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CONTENTS

5 Indicators of tax morale: an exploratory study
Margaret McKerchar, Kim Bloomquist and Jeff Pope

23

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Tax incentives to encourage migration of skilled labour: another tax expenditure or a failure of tax residence?

Andrew Halkyard*

Abstract

In a world of increasing labour mobility, is it good tax policy to use tax incentives to encourage migration to meet shortages of skilled labour? Countries as diverse as Australia, New Zealand, Singapore, Denmark and China, to name but a few,[1] think so. But is this the best response? This article seeks to answer these questions, first by analysing the taxation regimes of various countries which have encouraged migration of skilled labour by providing tax incentives and asking why they did so (Part I). It then examines empirical studies and related literature with a view to determining whether occupational or residence decisions really are responsive to the taxation of labour (Part II). There is a wealth of literature on tax incentives to promote foreign direct investment. But comparatively little analysis has critiqued tax incentive regimes designed to attract labour. This article aims to fill this gap and goes on to consider whether such regimes may best be viewed, not as tax expenditures, but as curing the failure whereby many countries adopt an over-embracing concept as to when an individual becomes a tax resident (Part III). It will be argued that, although the case for enacting a tax incentive regime as the best way to encourage migration of skilled labour is problematic and has not been made out, it would be unrealistic to expect countries to refrain from doing so. Accordingly, the article proceeds to set out the design elements such a regime should contain to ensure that the policy goals identified can best be satisfied (Part IV). Finally, the article explains the lessons learned from the analyses undertaken and answers the questions posed above (Part V).

1. A Comparative Study of Tax Incentive Regimes Aimed to Attract Migration of Skilled Labour

As indicated above, many countries have enacted taxation incentive regimes to attract migration of skilled labour. This article will examine five of these, namely, those in Australia, China, Denmark, New Zealand and Singapore. For comparative purposes, the experience of Israel will also be analysed – since its taxation incentive is directed at encouraging immigration generally. Most of these incentives provide an exemption to qualified persons for foreign source income and, where relevant, offshore capital gains. They are generally aimed at attracting foreign, non-resident skilled workers to relocate (and often to encourage expatriates to return) and virtually all are time limited

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[1] An OECD study found that as of 2010 15 OECD countries had introduced targeted income tax concessions to attract migration of highly-skilled workers: see OECD Tax Policy Studies: Taxation and Employment (No 21) (2011), p 124. Some of those countries, such as the United Kingdom and Switzerland, go further. They use tax incentives to encourage wealth migration.

(i.e. incentives expire after a stated period or when the relevant person becomes a permanent resident). Table 1 summarises the main features of these regimes.

TABLE 1

Country	Qualifying person	Form of incentive and type of income covered	Compliance obligations and qualification conditions	Time period
Australia[2]	Temporary resident – a person who is a tax resident but who does not hold a permanent visa[3] or citizenship and does not have an Australian spouse	Exemption for foreign source income that is not part of the person's Australian employment income [Notes – a temporary resident is also exempt from capital gains tax unless the asset is 'taxable Australian property'. Special rules apply to tax capital gains on shares and rights acquired under employee share schemes.]	Normal compliance obligations apply, except that interest paid to foreign lenders is not subject to withholding tax	Exemption ceases when the person is no longer a temporary resident
China[4]	A person who is not domiciled in China and who has resided in China for less than 5 years[5] [Note – even where a non-Chinese domiciliary (expatriate) stays in China for more than 5 years, it is relatively easy for that person to avoid becoming a resident taxpayer under the Individual Income Tax Law. To achieve this result, the person must stay outside China for more than 90 days cumulatively, or 30 days consecutively, within the relevant calendar year.[6]]	Exemption for all non-Chinese source income and gains, except where it is paid or borne by a Chinese entity or individual	Normal compliance obligations apply	Exemption applies for 5 years [Note – see, however, Note contained in the first substantive column of this table which shows that, for an expatriate, non-resident tax status is relatively easy to achieve.]

[2] Income Tax Assessment Act 1997 (Cth), s 768-910.

Denmark[7]	Overseas researchers (scientists) and high income earners[8] employed in other professions. The person must have been recruited abroad and not been liable to tax in Denmark in the prior 10 years. Danish citizens living abroad can apply for the incentive	Flat rate of income tax of 26% (no deductions from income allowed), instead of the normal progressive income tax with a top marginal rate (including labour market contributions) of around 56% (2012). The incentive only applies to earnings from the qualifying employment; all other income is taxed at normal rates	The foreign national must apply for a tax and social security number within 3 months of arriving in Denmark and at the same time make a formal application for the tax incentive	The incentive expires after 60 months[9]
Israel[10]	New immigrants and returning residents – the latter category refers to an individual who resided overseas for at least 10 y			

New Zealand[12]	Transitional resident – a person (who may or may not be a citizen) who was not a tax resident for the previous 10 years	Exemption for foreign source income (except employment income from overseas employment performed while living in New Zealand and business income relating to services performed offshore)	The exemption applies automatically to a qualified person. The normal compliance obligations apply	The exemption applies for 4 years from the first calendar day of the month the person qualifies as a tax resident in New Zealand
Singapore[13]	Not ordinarily resident – a person (who may or may not be a citizen or permanent resident) who was not a tax resident for at least 3 years prior to becoming a tax resident in Singapore	Exemption for a portion (that corresponds with the number of days spent outside Singapore for business reasons in a year) of the person's Singapore source employment income [Notes – Singapore's jurisdiction to tax is based on source and, to a limited degree, remittance. However, except in a very limited manner, the remittance jurisdiction does not apply to resident individuals.[14] The source of employment income is determined by where the employment is exercised, and not simply by where the employment duties are performed.[15]]	To qualify, a person must spend a minimum of 90 days outside Singapore for business purposes pursuant to his or her employment in the year of assessment and have a minimum employment income of S$160,000. In addition, where the tax on the apportioned income is below 10% of the person's total Singapore employment income, the person must pay a tax rate of 10% on his or her total Singapore employment income. A one-time election, using a special form, must be submitted to the IRAS on an annual basis no later than 15 April in each Year of Assessment	The incentive ceases after 5 years

Given the popularity of these regimes, what prompted the surveyed countries to adopt them? Table 2 answers this question. As will become apparent two broad rationales are generally advanced when introducing tax incentives to promote migration of skilled workers – to remove taxation barriers for migration decisions and to attract and/or retain skilled workers.

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[12] Income Tax Act 2007 (New Zealand), CW 27 and HR 8. The rules came into effect on 1 April 2006 and were enacted by the Taxation (Depreciation, Payment Due Dates Alignment, FBT and Miscellaneous Provisions) Act 2006. See generally www.ird.govt.nz/yoursituation-nonres/move-nz/temp-tax-empt-foreign-inc.html (accessed 18 February 2013).

[13] Income Tax Act (Cap 134, 2008 Rev Ed) ('ITA'), s 13N. The rules came into effect in the Year of Assessment 2003. See generally IRAS Circular, 'Not Ordinarily Resident Scheme' (7 July 2008) (updated on 29 August 2008), at www.overseassingaporean.sg/sites/blog/files/NOR%20Circular_07_07_08%20.pdf (accessed 18 February 2013).

[14] ITA, s 13(7A).

[15] See Pok, Ng and Timms (Eds), The Law and Practice of Singapore Income Tax (Singapore: LexisNexis, 2011), chap 19.

TABLE 2

Australia[16]	China	Denmark	Israel	New Zealand	Singapore
To attract internationally mobile skilled labour, and to ease the cost pressures for Australian business of employing skilled foreign workers[17] [18]	To distinguish between ordinary residents and non-permanent or short-term residents. China's rules are similar in concept to those of Japan[19]. The tax policies underpinning China's rules emanated from the 1980s and were designed to complement China's numerous tax incentives to increase foreign direct investment. They were thus intended to attract skilled expatriates, experts and scholars to work in China and are not represented by China to be a labour migration incentive, even though they should have some incentive effect[20]	To strengthen the competitiveness of Danish companies and research institutions by facilitating research and product development. The incentive also addressed concerns about the high costs borne by Danish companies and research institutions of employing researchers and skilled professional staff[21]	Essentially this is an immigration policy aimed specifically to increase the number of people who choose to return or to come and live in Israel. The reform is described by the Ministry of Finance as "one more benefit the Ministry of Immigrant Absorption initiated for Israel's 60th anniversary, all intended to ease the return of Israelis living abroad and the absorption of new immigrants."[22]	To help New Zealand businesses recruit highly skilled individuals from overseas, resulting in positive effects for the New Zealand economy[23] This incentive also addressed concerns that had been expressed relating to the additional costs borne by New Zealand businesses in recruiting overseas talent by virtue of New Zealand's wide jurisdiction to tax foreign income earned by all residents	To attract talent to relocate to Singapore[24]

[16] The temporary resident tax incentive was based on recommendation 22.18 of the Review of Business Taxation (known as the Ralph Review, 1999) that, inter alia, considered what reforms should be made to Australia's international tax regime: see www.rbt.treasury.gov.au/ (accessed 18 February 2013).

[17] Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 1) Bill 2006 (Cth).

[18] Australian Government, Budget Paper No 1: Budget Strategy and Outlook 2005-06 (2005) 'Part 1: Fiscal Outlook and Budget Priorities', pp 1-15: see www.budget.gov.au/2005-06/bp1/html/bst1-05.htm (accessed 18 February 2013). Some highly paid expats, prior to relocation overseas, negotiate so-called 'equalisation' payments as part of their Australian remuneration package (so that they are no worse off in tax terms by becoming an Australian tax resident). This was considered an added cost to Australian business which may make it more expensive to recruit and retain skilled foreign workers.

[19] See http://www.nta.go.jp/tetsuzuki/shinkoku/shotoku/tebiki2011/pdf/43.pdf (accessed 18 February 2013). Specifically, a non-permanent resident is one who meets the normal residence test but is not a Japanese national and has not maintained a residence in Japan for an aggregate of 5 years during a 10 year period. A non-permanent resident is taxed only on domestic source income and foreign-source income which is remitted to Japan.

[20] The author is grateful to Professor Cui Wei, China University of Political Science and Law for this comparison and to Dr Ren Linghui, Ernst & Young Tax Services Ltd (Hong Kong) for placing this 'incentive' in its historical perspective.

[21] See www.eatlp.org/uploads/Members/Denmark02.pdf (accessed 18 February 2013), sourcing material from the SKAT homepage; see further, OECD Tax Policy Study (2011), n 1 above, p 132.

[22] See http://www.gov.il/FirstGov/TopNavEng/PageReturnHomeEng (accessed 18 February 2013).

2. Are Occupational or Residence Decisions Really Responsive to the Taxation of Skilled Labour?

Published studies on this question relating to mobile highly skilled workers, who are the target of the analysis in this article, are fairly uniform in concluding that the empirical evidence available does not suggest that migration decisions are highly responsive to taxation.[28]

However, the OECD Tax Policy Study which supports this conclusion cautions that:

> "While the literature is to an extent mixed, it suggests that tax can affect migration decisions, especially for the high-skilled, but that this effect is likely to be relatively small. This is unsurprising given the number of other factors that affect the migration decision. However, as mobility continues to increase it is likely that the influence of tax on migration decisions will also increase. This poses a number of issues for tax policy."[29] (emphasis added)

Other studies express similar reservations:

> "More empirical research is needed to determine which [labor mobility] benchmark is most important. We do not yet know whether locational, leisure, occupational, or residence decisions are most responsive to the taxation of labor, but as labor mobility becomes more important in the global economy, the need for answers to these questions will become more pressing."[30,31]

In relation to domestic patterns of migration, tax elasticities may be more pronounced:[32]

> "Tax – along with potential for professional development and better career options – is a major influence on people's decision to migrate. Looking specifically at tax as a motivator for migration, Richard Vedder from Ohio University has been looking at domestic migration patterns within the US. Vedder has found indications that Americans by and large choose to migrate into low tax states and that this tendency has been consistent over the last 20 years.[33] Kathleen Day has also found that regional fiscal policies including taxation to some degree influences interprovincial migration in Canada."[34]

Finally, given the longevity of the Danish tax incentive for foreign researchers and skilled workers, initiated more than two decades ago, it is not surprising that several

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[28] Ibid, p 11.

[29] Ibid, p 129.

[30] Mason, 'Tax Expenditures and Global Labor Mobility' (2009) 84 NYU Law Review 1540, p 1622.

[31] Tangentially, the OECD Tax Policy Study (2011), n 1 above, p 10 also concluded that: "Empirical evidence suggests that low-income earners, single parents, second earners and older workers are relatively responsive to changes in labour income taxation, particularly at the participation margin. In addition, taxable income elasticities suggest that higher-income individuals are more responsive to taxes than middle- and lower-income workers."

[32] Ulrich, 'Taxing Talent' Adam Smith Institute Policy Paper (2010), available at www.adamsmith.org/sites/default/files/resources/ASI_Immigration_AW.pdf (accessed 18 February 2013).

[33] Citing Vedder, The Heartland Institute (2005).

[34] Citing Day, 'Interprovincial Migration and Local Public-Goods', (1992) 25(1) Canadian Journal of Economics-Revue Canadienne D'Economique 123–144.

studies have analysed its efficacy. The main conclusions reached can be summarised as follows:

- The tax incentive has increased in popularity since it was introduced – from 229 people in 1992, to more than 2,800 in 2009. Although 2,800 may seem a small figure, it is not insignificant in a labour force of 3,000,000 people.[35]
- From these statistics, it is arguable that the tax incentive has shown that highly skilled workers are responsive to lower taxes and that it is a viable way to attract qualified people to Denmark.
- However, it is important to appreciate that this conclusion focuses upon the

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taken by several countries (including those surveyed in this article), particularly those imposing higher than average effective tax rates on employment income and high and/ or complex taxation on foreign source income.[39] The question remains, however, whether this is the best policy response and how can we evaluate it?

3. A CRITIQUE OF TAX INCENTIVES TO A

incentive chosen is the most effective option for a country to attract highly skilled labour of the type it wishes to increase?[46]

Even if the answer to this question is assumed, or answered positively, we must proceed to examine whether the incentive chosen is the most efficient (least costly) and whether, and to what extent, considerations of equity and fairness between taxpayers[47] and the community interest and transparency indicate any contrary conclusion.

At the risk of repetition, it would be remiss not to acknowledge the difficulties and limitations faced in evaluating the tax incentive regimes set out in Table 1. In short, there are major problems in obtaining relevant data that could provide a statistical and empirical basis to support a typical tax incentive analysis. Specifically, as illustrated by Part II above, the surveys relating to the influence of taxation upon mi70.92 8wrob

What does seem clear in this context is that, whether tax incentives are introduced or not in response to the increasing calls for them, the debate should not be focused upon doomsday stories from self-interested parties. Rather, to the extent that tax incentive analysis is engaged, this debate should not be divorced from benchmarking the policy goals sought to be achieved with considerations of effectiveness, efficiency, fairness, clarity and transparency – concepts which have been the subject of numerous policy and empirical studies, albeit in other fields. It is the desirability for a measured and principled approach to granting tax incentives which this article advocates.

(d) A Different Analysis Focusing Upon Tax Residence

What often seems lacking in tax incentives analysis is a detailed consideration of the role they play within the context of a country's income taxation system as a whole – and this leads us to another way to analyse 'tax incentives' to attract migration of highly skilled labour. Rather than evaluate them by reference to the classic benchmarks generally applied to tax incentives, a more satisfying justification for their existence is to consider such provisions as reflecting a key element of most tax systems (including most of those surveyed in Part I above) – whereby non-residents are taxed on a different basis (tax on domestic source income only) to residents (tax on a worldwide basis).

If one accepts that these provisions are often designed to remove taxation barriers for highly skilled workers to migrate by exempting foreign source income for a relatively short period of time (a conclusion supported by Table 2 above, with the possible exception of Denmark), then it might be argued that they only benefit workers who in a more perfect tax world should be treated as non-residents. In the absence of such provisions, an individual normally becomes subject to worldwide taxation in the host country simply by staying in that country for a fairly limited period of time. After satisfying what is typically a low threshold (which, depending on individual facts and circumstances, may be evidenced by physical presence of much less than 183 days in

resident developed in a very different era makes sense today or whether it is more logical to refine the definition for today's world.

Finally, the theme of this article illustrates the broader problem that global taxation of personal services income is far from perfect. In addition to widely held concerns regarding the threshold and criteria for tax residence of an individual, the difficulty in distinguishing between dependent and independent services and why these are taxed differently, and why under double tax treaty agreements (DTAs) employees are treated differently from directors and sportsmen and artistes are treated differently still, clearly show the necessity for reform both domestically and under DTAs. Given that service provision is increasingly important in our world economy, it seems a shame to end with the observation that in many ways taxation of personal services income is confusing – but it is a mess[55] and, notwithstanding the difficulty, it is important to clean it up.

[55] The author gratefully acknowledges the analogy provided by Brian Arnold, 'The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess' (2011) Bulletin for International Taxation 59.