PricewaterhouseCoopers

ZEW
Zentrum für Europäische Wirtschaftsforschung GmbH
Centre for European Economic Research

International Taxation of Expatriates

Survey of 20 Tax and Social Security Regimes and Analysis of Effective Tax Burdens on International Assignments

Fachverlag
Moderne Wirtschaft

International Taxation of Expatriates
Executive Summary

Edited by PricewaterhouseCoopers and
Zentrum für Europäische Wirtschaftsforschung (ZEW)

By Otto H. Jacobs, Dieter Endres, Christoph Spengel,
Christina Elschner, Renate Höfer, and Oliver Schmidt

Die 102-seitige Studie ist im Fachverlag Moderne Wirtschaft erschienen und kann bei Frau Ebru Isiltan unter (0 69) 95 85-54 68 bezogen werden.

Fachverlag
Moderne Wirtschaft

Executive Summary

At one time, the field of individual taxation was mostly treated as a purely domestic matter. Since individuals were less mobile than companies, international tax competition between countries and international tax planning activities concentrated on company taxation. Nowadays, however, there is clear evidence that individuals have become more mobile, in particular in the area of international assignments of employees, so-called expatriates. Moreover, there is considerable evidence that the relative taxation of highly skilled expatriates has an impact on the location decisions of multinational investors. This is because the typical contract structure of international assignments assumes that the total gross labour costs, including personal income taxes and similar charges, will be borne by the employer. Consequently, the comparative international taxation of expatriates is increasingly relevant for policy makers and multinational investors alike.

The study covers 20 countries across Europe, the United States, and Asia: Germany, Austria, Belgium, China, the Czech Republic, Finland, France, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Russia, Slovakia, Slovenia, Sweden, Switzerland (Canton of Zurich), the United Kingdom, and the United States (State of California).

The main objective of this study is to collate information on the taxation of employment income in different countries and to calculate and compare the costs of cross-border assignments. The second objective is to estimate the impact of the various drivers on the assignment costs. In particular, we wish to elaborate on how the assignment costs are influenced by the different elements of the tax and social security regimes applicable. This includes the number of taxes, tax rates, and tax bases as well as the social security contributions levied on employment income. Moreover, the study takes into account the special tax regimes for international expatriates found in some of the countries. The third objective is to rank the countries by total assignment costs. This takes into account the various options with respect to the different elements of the expatriate's income, i.e. the compensation package, as well as the individual characteristics of the expatriate (such as the level of income or marital status). With respect to international assignments the main focus is on Germany as a home and a host country. Therefore, the study also provides information about the relative attractiveness of Germany as a location for internationally mobile employees. The second focus is to develop a ranking of the European countries with respect to their attractiveness as a host country for international assignments from a third country. To do this, the study calculates and compares the costs of US-assignments to all European countries covered.

The calculation of the assignment costs is based on a simulation model developed by the Centre for European Economic Research (ZEW). The so-called *Human Resource Tax Analyser* is applied for the first time in this comprehensive study. In contrast to other approaches measuring the tax burden on labour income, which are backward looking and based on macro data in general, the *Human Resource Tax Analyser* is a multi-period forward-looking approach based on individual data.

The calculations provide estimates of effective average tax burdens on employment income taking into account the tax and social security regimes as of 2004. In order to investigate the situation of Germany in more detail, the effects of the German tax rate cut in 2005 were also taken into account. The model reflects different assumptions of the marital status of the expatriate, the level of the total compensation and the various items of the compensation package which are typically part of the income of international expatriates (e.g. cash compensation, old-age pension provisions, benefits in kind, and assignment cost reimbursement). Information on the tax and social security regimes in the different countries was provided by the local offices of PricewaterhouseCoopers.

Qualitative Assessment: Taxation of Employment Income and the Social Security Systems

The international comparison of the taxation of expatriates reveals that the most important tax is the personal income tax on employment income. Wage taxes and similar charges borne by the employer are of minor importance in Austria, Belgium, France, and Slovenia.

In addition to personal income tax, various social security contributions have to be taken into account. In most countries the levy of social security contributions is limited, at least in part, by an upper income ceiling. Therefore, the personal income tax is truly the more important factor determining the overall tax burden on expatriates. Moreover, since expatriates often prefer to keep their membership in the social security system of their home country, it is the personal income tax that is the decisive factor in the international tax competition for expatriates.

With respect to the personal income tax, both the rates and the bases vary to a great extent (see also the following table).

- Except for Russia and Slovakia all countries apply progressive tax rates varying between 32% (Czech Republic) and 55.5% (Sweden). Since the intermediate scales vary widely by country no general conclusion on the effective income tax rates is possible. The actual income tax burden depends on the concrete level of the taxable income. In this respect, however, further difficulties arise. Since many countries grant family allowances within their income tax schedules, the tax burden also depends on the marital status and the number of children of the expatriate.
- Moreover, since the total compensation of expatriates typically includes different items such as cash compensation, benefits in kinds, and expense reimbursements, special attention has to be paid to the definition of the base of the personal income tax. Some of these items might be exempt from income tax or might receive other tax privileges in some countries. It is, therefore, unclear as to whether the favourable allowances in the tax base compensate for higher tax rates and vice versa.
- Finally, special tax regimes for expatriates prevailing in some countries (e.g. in Finland, the Netherlands, and Sweden) have to be taken into account.

	Top income tax rate in %	Highest income bracket in €	Average tax rate on € 100,000 taxable income (single person) in %
Austria	50.0	50,870	41.8
Belgium	53.7	30,210	49.6
China	45.0	117,000	28.3
Czech Republic	32.0	10,406	30.7
Finland	51.5	55,800	42.6
France	48.1	47,932	38.6
Germany	44.3	52,152	38.7
Hungary	38.0	5,940	37.0
Ireland	42.0	28,000	35.8
Italy	46.4	70,000	36.7
Luxembourg	38.0	34,500	30.3
Netherlands	52.0	50,652	35.7
Poland	40.0	16,888	37.3
Russia	13.0	1	13.0
Slovakia	19.0	1	19.0
Slovenia	50.0	39,283	44.9
Sweden	55.5	48,384	46.7
Switzerland (Zurich)	40.4	147,640	23.9
United Kingdom	40.0	44,108	31.6
United States	44.3	282,531	31.3

The study analyses German outward assignments to all other countries and inward assignments to Germany from the other countries. We also compare the costs of these international assignments to those of domestic employment. The study also covers outward assignments from the United States to all European countries. It is assumed that expatriates stay in the social security systems of their home countries. The base case quantifies the assignment costs for an employer wishing to provide the expatriate with a disposable income (i.e. net of any taxes and charges to social security) of € 75,000 and assignment-induced reimbursements of € 30,000 (€ 70,000 in case of a married expatriate).

The Costs of Outward Assignments from Germany

Host countries are in competition for expatriates with their personal income tax systems. With respect to the different elements of the income tax system the tax rate turns out to be the most relevant factor influencing the assignment costs. The marital status and the number of children of an expatriate is also an important factor for the attractiveness of the host country's tax system.

Total assignment costs with taxes and social security contributions are based on the following assumptions:
Single expatriate: disposable income € 75,000, assignment-induced reimbursements € 30,000
Married expatriate: disposable income € 75,000, assignment-induced reimbursements € 70,000

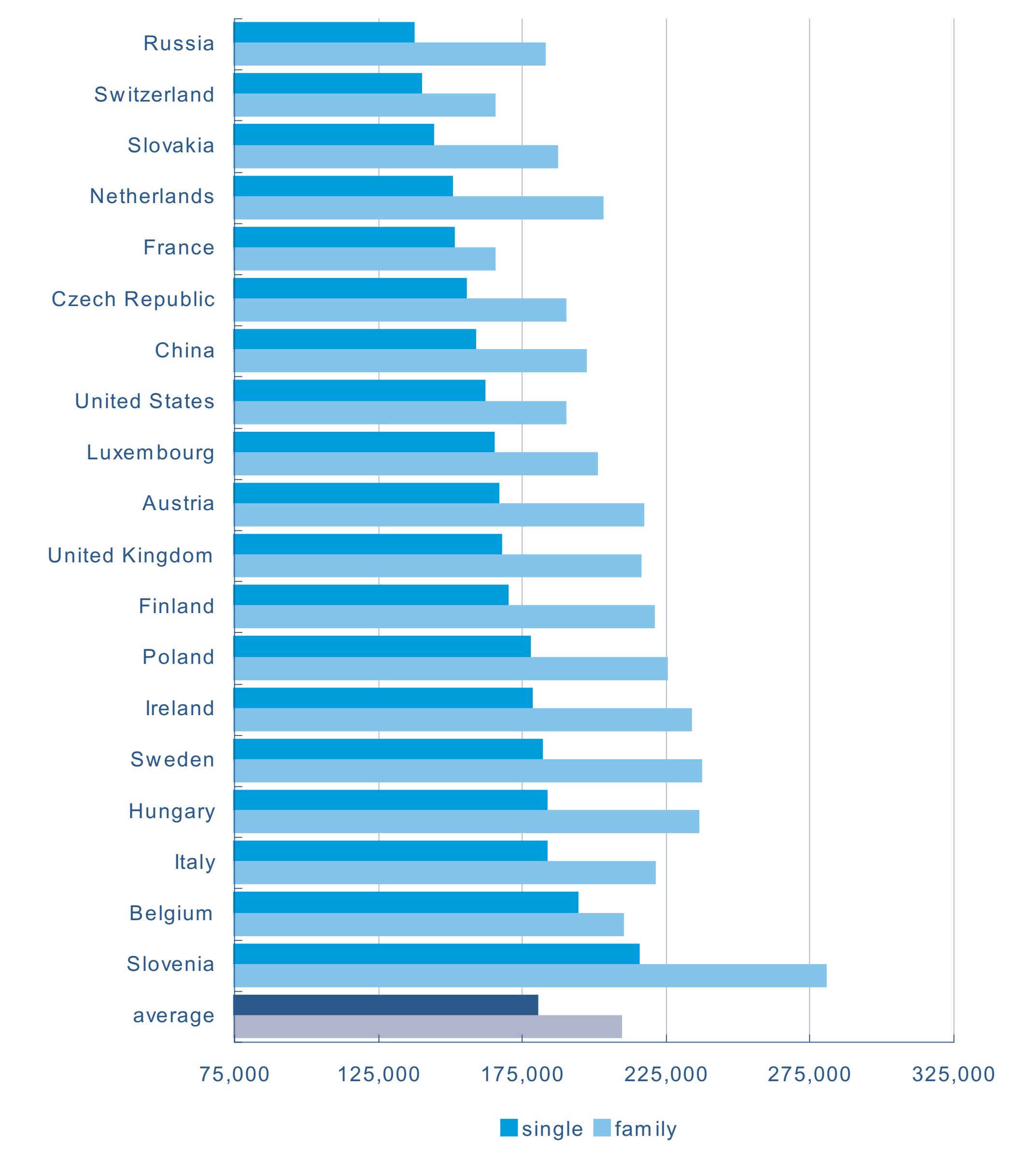

Figure 1 Tax costs of German outward assignments

- The annual assignment costs for a *single expatriate* vary between € 137,183 and € 215,247. The average assignment costs of all 19 countries amount to € 167,330. From the perspective of Germany, assignments to Russia and Switzerland bear the lowest and assignments to Belgium and Slovenia the highest costs. In general, the ranking of the host countries from the lowest to the highest assignment costs follows the ranking of the top income tax rates. The composition of the tax base, therefore, is of minor importance. This conclusion has to be modified for countries applying special tax regimes for expatriates. The global reduction of the income tax bases of expatriates in the Netherlands and in Sweden is of clear benefit. The relative advantage, however, decreases with increasing income. By contrast, the lower tax rate on the expatriate's income charged in Finland improves Finland's position in the country ranking if the taxable income increases.
- For *married expatriates with two children* the assignment costs vary considerably between € 165,148 and € 280,445. The average is € 209,320. All countries granting special tax allowances for families, such as joint filing or transfer of income to non-

working spouses, improve in the country ranking on that for single expatriates (Belgium, France, Ireland, Luxembourg, Poland, Switzerland, and United States). For married expatriates, assignments to France and Switzerland bear the lowest and assignments to Sweden and Slovenia the highest costs.

- *Altogether*, for both single and married expatriates, assignments to France, Russia, Slovakia, and Switzerland bear a low and assignments to Slovenia a high level of costs.

Because benefits in kind (e.g. a company car) instead of cash contributions are subject to favourable tax regulations in many countries there are various options to reduce assignment costs. This reduction of assignment costs, however, depends on individual circumstances and on the concrete tax system of the host country.

The Costs of Outward Assignments Compared to Domestic Employment in Germany

On the assumption of the base case (i.e. the employee receives a disposable income of € 75,000) the costs for local employment in Germany would amount to € 147,098 for a single and to € 119,415 for a married employee. The total costs of an outward assignment will almost always be higher than for local employment in Germany, if only because of the assignment-induced reimbursements of € 30,000 (single expatriate) or € 70,000 (married expatriate) respectively. However, ignoring these costs allows the impact of the domestic personal income tax systems to be seen in isolation.

- For a *single employee* personal income taxation in Germany turns out to be high in comparison. Only for assignments to Slovenia and Belgium does the employer bear higher costs than for local employment in Germany. At the other end of the scales assignments to Russia, Switzerland, and Slovakia are cheaper even including the assignment-induced reimbursements.

The zero line symbolises costs for local employment of a single employee in Germany. Assignments to Slovenia bear higher costs of 46.3% (including assignment-induced reimbursements € 30,000) and the costs of assignments to Russia are lower by 30.2% (without assignment-induced reimbursements € 30,000).

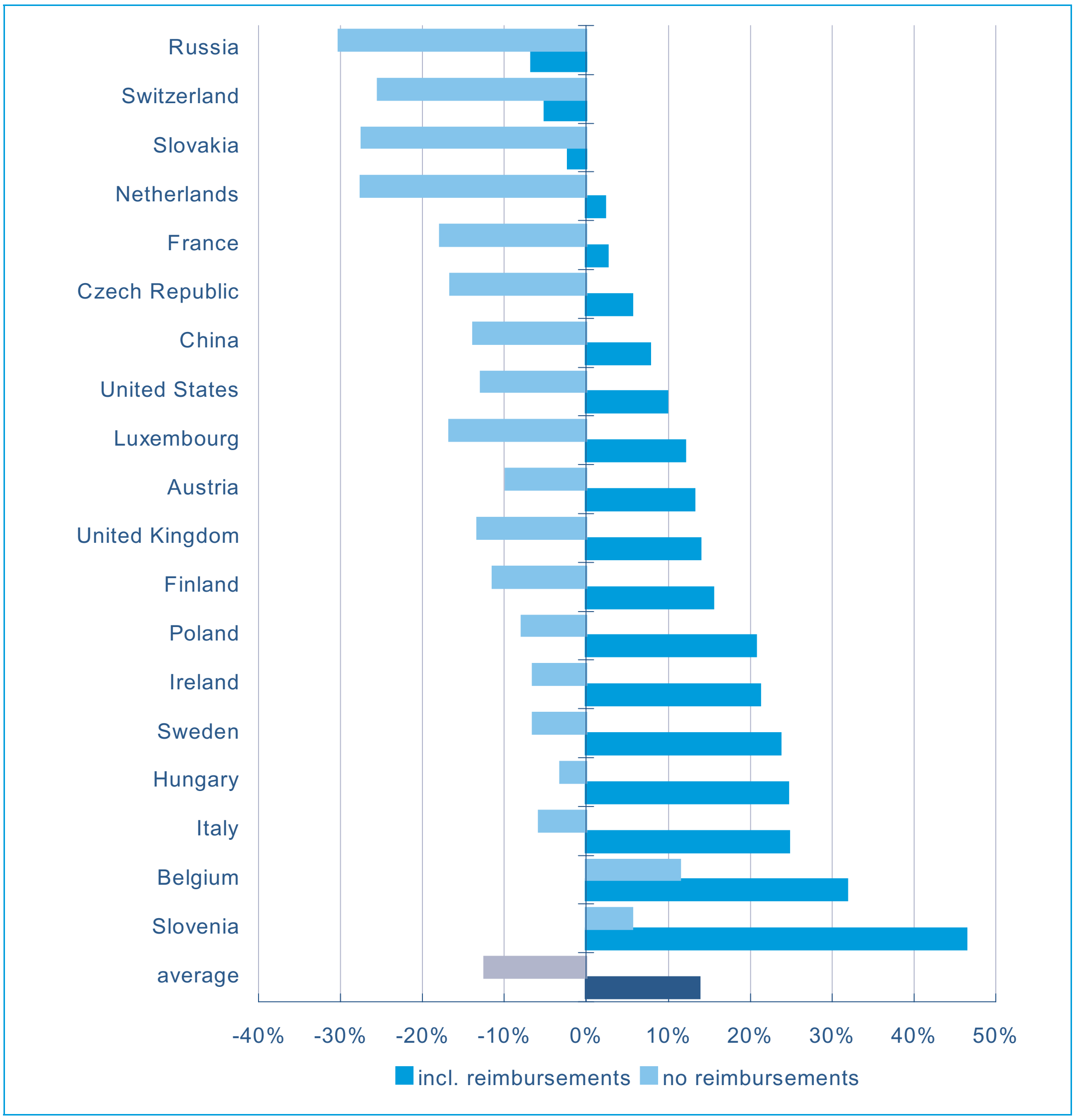

Figure 2 Assignment costs compared to employment costs in Germany (single expatriate)

- By contrast, Germany offers attractive rules for the taxation of *married employees* since income splitting is not common in many countries. In the event of a married expatriate, personal income taxation turns out to be lower than in Germany in only eight other countries.

The zero line symbolises costs for local employment of a married employee with two children in Germany. Assignments to Slovenia bear higher costs of 134.8% (including assignment-induced reimbursements € 70,000) and the costs of assignments to France are lower by 20.3% (without assignment-induced reimbursements € 70,000).

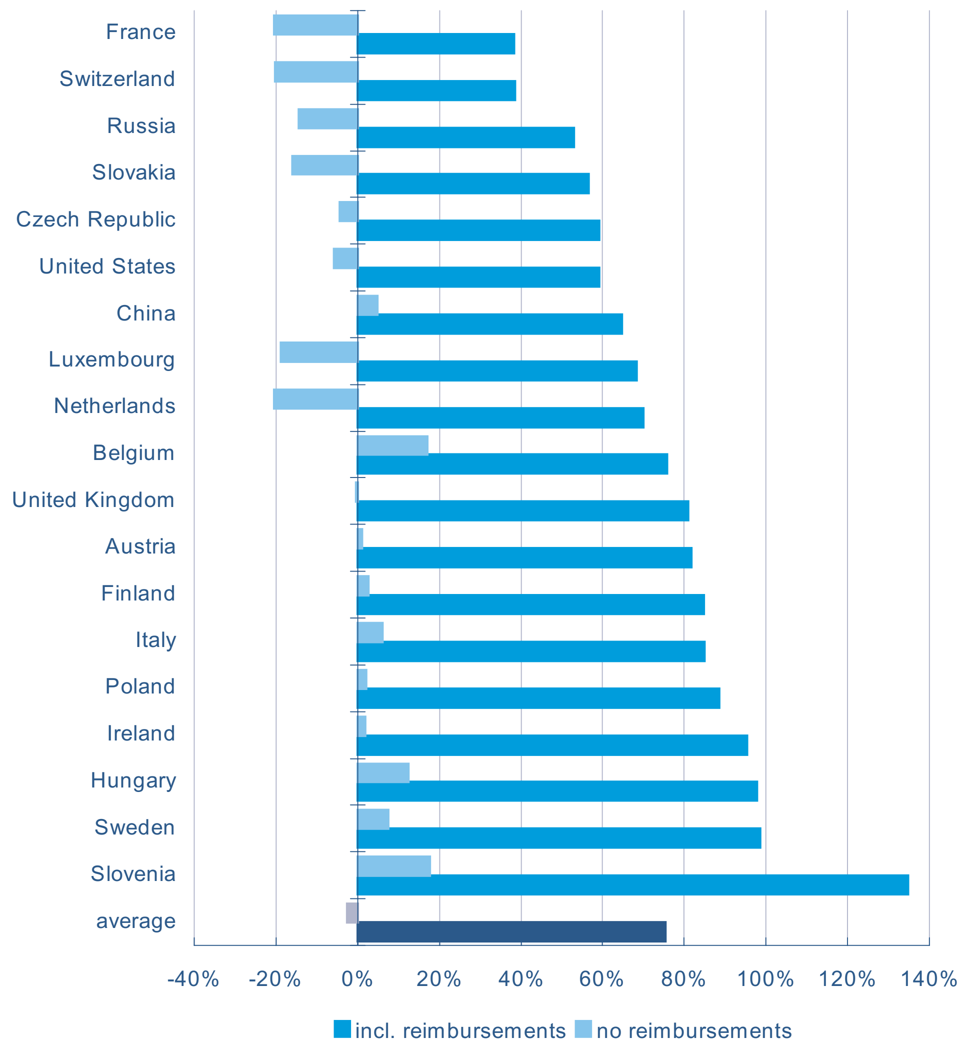

Figure 3 Assignment costs compared to employment costs in Germany (married expatriate with two children)

The Costs of Inward Assignments to Germany

In the case of inward assignments expatriates stay in the social security system of their home country and are subject to personal income tax in Germany. Therefore, the assignment costs consist of the German income tax and the foreign social security contributions. Consequently, expatriates assigned from countries levying high social security contributions bear high costs. In contrast to other host countries, there are no special tax incentives in Germany for inward expatriates compared to local employees. Tax planning strategies to reduce the German tax burden are also limited. The tax burden can be reduced to some extent – between 2.2% and 3.7% depending on the home country of the expatriate – by granting benefits in kind instead of cash contributions.

Assignments to Europe from the United States and Attractiveness of Germany as a Location for Expatriates

In order to assess the attractiveness of the European countries as a host country for expatriates, the costs for assignments from the United States to all 18 European countries included in this study were quantified. As with the analysis of outward assignments from Germany it turns out for both single and married expatriates that France, Russia, Slovakia, and Switzerland are the most attractive host countries for international assignments. Assignments to Slovenia bear the highest assignment costs.

Assignments of single expatriates to Germany bear comparatively high costs. From the 18 European countries Germany ranks 16th. Only assignments to Belgium and Slovenia are more expensive. For married expatriates Germany is more attractive as a host country. Due to the favourable taxation of families (income splitting between spouses) assignments to Germany now rank 10th.

Total assignment costs with taxes and US social security contributions based on the following assumptions:
Single expatriate: disposable income € 75,000, assignment-induced reimbursements € 30,000
Married expatriate: disposable income € 75,000, assignment-induced reimbursements € 70,000

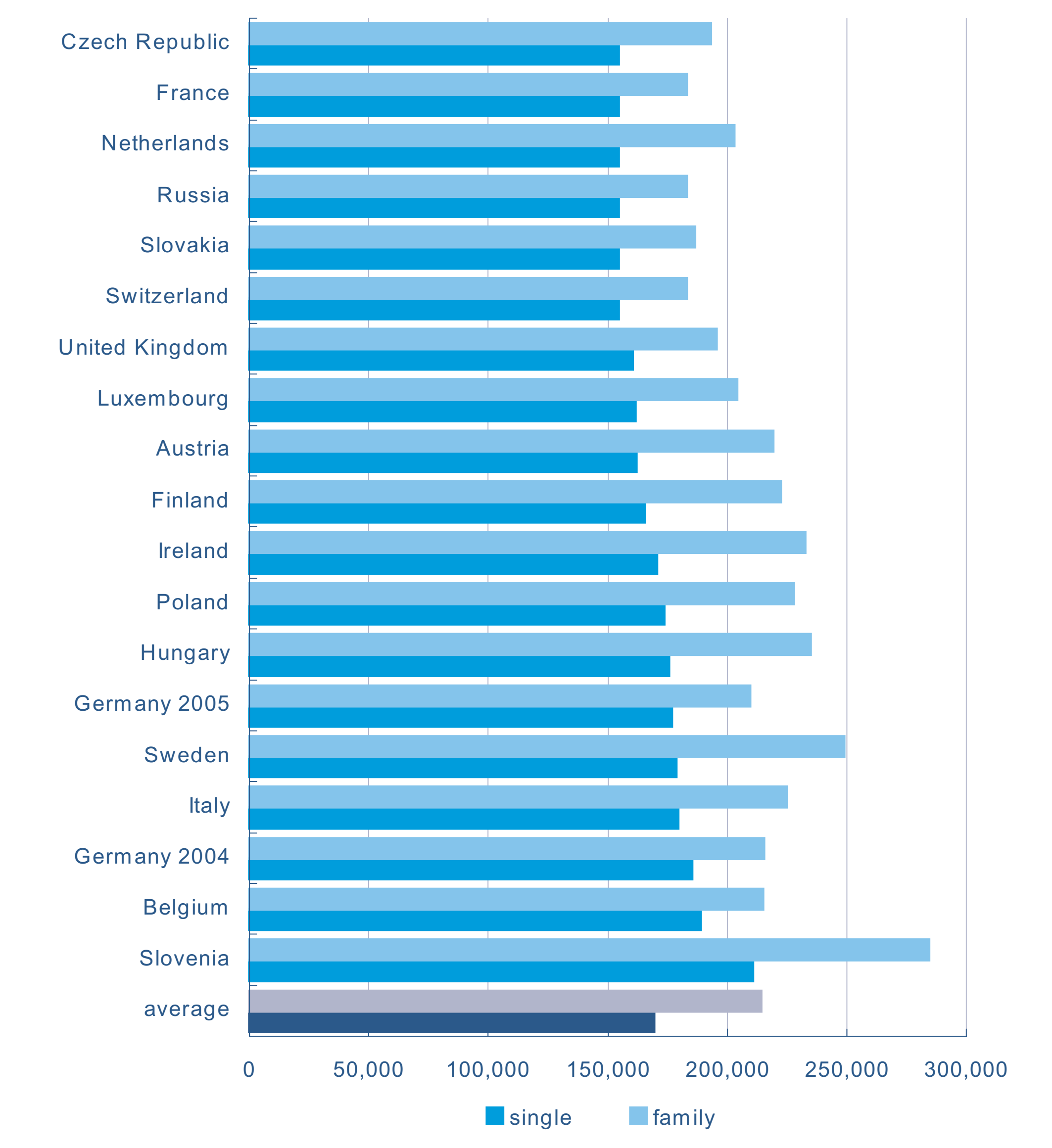

Figure 4 Cost of US outward assignments to Europe

The 2005 reduction of the income tax rate improves the attractiveness of Germany as a host country. The basic and the top rate of income tax are reduced from 16% to 15% and from 45% to 42% respectively. For a typical compensation package, assignment costs to Germany decrease by 4.5% for a single expatriate and by 2.5% for a married expatriate. As a result, Germany improves in the country ranking, moving to the 14th position for single expatriates and to the 9th position for married expatriates.

Tax Planning Strategies

The tax burden on international assignments can be decreased by

- structuring the timing of payments,
- dividing the taxation right between several countries and
- granting stock options in a tax beneficial way.

In all three cases advantage can be taken of the Double Tax Treaties to lower the tax burden.

The study also reveals tax obstacles for assignments abroad. A major obstacle is the possibility of double taxation on pensions from occupational pension schemes resulting from the mismatch of the national tax systems. Double taxation on cross-border pension payments increases the costs on international assignments. Therefore, international assignments are discriminated against domestic employment. This discrimination violates at least one of the fundamental freedoms of the EC Treaty, the free movement of workers laid down in Art. 39-42 EC. Expatriates and employers suffering from international double taxation should therefore claim their rights in court, and if necessary demand that their case be referred to the European Court of Justice.

Internationally, Germany is seen as a high tax country, at least as regards direct taxes on business profits. For an expatriate living here the picture is not quite as bleak, although, even so, the survey shows Germany to be no better than middling in her efforts to commend herself to highly qualified and internationally mobile staff. One of the conclusions must be that Germany should look to the taxes charged on high level salaries as well as to those on corporate profits, if she is to offer investors a truly attractive tax climate. Given the usual practice of net-of-tax remuneration agreements for expatriates, their taxes are ultimately just as much a charge on the employer as those directly assessed on the business.

Contact Addresses of the Authors

This study is a joint project of PricewaterhouseCoopers in Frankfurt and the Centre for European Economic Research (ZEW) in Mannheim.

Prof. Dr. Dr. h.c. mult. Otto H. Jacobs
University of Mannheim and ZEW
Chair of Business Administration and International Taxation
Schloss
D-68131 Mannheim
Phone: + 49 (6 21) 1 81 - 17 03
Fax: + 49 (6 21) 1 81 -17 07
E-Mail: o.h.jacobs@bwl.uni-mannheim.de
Website: www.bwl.uni-mannheim.de/jacobs

Prof. Dr. Dieter Endres
Tax Partner
PricewaterhouseCoopers
Marie-Curie-Str. 24-28
D-60439 Frankfurt/Main
Phone: + 49 (69) 95 85 - 64 59
Fax: + 49 (69) 95 85 - 65 73
E-Mail: dieter.endres@de.pwc.com
Website: www.pwc.com/de

Prof. Dr. Christoph Spengel
University of Gießen and ZEW
Chair of Business Administration and Taxation
Licher Straße 62
D-35394 Gießen
Phone: + 49 (6 41) 99 - 2 25 50
Fax: + 49 (6 41) 99 - 2 25 59
E-Mail: christoph.spengel@wirtschaft.uni-giessen.de
Website: www.wiwi.uni-giessen.de/home/steuerlehre

Christina Elschner
Centre for European Economic Research (ZEW)
Department of Corporate Taxation and Public Finance
L7,1
D-68161 Mannheim
Phone: + 49 (6 21) 12 35 - 1 62
Fax: + 49 (6 21) 12 35 - 2 23
E-Mail: elschner@zew.de
Website: www.zew.de

Renate Höfer
Tax Partner
PricewaterhouseCoopers
Marie-Curie-Str. 24-28
D-60439 Frankfurt/Main
Phone: + 49 (69) 95 85 - 64 40
Fax: + 49 (69) 95 85 - 67 23
E-Mail: renate.hoefer@de.pwc.com
Website: www.pwc.com/de

Dr. Oliver Schmidt
Senior Manager Tax
PricewaterhouseCoopers
New-York-Ring 13
D-22297 Hamburg
Phone: + 49 (40) 63 78 - 14 78
Fax: + 49 (40) 63 78 - 10 40
E-Mail: oliver.schmidt@de.pwc.com
Website: www.pwc.com/de

www.pwc.com/de

PricewaterhouseCoopers