




BLIND MAN'S BLUFF!

THE PERILS OF OVERLOOKING INTERNATIONAL ASSIGNMENT COMPLIANCE ISSUES

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In the hustle and bustle of planning an international assignment, compliance issues can get lost in the shuffle; however, being blind to immigration, tax, data privacy, and labor laws can put both the assignee and company in a serious bind. Rosenzwaig focuses on key areas to consider for international assignment audits and the risks associated with noncompliance.



Of all the potential challenges that human resource (HR) administrators handle in the course of an international assignment, an area that easily can be overlooked is compliance with immigration, tax, data privacy, and labor laws.

Amid the flurry of logistical activity—to relocate the employee and family members, ship or store household goods, deliver pay on time (and in the right currency), and have the employee ready for work without too much lost time—ensuring that administration of this activity meets compliance requirements can seem like an impossible task.

The first step for those involved in administration is to gather a core team of experts to participate in the assignment process. These experts can be internal to the organization (e.g., HR, payroll, accounting, legal) or industry experts who will provide necessary counsel to develop the internal policies and processes that will foster compliance and facilitate the periodic review or audit of administrative matters.

Although many companies have internal (or external independent) audit programs that focus on general operating procedures, financial processes, and payroll processes, they may not include areas specific to international assignments. The reason for exclusion might be levels of materiality from a cost perspective (i.e., an internal audit may look at transactions with a value of US \$20,000 or more—

a higher threshold than the cost of processing a visa), an assumption of limited risk within the assignment program, or limited understanding of the implications of international assignments on the global organization. In addition, with regard to tax, legal, and immigration standards and compliance, the lines often blur.

Employers can avoid potential exposure—in terms of time, money, and reputation—by reviewing general compliance with the requirements of home-country and foreign jurisdictions, as well as the overall administrative process involved with either using expatriates or hiring local employees. The following discussion will focus on key areas to consider for international assignment audits and the risks associated with noncompliance (See sidebar below.).

Taxes — Knowledge Is Power

In any context, the term “tax issues” can be a bit threatening, mostly because of our natural fear of

the unknown. However, understanding the implications of international assignment tax matters—corporate and individual income tax—not only can shape policy and thereby enhance an organization’s reputation for good corporate citizenship, but also can offer the potential for significant cost savings.

Permanent establishment. At the most basic level, it is important to know the laws relating to the “permanent establishment” of a new entity in another country. Where no existing corporate operations have been documented previously with local authorities, the assignment of a single employee to a new location may signal the establishment of a corporate entity. Under such circumstances, the individual earnings of the employee may be subject to corporate tax in the local jurisdiction. Therefore, assignments designed for business development or site start-up need to consider the local tax and business laws in advance.

Individual taxation. Regarding the individual’s income tax, expatriates usually face complicated regulations at home and abroad. Most governments require expatriates to pay taxes on income attributed to working in that country, sometimes at high rates. Obligations for home-country tax vary. Most countries do not require nonresidents to report, or be taxed on, income earned outside the country, but many expatriates have continuing home-country tax obligations from non-employment income (e.g., spousal income and investments). The United States is a rare example of a country that requires citizens and permanent residents to be subject to U.S. tax on total income—regardless of where that income is earned.

Among the general local-national employee population, employers usually do not get involved with an individual’s tax beyond ensuring that appropriate documents (e.g., W-4s in the United States) are completed and an estimated withholding made with each scheduled payroll or bonus distribution. For international assignments, however, employers often pay incremental income taxes on behalf of the employee under the “tax equalization” approach. This methodology requires employees to pay tax comparable to what they would have paid had they remained in the home country; in turn, the employer pays actual foreign income taxes and any incremental home-country taxes owed as a result of the assignment. The employer also benefits from assignment-related tax refund carry forward.

Although there are alternative models for tax treatment of an expatriate’s earnings, tax equalization is the most prevalent and carries the

AUDIT CHECKLIST:

WHAT HR (OR AN EXTERNAL EXPERT) SHOULD KNOW

- HOST-COUNTRY PERMANENT ESTABLISHMENT LAWS;
- HOME- AND HOST-COUNTRY TAX LAWS;
- COMPANY TAX, COMPENSATION, AND BENEFIT POLICIES, AND ANY EXCEPTIONS TO THEM;
- LOCATION AND DURATION OF EMPLOYEE TRAVEL;
- PAY AND RELATED RECORDS, BENEFITS, AND CONTRACTS;
- HOME- AND HOST-COUNTRY IMMIGRATION REQUIREMENTS;
- HOME- AND HOST-COUNTRY TERMINATION LAWS;
- HOME- AND HOST-COUNTRY EMPLOYMENT LAW; AND
- INTERFACE BETWEEN HR AND PAYROLL.

TAX TREATMENT OPTIONS

Tax equalization. Expatriates are responsible for income taxes comparable to what they would have paid had they not gone overseas. Here is how it works: the employer withholds a hypothetical income tax—assessed against compensation at the same level as a home-country peer—and, in turn, is responsible for the tax assessed on the expatriate's company-earned income. Tax equalization ensures consistency in the tax treatment of all assignees and avoids potential windfalls to them. However, an important question is the extent of coverage regarding income, including non-company-source income, to be equalized—particularly if the individual has sizable non-company-source income (e.g., investments).

The employer uses the hypothetical tax to submit payments for the assignee's home- and host-country taxes. Should the foreign authorities prohibit the employer from directly paying the assignee's foreign taxes, the expatriate is responsible for payment (with subsequent reimbursement by the employer). If taxes are higher on assignment than what the assignee would have paid at home, the employer reimburses the difference. If taxes are lower, the company keeps the savings.

Tax protection. The organization accepts responsibility for expatriate income taxes that are higher than what they would have been at home. This method allows windfalls to assignees if total taxes are lower. A major problem is that windfalls available only to some expatriates raise a serious issue of equity based on location—and the potential for an adverse effect on employee morale.

Laissez faire. An approach rarely used—except by some companies first entering the global market—*laissez faire* places the responsibility with the assignee for calculating and paying income taxes for the home and host countries. Potential windfalls, an extra liability burden for the assignee, and noncompliance—and the consequences—on the part of the assignee are all possible.

greatest obligation on the part of the employer (See sidebar above.).

According to the “2008 Global Tax Policy Survey” by ORC Worldwide, New York, NY, the percentage of participants who tax equalize company-source income include: American (90.4 percent), British (86 percent), Canadian (86.6 percent), French (90.9 percent), German (88.3 percent), and Swiss (95 percent). No more than 7 percent of these nationalities follow either tax protection or *laissez faire*.

Regardless of the tax philosophy followed, in locations where government enforcement is lax, there is a danger of falling into bad habits that contravene official regulations, leaving expatriates and the company vulnerable to penalties and a tarnished reputation that might affect future operations within that host country, not to mention the organization's bottom line.

“Stealth” expatriates. Further concerns and areas for exposure with

respect to income tax often arise when employees travel under the proverbial HR radar. It is not uncommon for organizations to have a highly mobile workforce who travel on business internationally with enough frequency to accumulate a period of stay sufficient to warrant resident income tax reporting in that host jurisdiction. Although there are tax treaties between many countries that would eliminate certain tax obligations for shorter periods of travel, the employer assumes a degree of risk if the travel of these employees—or those on short-term assignments that are unexpectedly extended—is not adequately tracked and earnings appropriately reported.

If allowed to continue without any control, these situations may lead to a number of potential risks:

- noncompliance with host-country immigration and tax laws, as well as existing social security agreements between the home and host countries;

- physical security risks in volatile situations if an assignee's (or family member's) whereabouts are uncertain or unknown;
- potential exposure of income from headquarters or the company at large to be treated and taxed as income in the host country even if the company does not have a permanent establishment;
- poor public relations; and
- inappropriate tax counseling for the assignee.

Tracking employees and data. It would be unrealistic to expect the corporate expatriate administrator to be conversant in all areas of income tax across all jurisdictions in which an organization may have expatriates. Consequently, it is standard practice to engage a tax specialist who is knowledgeable about home-country tax laws and either has direct experience or association with experts in foreign tax law.

The practical approach to tracking expatriate tax obligations begins with

a comprehensive list of employees who would be traveling outside their home countries—all employees formally on international assignment, cross-border commuters, short-term assignees, and frequent business travelers. As compiling such a list is more complicated in practice than it seems on paper, companies are turning to their internal travel departments or external travel agencies for assistance in tracking employee travel, relying on actual itineraries. This approach helps surface employees who are not specifically identified as “expatriates” but who may be frequent business travelers with trailing tax obligations. Travel calendars, often computer-based tools, are helpful, too.

Once the list of employees is established, the following items can serve as the starting point for an employer’s record-keeping:

- family size (and list of members);
- current home and host countries, frequent travel destinations, and national and local regional jurisdictions (canton, state, province);
- previous assignment locations and dates;
- date of assignment initiation and repatriation or reassignment;
- base salary and additional compensation eligibility (options, bonuses, stock, and so on);
- split payroll amounts;
- tax refund carry-forward; and
- local corporate entity in the host location (if none, flag for legal and tax follow-up).

An annual review and update of this list provides the basis for instructing the tax provider on individual tax returns to be prepared for employees. It also can further highlight necessary budget adjustments for the business units as a result of



incremental employer expenses for accrual of taxes owing.

Employer-paid taxes on behalf of the tax-equalized assignees can be significant—under certain conditions, even hundreds of thousands of dollars for an individual. In organizations with large assignee populations, especially those with high-salaried employees or assignments to high-tax locations, tax costs can be a material employee expense.

Understanding the long and short-term tax implications for assignees—especially those with stock options and other high base amounts on which taxes may be due—is important in avoiding “surprise” tax costs requiring financial statement adjustment at year-end, or restatement of prior reports.

The employer should keep a record of the tax return prepared by the outside specialist, the expected filing (actual mailing) by the assignee, and the expected corresponding payment in reconciliation and settlement of the annual tax equalization. This reconciliation may result in an amount the employer

owes the assignee to pay the remaining taxes for the year, or, as is often the case, a payment from the assignee to bridge potential unanticipated personal income not initially considered when the tax equalization was set up.

In most instances (e.g., in the United States), assignees must sign and file their own tax returns with an obligation to remit refunds to the employer. When the filing is delayed because of actions on the part of the employee, many companies hold the employee responsible for any resulting penalties, fines, or interest. Policy documents and/or letters of understanding should clearly spell out such arrangements.

It is recommended that assignment administrators work closely with their tax service providers to ensure timely filings for all assignees across all jurisdictions. Because the tax year differs by country, it is important to have ongoing updates of the tracking tools for assignee tax return preparation.

Immigration—What They Do Not Know Can Hurt You

Sending an employee on an international assignment also requires compliance with the immigration laws of the host country, which govern not only visa categories and restrictions on activities, but also the documents needed by those planning to either live or work in that country for a specific period. Employers need a practical strategy for dealing with these requirements, as expatriates’ initial status can affect their subsequent status, particularly if the assignment goes on longer than anticipated.

Understanding the document requirements and process for obtain-

ing appropriate work and residence visas, however, is not the only consideration. Once expatriates have been selected, a smart employer educates them about matters—such as not having proper documentation when traveling or making false statements to an immigration officer—that might have serious ramifications, including heavy fines, expulsion from the host country, and/or imprisonment in the host country.

It generally is understood and often explicitly stated in policy documents that an international assignment will not commence until the appropriate work authorization is obtained. Despite such statements, employers may quietly encourage an assignee to “do what you have to do” on a tourist visit while long-term work authorization is pending. Beyond the logistical nightmare of an employee’s being turned away at the point of entry, there is potential that any governmental action or penalty resulting from noncompliance may, at its worst, revoke a company’s ability to receive foreign nationals in that location or ban any future entry for the individual to that country—or, at best, create a public relations nightmare.

In either case, a misplaced assumption about the ease of entry to a given country could cause irrevocable damage for an organization, not to mention the immediate problem of getting the expatriate on the ground and working. These issues apply for the employee as well as accompanying family members. Immigration noncompliance of an employee’s non-spousal partner can be as damaging to an organization’s reputation as noncompliance by an employee.

A further important aspect of immigration that intersects the inter-

est of tax compliance relates to the type of visa. In certain locations—Italy, for instance—the type of work authorization may determine in what country pay is delivered (whether pay is required at host) and, accordingly, where the related income tax obligation may sit.

Immigration requirements also blend into employment and labor law. Some countries require specific filings for departure from that home location, such as Brazil, to retain home-country pension and other long-term benefits and establish non-resident tax obligations during the assignment. Similarly, employees who are permanent residents, but not citizens, of the home employment country (e.g., U.S. green card holders) may need to file documents regarding temporary departure from that country and may be obligated to periodically re-enter the country to retain their residency status.

Although maintaining current and valid passports and work authorization should be identified clearly as the employee’s responsibility, the company should include visa validity dates in the detailed assignee tracking tool to provide reminders of upcoming filing requirements. In addition, a firm’s immigration counsel may offer some support in providing a status tracking service or system. Ultimately, the variations among countries, the status or individual classification within each country, and the valid periods of work authorization require ongoing review.

Employment Law Dilemmas: Hiring, Firing, and Privacy

A number of issues arise under the umbrella of employment law, including termination of an expatriate dur-

ing an international assignment. The advice of knowledgeable legal counsel on applicable laws in both the home and host country is essential. A further consideration is the employment law of any country where the employee may have worked on a previous international assignment, as those laws may require some action by the company. For those expatriates who have been on several assignments—particularly the “highly mobile”—consulting different regulations may be especially complex.

Typical matters for which governments might have requirements include:

- obligations regarding indemnity or unemployment payments;
- registration of the termination with local labor courts and any related documentation;
- data privacy and property issues, as well as confidentiality, regarding the employee’s rights to recover personal belongings or files from the worksite; and
- other “unknown” issues for which the employer is responsible.

In the event of an employee termination—voluntary or involuntary—the employer also needs to understand the employee’s rights under local immigration laws (e.g., the period during which the employee can remain in the host country, benefit payment rules, among others). Also, consider the internal bad press if a termination is mishandled. Expatriate candidates may be reluctant to accept an offer if there is a history (or even a single occasion) of termination without sufficient repatriation support for the employee and family.

The need to keep paperwork to a minimum—not only for terminations but also all other HR-related

AUDIT AN EXPATRIATE BALANCE SHEET

The basic premise of the balance sheet approach is a simple one—the employer uses a series of allowances and differentials to supplement home-country base salary, with the goal of maintaining the expatriate's purchasing power in the assignment location. Under this philosophy, the expatriate neither financially gains nor loses from accepting an overseas assignment (except for incentives), but would have a neutral cash flow in terms of home-country spending patterns. When reviewing the pay packages for individual expatriates, consider the following questions:

Does the amount represented on the balance sheet actually reflect the policy?

- Is the goods and services differential calculated correctly, using the appropriate base salary and cost-of-living index type?
- Does the company deduct a housing norm? How is host housing treated (e.g., differentials, employer-paid)?
- Are car allowances paid?
- What goes into the calculation of hypothetical tax?
- Does the expatriate receive a hardship premium?
- Are caps applied per policy on housing, goods and services, hardship, and so forth?

Is the balance sheet properly translated to the home and host payrolls? Does the information on the balance sheet properly reflect current data? Has it been properly applied?

- In particular, when using software systems for balance sheet preparation, are home-country data files—norms, exchange rate, and index updates—properly updated each period? Held constant (e.g., housing norm) throughout? Do they properly reflect the data input?
- Have changes in the economy been properly captured in the balance sheet?

matters—is enormous. Balancing this need while meeting the home- and host-governments' compliance requirements is a difficult process. Monitoring is necessary for items such as:

- payroll data for tax filing and reports;
- salary and home-country notional/shadow payroll amounts for assignees who continue to participate in a home pension plan, social security, and other benefits;
- immigration records for the

assignee and family; and

- letters of understanding/contracts, as well as repayment agreements regarding assignment costs (an employee who resigns may be obligated to repay costs associated with the relocation based on a repayment agreement).

But maintenance of employee records carries another burden. Organizations must comply with data privacy rules that sometimes require an extra step in communication between countries, thereby lim-

iting the level of personal information that is electronically or otherwise transmitted between international offices.

Compensation — Crunch Numbers With Care

Whether employing a balance sheet approach, a host-based package, or other assignment pay models, documenting the compensation approach is an important step in administering packages consistently. While one-on-one solutions to an expatriate family's concerns may keep them happy, individual assignment package negotiations generally add up to long-term problems for the company from a financial and employee relations standpoint if not held closely in check. It is important to minimize the number of assignment policy exceptions and restrict the parameters involved in terms of time, money, and location.

Tracking exceptions to policy plays an important role in the assignment management process. It can reveal deficiencies or areas for change within a policy if recurring exceptions are identified. And exceptions without authorization or authorized too frequently may signal internal control gaps.

Unless exceptions are controlled, they eventually will become the rule. Too many special cases can lead to issues in salary inequity, policy inconsistency and distortion, unnecessary payments, and administrative confusion. Complicating the difficulty is the multitude of country laws and customs to consider, both from an inbound and outbound perspective. Although exceptions to policy always will occur, the trick is to keep them minimal, be fair, and watch the budget.

Another potential minefield for overspending is the actual pay package. A periodic review of assignment policy and its alignment with organizational goals and objectives is important. Such review should further consider any tax or immigration law changes that may affect the policy or its application. Because the global, economic, political, and social environments are dynamic, understanding the implications on assignment programs enables employers to keep current. Comparative review in the form of benchmarking assignment policies is a useful tool in tracking market trends.

For those companies that follow the balance sheet approach, an audit of individual expatriates' "balance sheet"—covering payments in both the home and host countries—is essential (See sidebar.). Learning of past under- or overpayments of assignment allowances can be costly and administratively cumbersome, as well as damaging from an employee relations perspective.

When taking the audit through the full assignment process, the company should review the transmission of balance sheet or other compensation data to payroll. A periodic reconciliation of payroll output with the assignee's defined compensation will highlight any inconsistencies with what the employee is receiving. The special considerations in this process are in tracking payroll distributions that may be from the host-location payroll. Ensuring that there are no double payments of assignment benefits through home and host payroll and through accounts payable requires an understanding of payroll and accounting systems, as well as the assignment policy. Accordingly, engaging internal accounting



resources, along with compensation and payroll experts, is a vital part of ensuring accuracy along the continuum of assignment program administration.

Compliance—Teamwork Is the Key

Employers should review the assignment process through the early stages of initiation right through repatriation or reassignment to another foreign country with the help of experienced HR staff or a vendor/service provider that specializes in the desired area. The audit team should consider whether all areas have been, and continue to be, appropriately addressed, monitored, and updated. If necessary, engage experts in the fields of immigration, employment law, expatriate compensation, and taxation to help develop the right policies and procedures. Remember, even though this step might be expensive, the price of ignorance can be high, too. ■

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