germany we bring you news of Federal Cabinet approval of changes to German VAT rates, the latest news on the EU Services and Working Time Directives, plus radical changes to Hungary's tax system.

Outside Europe there are changes to 457 Visa regulations in Australia and a wide range of personal tax cuts, with relaxation of spouses work permits in Hong Kong and a tightening of legislation in China designed to improve tax records for expatriate workers.

In America a New Jersey Court has ruled that contract workers may be entitled to the same levels of protection as employees, whilst a law suit has been won by individuals who contested their classification as 'white collar' workers and were therefore denied overtime pay.

Anyone interested in the perennially popular UK issue of 'deemed employment' will find this issue a must, as recent studies suggest that many companies may inadvertently be laying themselves open to claims from the Tax authorities. Glotel offer an audit service to assess the risks you may be facing. If you would like more information on this or any other topic covered in this issue please do not hesitate to contact lpelling@glotel.com.

Regards,
Lara Pritchard
Tax & Compliance Director

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European Union

EU Ministers reach agreement on draft deal for the EU Services Directive.

After much debate the EU Services Directive appears to be gathering momentum. The European Parliament voted in favour of a watered-down version of the Services Directive in February and the 25 member states accepted the new draft heavily based on Parliament's text. The directive must now go back to parliament for a second reading, possibly before the end of the year.

The dilution of the original service directive has angered many of the new member states. The so-called "country of origin" principle that would have allowed service providers to follow the rules of their home country when operating abroad was dropped following concern from richer countries that they would be undercut and quality and safety may be compromised.

In the end the member countries agreed to an Austrian proposal for member states to screen each others' legislation and to compile a register of restrictions imposed on Foreign Service suppliers where it is crucial for public policy, healthcare and environment protection. This was described as compensation for the country of origin principle. However, it has been condemned as creating a huge bureaucratic burden.

UK Trade Minister Ian McCartney has estimated that the new rules could benefit

the UK economy alone by £5bn. In 2005 116 million people, nearly 70% of the EU's workforce worked in the service sector.

Stalemate on the rules of the EU Working Time Directive.

As reported previously in Working WorldWide the legality of the opt-out of the EU working time directive, open to workers in some member countries, is being discussed in Ministerial talks. The Austrian Presidency attempted to break the dead lock by holding talks on the opt-out, the talks went past midnight but Austrian economy minister Martin Bartenstein said after the talks "I don't see chances for compromise".

The UK, together with several new member states, resisted an attempt to make the opt-out unlawful, whilst France and Sweden pressed for it to be scrapped. Mr Bartenstein continued that the two camps are "irreconcilable". EU social policy commissioner, Vladimir Spidla added "Some countries have pursued a passive strategy as it is convenient for them to keep the status quo and it has proved a successful strategy.

It remains to be seen when the issue of the opt-out will be reconsidered, until such time the opt-out remains legal.



Belgium

Formal requirements to obtain tax exemptions for foreign earned income announced.

The Belgian tax authorities issued a circular letter on 11 May 2006 introducing formal requirements for taxpayers to obtain tax exemption for foreign earned income. Simply reporting the foreign earned income on the tax return will no longer be sufficient.

Belgian residents are taxable on their worldwide income, even if part of the income is earned abroad. Tax treaties typically allocate taxing rights in either the residence state, or both the state where the income arises and residence state. In the latter case, the residence state must prevent double taxation. It is the responsibility of

the tax payer to claim the exception and demonstrate that all the conditions are met.

Belgian residents are required to report foreign earned income in various places on the tax return. However the reporting does not allow the authorities to judge whether the income is exempt from tax.

According to the circular letter, tax inspectors are now required to tax all foreign income, unless the taxpayer specifically requests the exemption and provides them with sufficient proof that they qualify for the exemption. Examples of acceptable proof of presence abroad include hotel invoices, boarding passes, minutes of meetings etc.



Germany

Federal Cabinet accept changes to the German VAT rate and employers' social security contributions

From 1 January 2007 the standard rate of German VAT will increase from 16% to 19%. The present 7% rate on certain goods and services will remain unchanged. After income tax VAT is the largest contributor to the German Government's coffers and this rise is the largest in German history. The rise expected to be in the region of €20

billion per annum will be offset partially by a drop in the employer's contribution to the compulsory unemployment insurance fund. As of 1 January 2006 employers will have to contribute 4.5% rather than 6.5% of each employee's salary to that fund.

These changes are still subject to approval by the Federal Council expected in the summer of 2006.



Hungary

Hungarian Government submit a bill to Parliament covering radical changes to tax system, aimed at halting growth of Hungarian budget deficit.

The following represent the main tax rises. It is feared that such significant increases may lead to companies moving their seat of business to more tax beneficial jurisdictions:

- 4% solidarity surcharge issued on companies and individuals. All taxpayers, profitable entities and private entrepreneurs will be subject to this surcharge.
- Plans to introduce a minimum amount of corporate tax liability payable by every company. The minimum tax base would be 2% of the annual revenue and subject to 10% or 16% of corporation tax. The minimum tax would not be applicable to the first year of incorporation.
- From 1 September 2006 it is proposed that VAT will rise from 15% to 20%.
- Health tax which was planned to be abolished in November 2006 will remain in effect. From January 2007 it will rise from its current level of HUF 1950.
- Employee healthcare contributions will be increased from 4% to 6% from 1 September 2006 and then by a further 1% in January 2007.
- Employees' unemployment contributions will rise from January 2007 from 1% to 1.5%.



Poland

Government announce a package of planned tax reforms, affecting, amongst others, personal income tax and social security contributions.

Personal income tax

With retroactive effect from 1 January 2006 the following changes have been introduced:

- Tax-deductible costs would be increased to PLN 1,283 (increase of PLN 56);
- Tax-free amount would be increased to PLN 2,969 (increase of PLN 179); and
- Tax brackets and rates are instituted as follows:

| Taxable income (PLN) | Rate (%) |
|----------------------|----------|
| Up to 42,764 | 19 |
| 42,764 – 85,528 | 30 |
| Over 85,528 | 40 |

With effect from 1 January 2009, there would be only two personal income tax rates, i.e. 18% and 32% with a tax threshold of PLN 85,528.

Social Security

From 1 January 2007 mandatory disability pension contributions would be reduced from 13% to 9% (employee and employer would share equally the cost of this contribution); and the health insurance benefits would be decreased from 2.45% to 1.8% (employers would bear the entire cost; currently, employees bear the entire cost).



Turkey

Turkish Ministry of Finance release circular clarifying the application of the new withholding tax rates applied to non-resident companies.

Under the new Corporate Income Tax Act the general withholding tax rate applicable to Turkish-source income derived by non-residents is fixed at 15%. However, the Council of Ministers is authorized to reduce the rate to zero, or increase it to 30% for different items of income. The new 15% general rate (applicable from 1 January 2006) will be valid until the Council of Ministers uses its above-mentioned authority. The rates fixed under the previous decrees of the Council of Ministers continue to apply, except that they may not exceed the "legal limits".

The term "legal limits" is interpreted by the Ministry of Finance so that it does not refer to the general limit set by the law (15%) but to the upper limit under which the Council of Ministers may use its authority (30%). Consequently, the following withholding rates will continue to apply until the Council of Ministers sets the new rates:

Royalties & Fees for professional services = 22%
Proceeds from the sale of copyrights, patents & other intangibles = 25%
Rental payments for movable and immovable property = 22%
Dividends and branch profits = 10%



United Kingdom

What financial penalties could you suffer if your self-employed contractor is deemed to be an employee?

Regular readers will have noticed the employment status of contractors has become a perennial "hot topic". Businesses MUST be aware of the ramifications of engaging freelancers who are subsequently deemed to be employees.

The recent case *Demibourne vs Her Majesty's Customs & Excise (HMRC) (SpC486)* addressed this very issue. A worker who was treated by the Company as being self-employed was reclassified by the Special Commissioner as an employee.

The usual settlement pre-*Demibourne* was to accept that the individual has paid self-employed tax for the period concerned and to treat this as tax paid, only collecting the amount of National Insurance Contributions (NICs) due by the employer. This would include both the employer and employee contributions that would have been due as an employee – up to 23.8% paid to the employee. There were no deductions available for Class 4 contributions made by the individual. All settlements were levied on the deemed employer.

In *Demibourne*, the HMRC took a much more aggressive approach and sought a full settlement of tax in addition to the NICs. This would now seem to be the HMRCs standard approach, for the following reasons:

1. The amount of tax paid by a self-employed individual on income may be lower than the amount due by an employee on the same income due to the ability to claim for allowable expenses against taxable income. Accepting the self-employed tax rather than the PAYE equivalent would leave the exchequer worse off;
2. Where an individual has been reclassified as an employee, it is open to that individual to revisit his self assessment returns and amend any which are still open for amendment. This would result in the repayment of the tax to the individual concerned;
3. Where the HMRC claim for tax and NICs it is possible for the employer to offset the amount already paid by the individual whilst he/she was classified as self-employed but only with a mandate from the individual.

Previously where workers have been reclassified as employees the HMRC only looked to recover sums from the current tax year and have not backdated the tax; this appears to be changing with the HMRC now going back further. This is unlikely to happen where HMRC can see that the employers have genuinely tried to get the employment status right.

Employment status is notoriously difficult and there are a number of different factors to be considered. Different working methods adopted by contractors could also make a difference in the potential penalties companies could face if self-employed workers are deemed employees.

If your company is concerned about the potential risk it faces, Glotel are able to carry out audits to check compliance and potential risk from contractors and self-employed individuals. Contact Lee Pelling – Compliance Manager on lpelling@glotel.com.

The Department of Trade and Industry (DTI) acts on the ECJ judgement in regards to rolled up holiday pay.

In the April edition of working worldwide we reported that the European Court of Justice (ECJ) ruled that rolled up holiday pay was incompatible with the Working Time Directive. Rather than amend the Working Time Directive itself the DTI has chosen to amend its guidance.

The guidance now tells employers they 'should' renegotiate contracts which involve rolling up holiday pay as soon as possible. Remember when holiday pay is rolled up it is paid as part of the employees salary and no pay is received whilst the employee is on holiday. The guidance states that payment for leave is made when holiday is taken.

The amended guidance is still silent on where genuinely casual workers comply. It is recommended that you should treat each employment as ending when each casual assignment ends and pay holiday under the pro rata formula in Regulation 14 3 (b).

In the case of *McMenemy vs Capita Business Services* the Employment Appeal Tribunal ruled that where part time workers do not normally work on days that are occasionally bank holidays (i.e. Mondays) they are not entitled to pro rata pay or time off in lieu.

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United Kingdom (continued)

UK Government considers charging VAT on temporary workers.

In June 2006 the HM Revenue and Customs (HMRC) launched a review of an exemption from VAT for companies that use staff through a recruitment agency.

The Association of Technology Staffing Companies (ATSCo) warned that if VAT was charged on staff hire the costs would significantly increase. ATSCo went on to say "The Government is forever praising the contribution of temporary workers make to UK competitiveness, but, if VAT is charged on temps' salaries, organisations will use fewer temps and the flexibility in the UK labour market will be compromised".

The Confederation of British Industry (CBI) also added this as another example of how UK competitiveness is being damaged by the Government.

VAT is only likely to be levied where the temporary staff are PAYE workers directly through the agency and not where temporary worker work via a limited company.

The HMRC review is expected to be published by 31 August 2006.



Australia

Base salary calculation is changed for the 457 Visas

Employers sponsoring employees under a 457 visa, have to pay the employee the minimum base wage (excluding mandatory superannuation contributions and any discretionary payments such as accommodation, board, salary incentives, bonuses or commissions, travel, holidays, health care/insurance). The current minimum salaries are:

- General Occupations: AUD \$41,850
- IT professionals AUD \$57,300

From 1 July 2006 applications will not be processed unless the salary presented is at the above stated level, based on a 38 hour working week. If the employment contract is for a higher number of hours per week, the annual base salary will be adjusted so that it is based on a 38 hour week.

Changes made to the Working Holiday Maker (WHM) program

From 1 July 2006, several changes will be made to the Working Holiday Maker (WHM) - visa subclass 417 - program, including:
Increasing the work limitation with each employer from 3 to 6 months;
Increasing the study/training limitation from 3 to 4 months; and
Expanding the definition of 'seasonal work' (for second WHM visa eligibility) to include some primary industries (see new definition below).

These changes apply only to WHM visa applications lodged on or after 1 July 2006.

Seasonal work completed before 1 July 2006, in the industries listed below, may be counted toward the three months of seasonal work in regional Australia requirement for WHM visa applications lodged on or after 1 July 2006.

- picking fruit, nuts and other crops
- pruning and trimming vines and trees
- general maintenance crop work
- immediate processing of plant products
- other work associated with packing or transporting the harvest
- cultivating or propagating plants, fungi or their products or parts
- maintaining animals for the purpose of selling them or their bodily produce, including natural increase
- immediate processing of animal products including shearing, butchery, packing and tanning

- manufacturing dairy produce from raw material
- conducting operations relating directly to taking or catching fish, turtles, dugong, beche-de-mer, crustaceans or aquatic molluscs
- conducting operations relating directly to taking or culturing pearls or pearl shell
- planting or tending trees in a plantation or forest that are intended to be felled
- felling trees in a plantation or forest,
- transporting trees or parts of trees that were felled in a plantation or forest to the place where they are first to be milled or processed or from which they are to be transported to the place where they are to be milled or processed.

2006/2007 Australian budget announced on 9 May 2006 provides welcome personal tax cuts.

Personal Tax cuts

The budget provided for personal tax cuts by decreasing tax rates and increasing the tax threshold. The changes are shown in the table below:

2005/2006 Tax Rates

| Income Range | Tax Rate (%) |
|---------------|--------------|
| 0-6,000 | 0 |
| 6,001-21,600 | 15 |
| 21,601-63,000 | 30 |
| 63,001-95,000 | 42 |
| 95,001 + | 47 |

2006/2007 Tax Rates

| Income Range | Tax Rate (%) |
|----------------|--------------|
| 0-6,000 | 0 |
| 6,001-25,000 | 15 |
| 25,001-75,000 | 30 |
| 75,001-150,000 | 40 |
| 150,001 + | 45 |

These cuts were higher than predicted and The Treasurer stated that the decision was a direct result of the Hendy-Warburton benchmarking report which stated that Australia had a higher marginal tax rate than the OECD average of 46.7%.

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Australia (continued)

Superannuation

The budget included proposals to simplify and streamline superannuation from July 2007 including:

- tax free benefits for people over 60 who are paid lump sums or pensions from super funds;
- abolishing reasonable benefit levels (the maximum amount that can be received from

- a super fund that is subject to concessionary tax rates);
- removal of age-based limits on deductible super contributions allowing younger people to make tax effective salary –sacrifice contributions to their fund;
- streamlining contribution and payment rules.



China

Employers of Expatriate Workers to be audited to ensure compliance with new regulations

The Chinese Authorities will be carrying out an audit from July-December 2006 to assess the effectiveness of Circular 58 issued in January 2006.

Under Circular 58, taxation authorities are required to establish and maintain individual income tax archives and records for every company in China that employs foreigners, regardless of how many foreign employees are on site or how long they are there.

The records should include names (Chinese and foreign language), gender, nationalities,

birthplace, overseas and Chinese address, name of the company that sent them to China, dates of entry/exit in and out of China, remuneration, source of remuneration, withholding agent, declared taxes, taxes withheld and dates of tax payments made to the State Treasury.

This idea is to intensify the monitoring of expatriates' tax filings by imposing further reporting requirements on employers of foreign citizens and ensuring that taxes are correctly collected.

Details of the audit will be issued in early 2007.



Hong Kong

Spouses of work permit holders can legally work without restrictions

From May 2006 spouses who accompany an individual holding a “professional expatriate” or a “capital investor” visa are allowed unrestricted work rights without the need to apply for a separate employment visa.

However, a legal spouse does not include common-law spouses or same-sex partners. Spouses of student visa holders are not eligible for work rights.

Spouses of existing qualifying visa holders can apply to the Hong Kong Immigration Department to have the employment restriction removed from their visa.



Indonesia

Changes to work permit application process may increase costs of immigration.

The Indonesian Government recently enacted a decree stating that all Indonesian companies filing work permit applications on behalf of professional expatriate workers need to pay application fees up front.

Without this prior payment they will not receive an approved Work Recommendation Application, whilst all applications must be filed and approved prior to the expatriate's entry into Indonesia. If an individual enters

Indonesia without approval, they may be refused entry and the work permit application will also be refused.

An expatriate is still able to enter Indonesia on a business visa for meetings, while a work permit application is pending approval with the Department of Manpower. However, they cannot transition from a business visa to a long-stay work permit whilst remaining in Indonesia. This will require exit from Indonesia so that they may apply for the work permit prior to re-entering the country to begin employment.



Brazil

Most Favoured Nation clause invoked to reduce Withholding Tax rate on royalty payments to Korea and Spain

The Brazilian tax authorities have issued Interpretation Acts stating that, as a result of the Most Favoured Nation clause (MFN) in Brazil's tax treaties with both Korea and Spain, the withholding tax rate on royalty payments to these countries (other than for the use of or the right to use trademarks) is limited to 10% as from 1 January 2006. This compares with rates previously provided for in the double tax treaties of 15% for Korea and 12.5% for Spain.

Royalties are generally defined for treaty purposes to include payments for technical assistance and technical service fees. Under Brazilian domestic law, royalty payments made to non-residents are taxed at a rate of 15%; this is normally the rate in Brazil's other tax treaties, except for Japan, where the rate is limited to 12.5%.

It should be noted that the provision of labour based services by foreign entities is subject to this withholding.



USA

A New Jersey court has held that contract workers may be entitled to the protection afforded regular employees under the Conscientious Employee Protection Act (“CEPA”).

The court’s holding is based on CEPA’s social goal of encouraging employees to disclose the unlawful activities of employers or co-workers, and on the Act’s definition of “employee,” which is broader than the definition found in New Jersey common law or other statutes. CEPA defines an employee as “any individual who performs services for and under the control and direction of an employer for wages or other remuneration.” Notably the definition does not exclude independent contractors.

The court ruled that the control-and-direction test should be liberally applied in deciding whether an individual is an employee under CEPA. The plaintiff alleged that the defendant controlled all aspects of his job. He had to work in a cubicle on the employer’s premises, and had been given specialised training on the employer’s systems and policies. His hours were dictated and he had received disciplinary counselling.

Employers increasingly are adding contract employees to the workforce. A New Jersey employer who controls and directs such workers should anticipate that they now have the protection of CEPA.

Plaintiffs have won more than \$160 million claiming that they were incorrectly classified as exempt “white collar” employees under the FLSA requirements and thus denied overtime pay.

The FLSA requires employers to pay employees overtime for all hours worked in excess of forty hours per week, unless the employee falls within the executive,

administrative, professional, outside sales or computer employee exemption. These are generally called “white collar” exemptions. The administrative exemption is most commonly applied and an employee qualifies for this if:

- the employee is paid on a salary basis at a rate not less than \$455 a week;
- the employee’s primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and
- the employee’s primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

It should be noted that salespersons do not qualify for the exemption under the U.S. Department of Labor’s regulations.

To date mortgage companies, banks and other financial institutions have been particularly vulnerable to these types of lawsuits as the individuals in question are often in the business of selling financial products and do not exercise discretion or independent judgment. Given the serious threat these overtime cases pose, employers should look more at the actual job description and practice rather than classifying employees as administratively exempt simply because they perform what is perceived to be sophisticated “office work.”



Kenya

The Budget for 2006/07 was presented to the National Assembly by the Minister of Finance on 15 June 2006.

The most important features of the Budget relating to the supply of international contractors are summarized below.

- a (final) turnover tax will be introduced with effect from 1 January 2007 at a rate of KES 150,000 per annum or 3% of turnover;
- the rate of non-resident withholding tax for service providers in the telecommunications sector will no longer be left to the discretion of the Kenya Revenue Authority, but will be fixed at the rate of 5% of the gross receipts;



Kuwait

A draft law has been approved to significantly reduce the corporate income tax rate.

In a bid to encourage more foreign investment the Kuwaiti Council of Ministers has approved a draft law which includes the introduction of a flat tax rate of 15% instead of the current schedule of (non-progressive) rates, which can be as high as 55%.

To become effective, the draft still needs the approval of the National Assembly and the Amir. However, since the parliament is currently dissolved the draft may be enacted and the new Assembly, to be elected on 29 June 2006, can vote on it retroactively.

New Income Tax Law proposes to impose tax on nationals

Contrary to the above concession it has been reported that the Kuwaiti Council of Ministers are examining a new income tax draft law, which would impose tax on nationals. It is understood that this would be levied at a flat rate of 10% and would cover every kind of income without regard to nationality of the taxpayer.



South Africa

Physical presence element of the residence test amended so fewer foreign nationals, employed on a temporary basis in South Africa, become resident for tax purposes.

The Revenue Laws Second Amendment Bill 41 of 2005 has been tabled and the original proposals changed. An individual will be resident if he or she is physically present in South Africa for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding that year of assessment, and for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment. The individual will be resident in South Africa from the first day of the relevant year of assessment.

The explanatory memorandum includes transitional provisions for individuals who were resident on 28 February 2005 as a

result of the previous three-year physical presence test. The new provision comes into operation on 1 March 2006 and applies for years of assessment commencing on or after that date. In respect of any other person the new provision comes into operation on 1 March 2005 and applies in respect of years of assessment commencing on or after that date.

In terms of the new legislation foreign nationals, who do not become ordinarily resident in South Africa; will be able to work in the country for at least five years before becoming resident for tax purposes. It is worth noting that non-residents remain liable to tax in South Africa on their income derived from South African sources regardless of who makes the payment and where the payment is made.



In brief: Malawi & Vietnam

Malawi

The 2006/07 budget has increased the tax-exempt threshold for employment income from MWK 60,000 to 72,000 per annum. In addition, the tax rate for the top bracket (i.e. on income exceeding MWK 108,000) will be reduced from 35% to 30% from 1 July 2006.

Vietnam

An expatriate who has been posted to work in Vietnam is now able to deduct compulsory contributions for health insurance and pensions that are paid in their home country from taxable income in their Vietnamese tax return.

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